



**THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA**

**OCTOBER 2023: PROFESSIONAL EXAMINATION**

**PTE II: INCOME TAX FOR SPECIALISED BUSINESS**

**ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.**

**TIME: 3 HOURS**

**QUESTION 1**

Heeton Bank Nigeria Limited (Heeton Bank or the Bank) was incorporated on July 1, 2010. It commenced operations on August 1, 2010 as a commercial bank which provides retail banking services to customers.

The bank had issues with the Federal Inland Revenue Service (FIRS) regarding its tax returns, which made the Financial Controller (FC) unsatisfied with the work of the previous tax consultants. The previous consultants were not thorough with the bank's tax returns, resulting in significant penalties from the FIRS.

The bank has hired your firm as its new consultant, and the FC has asked you to help prepare the bank's tax returns based on the 2022 financial statements. He specifically stated that he would like the returns to be in accordance with the provisions of the relevant Finance Act.

The financial information of the bank for the year ended December 31, 2022 is as follows:

	<b>₦</b>	<b>₦</b>
Interest income	300,192,000.00	
Interest expense	(97,568,000.00)	
Net interest income		202,624,000.00
Fee and commission income	170,002,000.00	
Fee and commission expense	(93,004,000.00)	
Net fee and commission income		76,998,000.00
Impairment charge for credit losses		(50,000,000.00)
Other operating income		130,000,000.00
Operating expenses		(59,000,000.00)
<b>Profit before tax</b>		<b><u>300,622,000.00</u></b>

**Notes:**

- i. Included in the interest income are:

Interest income on loans and advances to customers –	₦150,000,000
Interest income on long-term Federal Government bonds –	₦60,000,000
Interest income on treasury bills –	₦55,000,000
- ii. Included in the other operating income are:

- Dividend income on equity investment in 5 companies with turnover less than 25 million Naira each – ₦15,000,000
- Franked investment income – ₦ 5,000,000
- An equipment was disposed at ₦10,000,000 and the profit from the disposal of the equipment – ₦2,000,000 (The estimated balancing charge from this disposal is ₦1,200,000)
- Miscellaneous income – ₦8,000,000

Unrealised foreign exchange gain from the revaluation of balances – ₦12,000,000  
 Realised foreign exchange gain – ₦ 8,000,000.

- iii. The impairment for credit charge is made up of:  
 Collective impairment provision of ₦15,000,000  
 Bad debt written off ₦35,00,000(**N.B:** The bank has made every reasonable effort to recover this debt without success).

- iv. Operating expenses include:

- Expense attributable to generating the tax-exempt income – ₦ 8,000,000
- Depreciation – ₦ 9,000,000
- The company claimed a capital allowance of ₦10,000,000 on a generator bought at the beginning of the year. The generator use was shared 30% to the sister company and 70% to the bank
- Cheque book cost – ₦ 600,000
- Recruitment expenses – ₦ 500,000
- Fraud charges – ₦ 1,000,000
- Donations made for a Covid-19 intervention – ₦ 5,000,000
- Donation made to the Red Cross Society – ₦ 1,500,000
- CBN penalties – ₦ 5,000,000
- Tax consultancy fees – ₦ 5,500,000
- Auditor's fees – ₦ 5,000,000
- Additional tax assessment from a recently concluded tax audit – ₦13,500,000

- v. The bank has an unrelieved loss brought forward of ₦500,000,000 and unutilised capital allowance b/f of ₦20,000,000.

- vi. The capital allowance for the year is estimated at ₦16,000,000.

Your engagement partner has shared the bank's financial statements and other financial information with you as a senior consultant in your firm.

### Required:

- Compute the bank's tax liabilities and levies for the relevant year of assessment. All workings should be shown. (35 Marks)
  - Explain the capital allowance treatment in the provisions of Finance Act 2021 as it relates to small or medium company. (5 Marks)
- (Total 40 Marks)**

## Solution to Question 1

**(a) Heeton Bank Nigeria Limited**  
**Computation of income tax and levies for 2023 year of assessment**  
**Basis period (January to December 2022)**

	₦	₦
<b>Profit before tax</b>		300,622,000.00
<b>Add back:</b>		
Collective impairment provision	15,000,000.00	
Expense attributable to generating the tax-exempt income	8,000,000.00	
Depreciation	9,000,000.00	
Fraud charges	1,000,000.00	
CBN penalties	5,000,000.00	
Additional tax assessment from a recently concluded tax audit	<u>13,500,000.00</u>	
<b>Total add-backs</b>		<u>51,500,000</u>
		352,122,000
<b>Less:</b>		
Interest income on Federal government bonds	60,000,000.00	
Dividend income on equity investment	15,000,000.00	
Franked investment income	5,000,000.00	
Unrealized foreign exchange gain from the revaluation of balances	12,000,000.00	
Profit from the disposal of equipment	<u>2,000,000.00</u>	
<b>Total deductions</b>		<u>94,000,000</u>
<b>Assessable profit</b>		258,122,000
Balancing charge		<u>1,200,000.00</u>
		259,322,000
Loss available for relief	500,000,000.00	
Loss relieved	(259,322,000)	(259,322,000)
<b>Loss carried forward</b>	<b><u>240,678,000</u></b>	
Capital allowance b/f	20,000,000.00	
Capital allowance for the year	16,000,000.00	
Capital allowance adjustment (Sister company portion) = 30% *N10,000,000	(3,000,000.00)	
Capital allowance relieved	<u>--</u>	
<b>Capital allowance c/f</b>	<b><u>33,000,000.00</u></b>	
<b>Total profits</b>		<u>--</u>

**Tax on normal basis at 30% of total profits**

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**Minimum tax computation:**

**Gross turnover**

Interest income	300,192,000.00
Fee and commission income	170,002,000.00
Other operating income	<u>130,000,000.00</u>
<b>Total</b>	<b>600,194,000.00</b>

Less: Dividend income (Frank Investment  
Income and investments in small companies  
5,000,000.00 + 15,000,000) (20,000,000)

**Profit on disposal of equipment** **(2,000,000)**  
**Gross turnover for minimum tax** **578,194,000**

**Minimum tax @ 0.5% of N578,194,000** **₦2,890,970**

**Taxes and levies payable**

Companies Income Tax payable	2,890,970
Tertiary Education Trust Fund payable (2.5% of assessable profit of ₦258,122,000)	6,453,050
Information Technology Levy payable (1/101 of PBT) ₦300,622,000 x 1/101	2,976,455.44
National Agency for Science and Engineering Infrastructure .25% of PBT (₦300,622,000 * 0.25%)	751,555.00
Nigeria Police Trust Fund 0.005% of PBT (₦300,622,000 * 0.005%)	<u>15,031.10</u>
<b>Total tax and levies payable</b>	<u><b>13,087,061.54</b></u>

**(b) Explanation of the capital allowance treatment in the provisions of the Finance Act 2021 as it relates to small or medium company.**

The Second Schedule of Companies Income Tax Act as amended by Finance 2021, provides that: the capital allowance for any assessment year in which a company is considered as a small company or a medium company shall be computed in accordance with the provisions of the Second Schedule, and the amount so computed together with any unabsorbed allowances brought forward from previous years shall be deemed to have been made and consumed by such company in each such year of assessment and the residue carried forward into subsequent years.

## QUESTION 2

Equinox Unit Trust Scheme is an authorised Unit Trust Scheme incorporated in Nigeria in 2013. The company is authorised by the Investment and Securities Commission to deal in the business of a Unit Trust Scheme. The financial statements of the company for the year ended December 31, 2020, revealed the following details:

	₦'000	₦'000
Investment income:		
Rental income (gross)		129,300
Interest on fixed deposit with banks (net)		65,000
Dividend income (net)		<u>35,700</u>
		230,000
Deduct:		
Staff salaries and wages	28,000	
Repairs	8,500	
Managers' remuneration (10% of gross income)	23,000	
Other administrative expenses	33,400	
SEC penalty and fine	3,500	
Depreciation	<u>22,600</u>	<u>(119,000)</u>
Net profit		<u>111,000</u>

Notes:

- (i) Dividend and interest income have been subjected to deduction of withholding tax at 10%.
- (ii) Other administrative expenses include an amount of ₦1.2 million described as entertainment but the FIRS found this to be gratification to some officials of the Securities and Exchange Commission (SEC).

### Required:

- a. Compute the assessable profit of Equinox Unit Trust for the relevant year of assessment. (10 marks)
- b. Unit Trust Scheme is a non-incorporated collective investment scheme. It is a fund into which individuals, investors or subscribers contribute small sums of monies to form a pool and enable professional fund managers to invest in money market instruments, shares and stocks on their behalf.

### Required:

Explain the following terminologies:

- (i) Authorised unit trust (2 Marks)
- (ii) Unit holder (1 mark)
- (iii) Rights of unit holders (2 marks)

**(Total 15 Marks)**

## SOLUTION TO QUESTION 2

### (a) Equinox Unit Trust Scheme Computation of assessable profit for 2021 year of assessment

	N	N
Investment income:		
Rental income (gross)		129,300,000
Interest on fixed deposit with bank (gross) – ₦65,000,000/0.9		72,222,222
Dividend income (gross) – ₦35,700,000 / 0.9		<u>39,666,667</u>
		241,188,889
Dividend income (gross)		<u>(39,666,667)</u>
		201,522,222
Allowable expenses:		
Staff salaries and wages	28,000,000	
Repairs	8,500,000	
Manager's remuneration (10% of gross income)	23,000,000	
Other administrative expenses – (33,400,000 – 1,200,000)	<u>32,200,000</u>	<u>(91,700,000)</u>
<b>Assessable profit</b>		<b><u>109,822,222</u></b>

- (b)
- (i) Authorised unit trust means in respect of a year of assessment, a unit trust scheme that is authorised by the commission to carry on the business of dealing in unit trust scheme.
  - (ii) Unit holder means any investor, beneficiary or person who acquired units in a unit trust scheme and is entitled to a share of the investments subject to the trusts of a unit trust scheme.
  - (iii) Rights of unit holders include:
    - Right to shares of the unit trust;
    - Right to vote at any meeting of unit holders;
    - Right to share out of the net income of the unit trust

## QUESTION 3

Voicecom Telecommunication Limited is a South African company that engaged in telecommunication business in Nigeria. The global financial position of the company for the year ended December 31, 2017, revealed the following details:

	₦'000	₦'000
Income from calls and short messages originating in Nigeria	250,000	
Income from calls terminating in Nigeria	180,000	

Income from third parties in Nigeria from shared service income	<u>35,000</u>	465,000
Less:		
Sales and marketing expenses	14,500	
Salaries and other payroll costs	45,850	
Depreciation	26,000	
Repairs and maintenance expenses	28,450	
Overhead expenses	68,780	
Purchase of telecoms assets	<u>86,300</u>	<u>269,880</u>
<b>Net profit</b>		<b><u>195,120</u></b>

**Notes:**

- (i) The FIRS is satisfied that the South Africa tax authority computed and assessed tax on the same basis as the Nigeria tax authority.
- (ii) The South Africa tax authority has certified the adjusted profit and depreciation allowance ratios.
- (iii) Included in overhead expenses is management fee of ₦26.5 million paid to Voicecom South Africa. This payment was made without a NOTAP approval.

**You are required to:**

- (a) Compute the company's adjusted profit for the relevant tax year. (7 marks)
- (b) Determine the adjusted profit ratio and depreciation ratio. (3 marks)
- (c) Compute the total profits and income tax payable in Nigeria. (5 marks)

**(Total 15 Marks)**

**SOLUTION TO QUESTION 3**

**3 (a) VODACOM TELECOMMUNICATION LIMITED COMPUTATION OF ADJUSTED PROFIT FOR 2018 ASSESSMENT YEAR**

	<b>₦</b>	<b>₦</b>
Net profit as per accounts		195,120,000
Add/(Deduct)		
Depreciation	26,000,000	
Management expenses – management fee	26,500,000	
Purchase of telecoms assets	<u>86,300,000</u>	<u>138,800,000</u>
<b>Adjusted profit</b>		<b><u>333,920,000</u></b>

**(b) VODACOM TELECOMMUNICATION LIMITED  
COMPUTATION OF ADJUSTED PROFIT RATIO AND DEPRECIATION  
RATIO**

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i.	Adjusted profit ratio =	Adjusted profit/Global income x 100/1	
	Adjusted profit ratio =	$\frac{333,920,000}{465,000,000} \times \frac{100}{1}$	= <u>71.81%</u>
ii.	Depreciation ratio =	$\frac{26,000,000}{465,000,000} \times \frac{100}{1}$	= <u>5.59%</u>

**(c) VODACOM TELECOMMUNICATION LIMITED  
COMPUTATION OF TOTAL PROFIT AND INCOME TAX PAYABLE FOR  
2022 ASSESSMENT YEAR**

	<b>N</b>
Assessable profit:	
₦285,000,000 x 71.81%	204,658,500
Less:	
Capital allowance	
₦285,000,000 x 5.59%	<u>15,931,500</u>
<b>Total profit</b>	<b><u>188,727,000</u></b>
The higher of:	
CIT @ 30% of total profit	<u>56,618,100</u>
OR	
Minimum tax @ 2% of Nigerian income:	
₦285,000,000 x 2%	<u>5,700,000</u>

**∴ Income tax payable is 56,618,100**

**Workings**

	<b>N</b>
(a) Global income	<u>465,000,000</u>
(b) Nigerian income:	
Income from calls and short messages originating in Nigeria	250,000,000
Income from third parties in Nigeria from shared service income	<u>35,000,000</u>
Total	<u>285,000,000</u>



## QUESTION 4

A free trade zone is any location where goods can be shipped, handled, manufactured, reconfigured and re-exported without the involvement of customs agencies. A major seaport, an international airport or a border facility between two or more countries may be designated a free trade zone.

The operation of the free trade zones is deliberately incentivised to stimulate foreign direct investments (FDIs); domestic direct investments (DDIs); employment generation; infrastructure development; technology transfer; skills transfer to boost the country's prosperity profile, etc.

The enabling Act for Registered Free Trade Zones in Nigeria came into effect in 1992; whilst the first free trade zone is the **Calabar Free Trade Zone (CFTZ)**. It was fully completed by 1999 but started operation after official commissioning in November 2001. The CFTZ is owned by the Federal government.

### Required:

- a. State the procedure for registering a company in a free trade zone and factors to be considered for eligibility for a licence. **(7marks)**
- b. State the fiscal benefits or incentives for a company operating in a free trade zone.

## SOLUTION TO QUESTION 4

4. (a) The following are the steps for registering companies in a free trade zone:
  - (i) Obtain and complete the application form;
  - (ii) Submit the completed application form in the Zone Administration Office or perhaps NEPZA office with the required project plan/feasibility study;
  - (iii) The application will be reviewed and after review, it might be accepted by the administration or be rejected; and
  - (iv) When the application is actually approved, an operating licence (OPL) will be issued by the Administration of the Free Zone.

In considering eligibility for a Free Trade Zone licence, the Authority/Zone Management shall put the following factors into consideration:

  - The business activities, which the applicant proposes to engage in shall be in consonance with the free zone approved activities;
  - The proposed activities to be carried out shall or will add value to and be consistent with, the development programme for the Free Zone;
  - The applicant shall comply with the provisions of the Act and applicable Rules and Regulations that may be put in place by the Authority/Zone management from time to time;

- The technical, financial and managerial capabilities of the applicant;
- The applicant's experience and track record;
- The level of foreign direct investment proposed by the applicant; and
- For free zone developers, evidence of title to a suitable landing area free of encumbrances for the intended purpose.

Upon a License being granted to an approved entity by the Authority/Zone Management, the Authority shall cause all relevant details concerning such enterprise to be entered in the Free Zone Register and for a Certificate of Registration, duly executed by or on behalf of the Authority/Zone Management, to be issued.

The Nigerian Export Processing Zone Regulations provide that any approved Free Zone enterprise's investment in an approved activity within an EPZ must be of a value of at least \$500,000, and the operation of the activity must not cause damage to human life and property, damage the environment, or constitute a threat to public peace and order or national security.

- (b) The fiscal benefits/incentives for companies operating in a free zone include:
- (i) Legislative provisions pertaining to taxes, levies, duties and foreign exchange regulations shall not apply within the Zones;
  - (ii) Repatriation of foreign capital investment in the Zones at any time with capital appreciation of the investment;
  - (iii) Remittance of profits and dividends earned by foreign investor in the Zones;
  - (iv) No import or export licenses shall be required;
  - (v) Up to 25 per-cent of production may be sold into the customs territory against a valid permit, and on payment of appropriate duties;
  - (vi) Rent-free land at construction stage, thereafter rent shall be as determined by the Authority;
  - (vii) Up to 100 per-cent foreign ownership of business in the Zones allowable; and
  - (viii) Foreign managers and qualified personnel may be employed by companies operating in the Zones.

## Question 5

The Finance Act 2020 amended Section 1 of the Industrial Development (Income Tax Relief) Act by providing incentives for companies that engage in primary agricultural production.

### Required:

- a. State the incentives for the amendment. (2 Marks)
- b. Explain the conditions to be met before the incentives can be granted. (3 Marks)
- c. Explain "medium sized companies" and "small companies". (4 Marks)
- d. Explain "primary agricultural production". (6 Marks)

## SOLUTION TO QUESTION 5

- a. The law provides that any small or medium sized company engaged in primary agricultural production shall be granted, pursuant to an application to the President, through the Minister, an initial tax-free period of four years which may be extended, subject to the satisfactory performance of such agricultural performance of such primary agricultural production, for an additional maximum period of two years, and such company cannot be granted similar tax holiday under any other Act in force in Nigeria. In addition to the above, there is a reduction in import duty on tractors from 35% to 5%.
- b. **Conditions to be met include:**
- i. Must be a medium sized company, or
  - ii. Small sized company;
  - iii. Deals in primary crop production, and or
  - iv. Primary livestock production, and or
  - v. Primary forestry production, and or
  - vi. Primary fishing production.
- c. (i) **"Medium sized company"** means a company that earns gross turnover greater than ₦25,000,000 but less than ₦100,000,000 per annum, or as otherwise defined by the Companies Income Tax Act.
- (ii) **"Small sized company"** means a company that earns gross turnover of ₦25,000,000 or less per annum, or as otherwise defined by the companies Income Tax Act.
- d. **Primary agricultural production' means-**
- (i) **Primary crop production** comprising the production of raw and semi-processed crops of all kinds, but excluding any intermediate or final processing of crop or any other associated or manufactured or derivative livestock products;
  - (ii) **Primary livestock production** comprising of production of animals and their direct produce such as live or raw meat, live or raw poultry, fresh eggs and milks of all kinds, but excluding any other associated manufactured or derivative livestock products;
  - (iii) **Primary forestry production** comprising the production of timbers of various kinds such as firewood, charcoal, uncultivated materials gathered and other forestry products of all kinds, including seeds and saplings, but excluding the intermediate and final processing of timber and any other manufactured or derivative timber product; and
  - (iv) **Primary fishing production** comprising the production of fish of all kinds, including ornamental fish, but excluding any intermediate or final processing of any other manufactured or derivative fish product.

## QUESTION 6

- a. The operations of a SEC lending transaction in Nigeria is governed by certain regulatory provisions.

**Required:**

Explain the regulatory provisions governing the operations of a SEC lending transaction in Nigeria.

**(3 marks)**

- b. There are certain procedures and or steps which make securities lending transaction smooth and seamless.

**Required:**

Explain each of the steps that are involved in a typical securities lending transaction.

**(8 marks)**

- c. The Industrial Development (Income Tax Relief) Act (Pioneer Act), specifies the circumstances upon which the pioneer status granted a company may be cancelled.

**Required:**

State these circumstances.

**(4 marks)**

**(Total 15 Marks)**

## SOLUTION TO QUESTION 6

6. (a) The operation of SEC lending in the Nigerian capital market is regulated by the provisions of the Investment and Securities Act, Securities and Exchange Commission Rules 2013 (as amended) and other extant laws and regulations.

However, the taxation of SEC lending transactions is governed by the provisions of the Companies Income Tax Act (as amended) and other relevant tax laws.

- (b) The following are the steps involved in a typical securities lending transaction:

Step One: Securities lending initiation: The process begins with the borrower contacting a prospective lender or their lending agent (intermediary) asking for the availability of a particular security for lending. If the lending agent or prospective lender responds positively to the enquiry, the next step, negotiation of stock lending terms, begins;

Step Two: Negotiation of stock lending terms: The second step in securities lending is negotiation of terms covering issues relating to cash and/or non-cash collateral, loan duration, dividends and corporate actions, and the fees payable;

Step Three: Delivery of collateral: Having agreed on the terms, the borrower then delivers the agreed-upon collateral to the lending agent;

Step Four: Delivery of securities: Having “received” the collateral, the lender delivers the agreed upon securities to the agent or the intermediary;

Step Five: Investment of collateral: If the collateral posted by the borrower is a cash collateral, it is then placed in a short-term investment. This reinvestment step does not take place if the collateral is non cash;

Step Six: Daily mark to market calculation: Because the value of the securities loaned varies daily according to market conditions, the lender or his agent, needs to be able to monitor the daily value of the securities in order to find out if the collateral posted remains adequate or insufficient. Where the collateral becomes inadequate because the value of the loaned securities has increased, a collateral call is placed on the borrower, at which point the borrower is required to add to the collateral;

Step Seven: Return of borrowed securities: At the end of the duration of the contract, or when called by the lender, the borrower returns the borrowed securities through the lending agent; and

Step Eight: Return of collateral: The cash collateral plus the interest or rebate is the returned to the borrower and the loan closed.

- (c) The following are the circumstances in which a pioneer status may be cancelled:
- (i) Where the production day is extended for more than one year than that stated in the original application;
  - (ii) Where the values of the qualifying capital expenditure differ from the value stated in the original application;
  - (iii) Where the taxpayer has applied for a cancellation in writing; and
  - (iv) Where any specific condition laid down by the Minister is not fulfilled or if the provisions of the IDA and the guideline document are contravened.

## **QUESTION 7**

A real estate investment company (REIC) as defined by the Finance Act 2021, means a company (including a Real Estate Unit Trust) duly approved by the Securities and Exchange Commission to operate as a Real Estate Investment Scheme (REIS) in Nigeria.

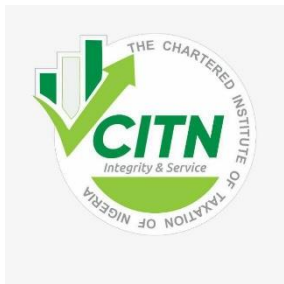
The regulations of REIS in the Nigeria capital market include the provisions of the Investment and Securities Act 2007, the Securities and Exchange Commission Rules 2017, and other extant laws and regulations.

### **Required:**

- (a) Identify the four broad classifications of the income of REIC. **(4 Marks)**
- (b) Discuss the taxation of dividend and rental income of REIC under real estate investment scheme (REIS). **(11 Marks)**

## **SOLUTION TO QUESTION 7**

- a) The four broad classification of the income of a real estate investment company (REIC) are as follows:
- i) Rental income;
  - ii) Dividend from another REIC;
  - iii) Gains from disposal of assets; and
  - iv) Others, for example, fees and other income not related to Real Estate Investment Scheme (REIS)
- b) The tax treatments of dividend and rental income of REIC earned under a REIS are as follows:
- i) Section 19 of CITA (as amended)
    - This section relates to dividend as a basis of computing companies income tax due to no total profits, or total profits are less than the amount of dividend paid. Rental and dividend made by REIC distributed to its shareholders under a REIS are exempt from tax in the hand of the shareholders.
    - For a dividend paid by REIC to be considered as a redistribution under a REIS, the redistribution to shareholders must not be less than 75% of the rental or dividend income, and redistribution must be done not later than 12 months after the end of the financial year in which the rental or dividend income was received by the REIC.
  - ii) Section 23 (1)(5) of CITA (as amended)
    - Dividend and rental income received by the REIC under REIS are exempted from further tax in the hand of the company. Simply put, the gross amount of each of these income is treated as non-taxable income because the income is regarded as received on behalf of its shareholders.
    - In computing assessable profit of a company, rental and dividend income will be deducted from the profits, if already included in same.
    - To qualify for this exemption, the REIC must ensure that:
      - A minimum of 70% of dividend and rental income received is redistributed as dividends to the shareholders, and
      - And such distribution is made not later than 12 months after the end of the financial year in which the dividend or rental income was earned.
    - Any rental or dividend not distributed is chargeable to tax.
    - It is pertinent to state that rental or dividend income received by a REIC will be treated as a taxable income, if the condition stated in Section 23 (1)(5) of the act are not met.
  - iii) Section 80 of CITA (as amended)
    - Any distribution or dividend paid to a REIC pursuant to REIS shall not be subject to deduction of withholding tax. Based on the foregoing, such payment shall not be regarded as franked investment income unless when such payment is made to a REIC not under a REIS.



# **THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA**

## **OCTOBER 2023: PROFESSIONAL EXAMINATION**

### **PTE II: INTERNATIONAL TAXATION**

**ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.**

**TIME: 3 HOURS**

#### **QUESTION 1**

Seedland Nigeria Limited is a Nigerian company that has been operating as a manufacturing company for several years in Nigeria. The company is into manufacturing of varieties of juice drinks. As a result of excellent business performance in the past, the company acquired a company that was into cultivation of its major raw materials such as orange, mango, pineapple, apple, and banana. The company was able to achieve its inorganic growth strategies after the acquisition.

Meanwhile, as a result of unfavorable business climate and high cost of production in Nigeria, the management of the company decided to establish a branch in Canada after receiving favorable feasibility report from the appointed business reorganisation expert, Midas Touch Consulting Inc. The Canadian branch is named Seedland Incorporation.

Seedland Nigeria Limited filed its corporate tax returns for 2022 year of assessment based on its result for the year ended December 31, 2021. The recent desk examination conducted by the Federal Inland Revenue Service (FIRS) on the 2022 year of assessment corporate tax returns filed by Seedland Nigeria Limited revealed some gaps. During the reconciliation meeting with the FIRS, there was an argument between the FIRS officials and the management of Seedland Nigeria Limited on the correct assessment of profits made by Seedland Incorporation. The Managing Director of Seedland Nigeria Limited is of the opinion that the tax paid by Seedland Incorporation in Canada should be the final tax since the company is only an overseas branch. He further submitted that the provisions of the Companies and Allied Matters Act 2020 are only applicable to companies incorporated in Nigeria. The Managing Director was furious when the company received a reminder of notice of assessment from the FIRS and has, therefore, threatened to approach the Tax Appeal Tribunal for redress.

Your firm has been engaged by the company as its Tax Consultant to provide professional advice on the tax implications of the profit made by Seedland Incorporation and possible representation at the Tax Appeal Tribunal sittings. The statement of profit or loss for the

year ended December 31, 2021 of both operations after the results of Seedland Incorporation have been converted into Naira at the prevailing exchange rate and other relevant documents were handed over to you by the Managing Director.

The extracts from the statements of profit or loss of the two corporate entities revealed the following:

	<b>Seedland Nigeria Limited</b>	<b>Seedland Incorporation</b>	<b>Total</b>
	<b>₦' 000</b>	<b>₦' 000</b>	<b>₦' 000</b>
Gross Turnover	<u>1,560,160</u>	<u>2,730,750</u>	<u>4,290,910</u>
Less:			
Cost of Materials	455,260	873,600	1,328,860
Repairs and Maintenance	91,440	101,040	192,480
Salaries and Wages	171,542	560,560	732,102
Loss on revaluation of non-current assets	69,960	28,272	98,232
Administrative expenses	68,550	166,350	234,900
Depreciation	90,720	176,760	267,480
Donation	12,750	--	12,750
Share of Head Office expenses	43,290	65,000	108,290
Income tax paid in Canada	--	<u>86,640</u>	<u>86,640</u>
	<u>1,003,512</u>	<u>2,058,222</u>	<u>3,061,734</u>
Net Profit	<u>556,648</u>	<u>672,528</u>	<u>1,229,176</u>

You are provided with the following additional information:

(i) Repairs and maintenance is made up of:

	<b>Seedland Nigeria Limited</b>	<b>Seedland Incorporation</b>
	<b>₦' 000</b>	<b>₦' 000</b>
Repairs of official vehicle	20,400	63,500
Construction of additional office space	65,440	29,040
Purchase of printer toner	<u>5,600</u>	<u>8,500</u>
	<b><u>91,440</u></b>	<b><u>101,040</u></b>

(ii) The details of Administrative expenses are as follows:

	<b>Seedland Nigeria Limited</b>	<b>Seedland Incorporation</b>
	<b>N'000</b>	<b>N'000</b>
Stamp duty on increase in share capital	12,150	--
Value added tax on administrative expenses	43,900	158,360
Penalty for late filing of PAYE tax returns	7,500	--
Audit fees	<u>5,000</u>	<u>8,000</u>
	<u>68,550</u>	<u>166,360</u>



(iii) Donation is made up of:

	<b>Seedland Nigeria Limited</b>	<b>Seedland Incorporation</b>
	N'000	N'000
Donation to clubs	2,000	--
Donation to Covid 19 Victims Fund	<u>10,750</u>	<u>--</u>
	<u>12,750</u>	<u>--</u>

(iv) The capital allowance of Seedland Nigeria Limited in respect of plant and equipment and other qualifying capital expenditure as agreed with the tax authorities was ~~₦~~33,000,000. The capital allowance of ~~₦~~44,000,000 claimable by Seedland Incorporation on qualifying assets was also certified by the tax authorities.

(v) The Canada tax rate is assumed to be 35%.

**Required:**

- (a) Advise the management of Seedland Nigeria Limited on the tax implications of the overseas branch. (7Marks)
- (b) Compute the tax liabilities of the company in line with your submission in (a) above. (20Marks)
- (c) State the objectives of Double Taxation Agreement with another country. (5Marks)
- (d) Explain tax treaty and what are the essential features of a Double Taxation Agreement? (8Marks)

**(Total 40 Marks)**

## **SOLUTION TO QUESTION 1**

**Powerlink Professional Services**  
**77, Osborne Street, Ikoyi, Lagos**

15 February, 2023

The Managing Director  
Seedland Nigeria Limited  
25, Shonibare Avenue,  
Ikeja, Lagos

**Dear Sir,**

### **RE: ADVICE ON TAX IMPLICATIONS OF PROFIT MADE BY SEEDLAND INCORPORATION, CANADA**

We refer to our discussion of February 13, 2023, in respect to the above subject matter and wish to comment as follows:

#### **(a) Tax implications of the overseas branch- Seedland Incorporation, Canada**

- (i) The provision in the Companies Income Tax Act 2004 (as amended) on profit of an overseas branch of a Nigerian company is that such profit is deemed to be derived in Nigeria and is therefore liable to tax in Nigeria.
- (ii) Any foreign tax suffered is not allowable in determining the overseas profit.
- (iii) Assets in use in such a branch will be entitled to capital allowances claim in Nigeria.
- (iv) Losses incurred from such a branch can be set off against profit in Nigeria, provided the losses were incurred from the same source.
- (v) Double taxation relief is available for any foreign tax suffered either based on bilateral agreement or based on tax relief available under the Commonwealth.

Since Seedland Incorporation, Canada is a branch of a Nigerian company, the above provisions of the Act are applicable and profit made in Canada is fully liable to tax in Nigeria. However, Seedland Nigeria Limited is entitled to claim double taxation relief to cushion the impact of tax paid in Canada.

#### **(b) Computation of tax liabilities of the corporation**

- (i) Following the provisions of the Act in respect of the status of Seedland Incorporation, the total profit of ₦949,240,000 from its operations in Canada is liable to tax in Nigeria.
- (ii) However, due to existing Commonwealth taxation relief between Nigeria and Canada, the profit is available for double taxation relief of ₦142,386,000 (but restricted to actual tax paid in Canada, ₦86,640,000).

- (iii) The relief reduced the companies income tax liability from ~~₦~~516,197,000 to ₦429,557,000.

Included in this report as Appendix 1, are the full computations of the tax liabilities for your records and ease of reference.

Please do not hesitate to contact us if you need any further clarification on the above.

Yours faithfully,

**For: Powerlink Professional Services**

**Edwin Moris**  
**Managing Partner**

**Appendix 1**  
**Seedland Nigeria Limited**  
**Computation of tax liabilities for 2022 year of assessment**

	<b>Seedland Nigeria Limited</b>	<b>Seedland Incorporation</b>	<b>Total</b>
	<b>N'000</b>	<b>N'000</b>	<b>N'000</b>
Net profit as per accounts	556,648	672,528	1,229,176
Add back disallowable expenses:			
Construction of additional office space	65,440	29,040	94,480
Stamp duty on increase in share capital	12,150	--	12,150
Penalty for late filing PAYE tax returns	7,500	--	7,500
Donation to clubs	2,000	--	2,000
Loss on revaluation of non-current assets	69,960	28,272	98,232
Depreciation	90,720	176,760	267,480
Income tax paid to Canada	--	<u>86,640</u>	<u>86,640</u>
Total disallowed expenses	247,770	320,712	568,482
Adjusted/Assessable Profit	804,418	993,240	1,797,658
Deduct: Agreed Capital Allowances	(33,000)	(44,000)	(77,000)
Total Profit	771,418	949,240	1,720,658
Companies Income Tax @ 30%			516,197
Deduct: Double taxation relief (working 1)			(86,640)
Net companies income tax payable			429,557
Tertiary education tax @ 2.5% of assessable profit			44,941
Police trust fund levy @ 0.005% of Net Profit			61

## Working 1

### Computation of Double taxation relief

Since Seedland Nigeria Limited is a resident, the commonwealth rate of tax will be compared with half Nigerian rate of tax

Nigerian rate of tax	30%
Half Nigerian rate of tax	15%
Commonwealth rate of tax	35%
Therefore, the lower of:	
(i) Half of Nigerian rate of tax	15%
(ii) Commonwealth rate of tax	35%

The double taxation relief rate will be half of Nigerian rate of tax, i.e. 15%.

Double taxation relief will be 15% of ₦949,240,000

This is ₦142,386,000

However, the calculated double taxation relief is greater than the actual tax paid in Canada. Therefore, the amount of double taxation relief claimable will be restricted to the actual tax paid in Canada, ₦86,640,000.

- (c) The main objectives of double taxation agreement with another country are to:
  - (i) Avoid double taxation of income;
  - (ii) Clarify taxing rights of each contracting state;
  - (iii) Encourage economic cooperation between states;
  - (iv) Prevent fiscal evasion with anti-avoidance provision;
  - (v) Lower the compliance cost; and
  - (vi) Provide certainty on tax treatment of transactions.
- (d)
  - (i) A tax treaty is a formal bilateral agreement made by two countries to resolve issues involving double taxation of taxpayers' income, capital, estate and wealth between the two countries. For a double taxation agreement to be binding in Nigeria, it must not only be signed by the appropriate tax authority, it must also be approved by the Federal Executive Council and then ratified by both chambers of the Nigerian National Assembly.
  - (ii) The following are the key features of a double taxation agreement:
    - The names of the two countries involved in the agreements would be stated together with the definition of residence and person affected;
    - The rates of tax applicable in the countries would be stated with a caveat that the rates may be changed without notice;
    - The transactions on which double taxation relief is applicable will be identified. This will usually include business profit, fees, capital gains tax, etc;
    - The arrangement for the exchange of information between the two tax authorities so as to minimise the incidences of tax evasion;

- The appeal procedures in the event of a dispute;
- The available diplomatic privileges for the taxpayers;
- The date of coming into force of the agreement and the possible termination date;
- Connected businesses, including enterprises in the two countries under common control or where one has control over the other;
- The distinction in industrial and commercial profits especially for enterprises engaged in business partly in one country and partly in other countries;
- The profits exempted from tax; and
- The methods by which the effect of double taxation is eliminated.

## QUESTION 2

Comparability process is key and relevant to the discussion on the arm's length principle in majority of real life situations. **You are required** to justify this claim with the data of Gowon Ltd, stated below.

(a) Gowon Ltd in Nigeria is in a controlled transaction with its related party AFSA in France and intra-group services are disclosed in the transfer price (TP) returns submitted for 2001. The service provided by AFSA is routine in nature at cost plus 7%.

AFSA provides comparable services to Vava SA, an independent entity resident in South Africa.

The TP team in Nigeria wants to ascertain that the pricing of the transaction at 7% cost plus is at arm's length and needs to decide to use internal or external comparability analysis.

### **Required:**

Discuss the comparative analysis that is suited to analyse this transaction. (5 Marks)

(b) Explain secret comparable.

(10 Marks)

**(Total 15 Marks)**

## SOLUTION TO QUESTION 2

(a) Given the fact that there is a comparable transaction between one party to the controlled transaction and an independent party, internal comparable would be the first step.

It is preferred in practice and external comparable is only being increasingly used due to lack of internal comparable or convenience of the use of databases.

**(b) Secret comparable**

This is a term used in transfer pricing context. It denotes a comparable whose data is not disclosed to the public or the taxpayer but known only to the tax authority which is making the transfer pricing adjustment.

This is a potential external comparable, and it serves great purpose in risk assessment.

Transfer pricing (TP) method cannot be applied based on such data unless the tax administration would be able, within the limits of its domestic confidentiality requirements to disclose such data to the taxpayer so that there would be an opportunity for the taxpayer to defend its own position.

**QUESTION 3**

Transfer pricing regulations ensure that tax authorities are able to tax taxable persons on an appropriate taxable basis corresponding to their economic activities in Nigeria.

Within the context of the Income Tax (Transfer Pricing) Regulations, 2018 in Nigeria, **you are required** to explain the following:

- |    |                                      |                         |
|----|--------------------------------------|-------------------------|
| a. | Connected taxable persons            | (3 Marks)               |
| b. | Arm's length principle               | (3 Marks)               |
| c. | Capital-rich, low-function companies | (3 Marks)               |
| d. | Thin capitalisation                  | (3 Marks)               |
| e. | Dispute resolution procedures        | (3 Marks)               |
|    |                                      | <b>(Total 15 Marks)</b> |

**SOLUTION TO QUESTION 3**

**(a) Connected taxable persons**

A Connected taxable person is a person that has the ability to control or influence the other person in making financial, commercial or operational decisions.

It also includes a third person who has the ability to control or influence both persons in making financial, commercial, or operational decisions.

Connected persons also include persons who are related, associated or connected to or one another as defined by Companies Income Tax Act, Petroleum Industry Act, Personal Income Tax Act, and Capital Gains Tax Act, Article 9 of the OECD and UN Model Tax Convention and the agreement for the Avoidance of Double Taxation between Nigeria and other countries and the OECD TP guidelines and UN TP manual.

The following persons will be regarded as Connected Taxable Persons (i.e. related parties) within the context of the Income Tax (Transfer Pricing) Regulations, 2018:

- (i) Any entity dealing with a related party (associate, subsidiary, joint venture);
- (ii) A member of a local group of companies;
- (iii) Member of a conglomerate;
- (iv) Multinationals;
- (v) An entity in a group located in a free zone;
- (vi) A group entity that has a pioneer status;
- (vii) Loss making entity within a profitable group; and
- (viii) Related parties subject to tax at different rates.

**(b) Arm's length principle (ALP)**

ALP is the fundamental basis of worldwide transfer pricing regulations.

This principle means that the conditions of a controlled transaction should not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances.

Every taxpayer is expected to comply with arm's length principle in dealing with transactions between related entities.

The Enterprise and Multinationals are expected to be guided with the following principles:

- (i) Where a connected person has entered into a transaction or series of transactions, the person shall ensure that the taxable profits resulting from the transaction or transactions are ascertained in a manner that is consistent with the arm's length principle;
- (ii) A controlled transaction is at arm's length if the conditions of the transaction do not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances; and
- (iii) Where a connected person fails to comply with the arm's length principle, the Service shall make adjustments, where necessary, in order to bring the taxable profits resulting from the transactions in conformity with the arm's length principle.

**(c) Capital-rich, low-function companies**

This means companies that are capitalised with a relatively high amount of equity (or equity-equivalent) capital, but which have limited capacity to carry out risk-management functions. Within multinational groups, such companies may, for example, provide debt funding to associated enterprises, or fund research and development programmes carried out by associated enterprises.

For example, where such a company funds a research and development programme conducted by an associated enterprise, but does not have the capacity to make the key decisions that manage the risks associated with the programme, it will be considered to be conducting a funding function only, and will be allocated a return on that funding on the assumption that the funding is risk-free.

#### **(d) Thin Capitalisation**

When a company is financed with a much greater proportion of debt than equity it is said to be thinly capitalised.

The tax authority is disturbed because of the excessive interest deductions particularly if the loans are obtained from connected or related parties at non-commercial rates or from foreign entities.

Interest deduction reduces the profits available for tax. To circumvent the negative effects of thin capitalisation, some countries place a limit on the debt to equity ratio, while others disallow interest deductions above a certain level.

#### **(e) Dispute Resolution Procedures**

Based on the Income Tax (Country by Country Reporting) Regulations, 2018, a taxpayer who has any objection on assessment emanating from transfer pricing matters cannot approach the Decision Review Panel for a review of the assessment received from FIRS.

Taxpayers are now expected to lodge their complaints with the Head, FIRS Transfer Pricing Unit (TPU) within 30 days after the date of receipt of the assessment notice.

Effective March 12, 2018, the Head of TPU has the prerogative to decide whether or not to refer the taxpayer's objection to the Decision Review Panel.

### **QUESTION 4**

The Federal Inland Revenue Service (FIRS) released the Income Tax (Country by Country Reporting) Regulations, 2018 (the Regulations) which was published in an official gazette dated January 8, 2018. The regulations among other things majorly focused on taxation of Multinational Enterprises' (MNEs) in Nigeria.

#### **Required:**

- (a) State the objectives of the Income Tax (Country by Country Reporting) Regulations, 2018. **(3 Marks)**
  - (b) Explain the essential provisions of the Income Tax (Country by Country Reporting) Regulations, 2018, relating to filing and notification obligations, including the penalties for non-compliance. **(12 Marks)**
- (Total 15 Marks)**



## **SOLUTION TO QUESTION 4**

- (a) The main objectives of the Income Tax (Country by Country Reporting) Regulations, 2018 are:
- (i) To provide the Federal Inland Revenue Service with information about Multinational Enterprises' (MNEs) global activities, profits and taxes;
  - (ii) To better assess international tax avoidance risks;
  - (iii) To improve transparency in the tax practices of the MNEs; and
  - (iv) To prevent tax evasion or avoidance through base erosion and profit shifting.
- (b) The essential provisions of the Income Tax (Country by Country Reporting) Regulations, 2018, relating to filing and notification obligations, including penalties for non-compliance are as follows:
- (i) Each Ultimate Parent Entity (UPE) of an MNE Group having Consolidated Group Revenue of N160 billion or above is required to file a Country-by-Country (CbyC) Report in a specified format with the FIRS on an annual basis, provided that such entity is resident in Nigeria for tax purposes. The CbyC Report should be filed not later than 12 months after the last day of the Reporting Accounting Year of the MNE Group;
  - (ii) A Constituent Entity which is not the UPE of an MNE Group that meets certain conditions will also be required to file a CbyC Report with the FIRS within the time specified;
  - (iii) A Constituent Entity will not be required to file a CbyC Report if same has been filed through a Surrogate Parent Entity in the format specified in the Regulations;
  - (iv) Failure to submit the CbyC Report within the time stipulated would attract a penalty of N10,000,000 in the first instance and N1,000,000 for every month in which the default continues;
  - (v) Any Constituent Entity that is resident in Nigeria for tax purposes should notify the FIRS whether it is a UPE or Surrogate Parent Entity. Where it is neither of the two, it should notify the FIRS of the identity and tax residence of the Reporting Entity not later than the last day of the Reporting Accounting Year of the MNE Group; and
  - (vi) Where a Constituent Entity fails to provide notification to the FIRS on whether it is a UPE or Surrogate Parent Entity or where it is neither of the two or notify the FIRS of the identity and tax residence of the reporting entity, such entity will be liable to a penalty of N5,000,000 in the first instance and N10,000 for every day in which the default continues.

## QUESTION 5

Cases of tax evasion are usually viewed seriously by the tax authorities in Nigeria. In addition, the tax authorities are empowered to set aside tax avoidance schemes that result in artificial or fictitious transactions. Tax evasion is usually more prevalent when the tax system is perceived to be unjust by the taxpayers.

### You are required to:

- (a) Explain the essential features of a good tax system. (8 Marks)
  - (b) Differentiate between tax avoidance and tax evasion. (7 Marks)
- (Total 15 Marks)**

## SOLUTION TO QUESTION 5

- (a) The following are the essential features of a good tax system:

- (i) **Equity/Impartiality:** This requires that those in equal circumstances should pay an equal amount of tax. The equity criteria may be "horizontal" meaning that those with the same income should pay an equal amount of tax or "vertical" which require that those with different income should pay different amount of tax. The rich should pay more and the poor should pay less tax, so that the tax will be progressive in nature;
- (ii) **Certainty:** This requires that a taxpayer should be in a position to know with some measure of certainty what is expected from him. This presumes that taxation is not arbitrary which may cause some resentment. The time, manner of payment and the amount to be paid should be clear and plain to the taxpayer;
- (iii) **Convenience:** The time and mode of payment of tax should be devoid of all possible inconveniences it may give the taxpayer;
- (iv) **Economical:** A good tax system should be economical to the government in the sense that the cost of collection of the tax should be minimal in proportion to the revenue generated from it. The tax system should be such that brings in sufficient revenue to the government. The cost of administering the tax should be less than the revenue it generates;
- (v) **Flexibility:** It is recognised under this canon that instead of a rigid tax system, a tax system that is responsive to the changing realities is preferred. An adjustable tax system would allow any tax found obsolete to be scrapped and replaced with a meaningful and collectible tax;

- (vi) **Simplicity:** The tax should be coherent, simple and straightforward. A tax system must be easily understood and very simple to administer. A properly understood tax system eliminates the chances of corruption and oppression by tax officials;
- (vii) **Sustainability:** The tax system should promote sustainable revenue, economic growth and development; and
- (viii) **Taxation must be dynamic:** This means that a country's tax structure ought to be dynamic and diverse in nature.

- (b) Tax evasion is a contravention of the tax laws whereby a taxable person neglects to pay the tax due or reduces the tax liability by making fraudulent or untrue claims on the income tax forms or returns.

Tax avoidance on the other hand arises in a situation where the taxpayer arranges his financial affairs in a form that would make him pay the least possible amount of tax. Tax avoidance schemes are carried out after a critical review of the tax laws. The taxpayer would then implement devices to exploit loopholes in the tax laws that would enable him avoid or minimise tax.

Tax avoidance and tax evasion can be compared as follows:

S/N	Tax Avoidance	Tax Evasion
1	Legal	Illegal
2	Achievable through exploiting loopholes in the tax laws	Achievable through deliberate action of fraud and deceit or rendering incorrect returns
3	Results in taxpayer paying minimum tax possible without breaking the law	Results in taxpayer not paying correct tax or paying minimum tax through the breaking of the tax laws
4	Supported by courts in decided cases	No support by the courts
5	No criminal liability	Tax evader could be charged to court for criminal offence with the consequent fines, penalties and, at times, imprisonment
6	When stretched to the extreme, the scheme could be disregarded (set aside) by the Revenue Service applying appropriate anti-avoidance legislation	At any level, Revenue Service will frown at tax evasion
7	No Revenue Service investigation as a result of tax avoidance. Prior years assessments will not be reopened	Revenue Service investigation will be instituted. Revenue Service has the power to open prior assessments beyond

		the statutory six-year limit, subject to the approval of the courts.
--	--	--

## QUESTION 6

- (a) The multilateral Convention on Mutual Administrative Assistance in tax matters was developed to facilitate international cooperation among tax authorities in order to tackle tax avoidance and evasion.

International cooperation in tax matters requires Nigeria and other participating jurisdictions to exchange information relevant for enforcing the domestic tax laws of the jurisdictions that are party to the convention.

**You are required** to explain the following within the context of the convention:

- (i) Exchange of information on request (4 Marks)
  - (ii) Automatic exchange of information (4 Marks)
  - (iii) Spontaneous exchange of information (4 Marks)
- (b) Explain the implications of exchange of information among parties covered by the convention to the Federal Inland Revenue Service. (3 Marks)
- (Total 15 Marks)**

## SOLUTION TO QUESTION 6

- (a) (i) **Exchange of information on request**  
With respect to this approach on exchange of information, one country ("Applicant State") may request for tax information relating to a particular case from the tax file of another country ("Requested State").

Where the information available in the tax files of the Requested State is not sufficient, it shall take all relevant measures to provide the Applicant State with the information requested.

- (ii) **Automatic exchange of information**  
This refers to information exchanged periodically on an automatic basis, without any prior request.

Automatic exchange of information requires additional procedures to be mutually agreed between the countries that intend to exchange information automatically.

After the relevant procedures are in place, parties are expected to automatically transmit information that is foreseeably relevant for the administration or enforcement of their domestic laws concerning the taxes covered by the convention.

(iii) **Spontaneous exchange of information**

According to the convention, a jurisdiction is obliged to provide information to another participating jurisdiction without the latter requesting for it.

This form of information exchange is beneficial where a jurisdiction has knowledge of tax affairs of any multinational enterprise (MNE) that may result in a tax loss in another jurisdiction, reduction of taxes in one State that may increase taxes in the other jurisdiction, or a party supposes that there are tax savings by MNE resulting from artificial transfer of profits within the group. In effect, spontaneous exchange of information may place focus on the tax planning activities of MNEs without any formal request. It does not require a mutual agreement between both countries.

(b) The implications of exchange of information among parties covered by the convention to the Federal Inland Revenue Service are:

- (i) The FIRS will have better access to information on non-resident companies operating in Nigeria that it would previously not have had due to limitation in its authority to act outside Nigerian jurisdiction;
- (ii) The FIRS will be required to share information with other signatories to the Convention, the FIRS needs to invest more in information management systems that are robust and flexible; and
- (iii) The FIRS will also need to build its in-house capacity for the purpose of simultaneous tax examinations and participating in tax audits abroad.

## **QUESTION 7**

There is a general notion that regional economic integration paves way for countries to focus on issues that are relevant to their various stages of development as well as encourage trade between neighbours.

**Required:**

(a) Mention five (5) objectives of regional economic integration. (5 Marks)

(b) Discuss three (3) benefits and two (2) shortcomings of regional economic integration. (10 Marks)

**(Total 15 Marks)**

## **SOLUTION TO QUESTION 7**

- (a) Regional economic integration is the joining of individual States within a region into a larger whole. Regional economic integration aims at achieving the following objectives:
- (i) The strengthening of trade integration in the region;
  - (ii) The creation of an appropriate enabling environment for private sector development;
  - (iii) The development of infrastructure programmes in support of economic growth and regional integration;
  - (iv) The development of strong public sector institutions and good governance;
  - (v) The reduction of social exclusion and the development of an inclusive civil society;
  - (vi) Contribution to peace and security in the region;
  - (vii) The building of environment programmes at the regional level; and
  - (viii) The strengthening of the region's interaction with other regions of the world.
- (b) The following are the benefits derivable from regional economic integration:
- (i) Trade creation: These agreements create more opportunities for countries to trade with one another by removing the barriers to trade and investment. Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries. Studies indicate that regional economic integration significantly contributes to the relatively high growth rates in the less-developed countries;
  - (ii) Employment opportunities: By removing restrictions on labour movement, economic integration can help expand job opportunities;
  - (iii) Consensus and cooperation: Member nations may find it easier to agree with smaller numbers of countries. Regional understanding and similarities may also facilitate closer political cooperation;
  - (iv) Increase in technology sharing and cross border investments; and
  - (v) Impetus for private sector planning and investment: Regional economic integration can serve a useful economic purpose beyond the direct gains from trade liberalisation, by reducing uncertainties and improving credibility and thus making it easier for the private sector to plan and invest. Indeed, reducing uncertainty may be vital for realising gains from liberalisation. Whether economies benefit from a particular regional trade agreement depends on the scope and coverage of its provisions, the nature of the enforcement mechanism and the circumstances in which the agreement can be modified.

The shortcomings of regional economic integration include:

- (i) **Trade diversion:** The flip side to trade creation is trade diversion. Member countries may trade more with each other than with non-member nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country. In this sense, inefficient companies can be protected inadvertently with the bloc agreement acting as a trade barrier. In essence, regional agreements have formed new trade barriers with countries outside of the trading bloc;
- (ii) **Employment shifts and reductions:** Countries may move production to cheaper labour markets in member countries. Similarly, workers may move to gain access to better jobs and wages. Sudden shifts in employment can distort the resources of member countries; and
- (iii) **Loss of national sovereignty:** With each new round of discussions and agreements within a regional bloc, nations may find that they have to give up more of their political and economic rights.



# THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

## OCTOBER 2023: PROFESSIONAL EXAMINATION

### PTE II: FINANCIAL TAX ANALYSIS

**ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.**

**TIME: 3 HOURS**

#### QUESTION 1

Two young men and graduates of Computer Engineering from Pragmatic University of Technology, Lagos started two enterprises during their National Youth Service year. They have now taken advantage of the Finance Act 2020 which allows single shareholder private limited liability company to register the two businesses with Corporate Affairs Commission (CAC) as private Limited liability companies under the names, Bulldozer Ltd and Caterpillar Ltd.

They engaged in "Business to Customer" category of electronic commerce (E-commerce) sector dealing in manufactured products. One of the companies is operating the policy of selling goods with a low price in order to increase the volume of sales while the other prefer giving special attention to customers service and charged high prices for its products. As the businesses are expanding they want you, as their Financial and Tax Consultant, to analyse their business operations using the following information generated from their financial statements:

#### **Income Statement for the year ended December 31, 2022**

	<b>Bulldozer Ltd</b>	<b>Caterpillar Ltd</b>
	<b>₦'000</b>	<b>₦'000</b>
Revenue	32,000	32,000
Cost of Sales	(22,400)	(23,360)
Gross Profit	9,600	8,640
Operating expenses	(7,584)	(6,797)
Profit	<u>2,016</u>	<u>1,843</u>



# Statement of Financial Position as at December 31, 2022

	Bulldozer Ltd	Caterpillar Ltd
	₦'000	₦'000
Non - current assets	20,800	12,800
Current assets		
Inventory	9,680	4,920
Receivables	3,720	680
Cash	<u>800</u>	<u>3,160</u>
	14,200	8,760
Current liabilities	<u>(3,200)</u>	<u>(320)</u>
Net current assets	<u>11,000</u>	<u>8,440</u>
	<u>31,800</u>	<u>21,240</u>
Equity		
Share capital	15,800	15,800
Revenue reserve	<u>16,000</u>	<u>5,440</u>
	<u>31,800</u>	<u>21,240</u>

## Required:

The opening inventory are: Bulldozer Ltd - ₦5,120,000 and Caterpillar Ltd - ₦1,280,000:

(a). Calculate the following ratios.

- Gross profit to sales ratio
- Net profit to capital employed
- Net profit to sales ratio
- Quick/Acid test ratio
- Current ratio
- Rate of inventory turnover
- Sales to non - current assets
- Receivable turnover period

(16 Marks)

(b). Prepare a report addressed to the two companies using the ratios calculated and the information provided with focus on profitability and liquidity. Also identify which company is operating a policy of charging low price for its goods in order to increase the volume of sales and the company that gives special attention to customers service with a high prices for its products.

(14 Marks)

(c). Explain Private Limited Liability company, its minimum requirements for registration and advantages.

(10 Marks)

**(TOTAL 40 MARKS)**

## SOLUTION TO QUESTION ONE

### 1 (a) Ratios Calculation

	Bulldozer Ltd	Caterpillar Ltd
(i) Gross profit to sales ratio		
$\frac{\text{Gross profit}}{\text{Sales}} \times 100$	$\frac{9600}{32,000} \times 100$	$\frac{8,640}{32,000} \times 100$
	<u>30%</u>	<u>27%</u>
(ii) Net profit to capital employed		
$\frac{\text{Net profit}}{\text{Capital employed}} \times 100$	$\frac{2016}{31,800} \times 100$	$\frac{1,843}{21,240} \times 100$
	<u>6.34%</u>	<u>8.68%</u>
(iii) Net profit to sales ratio		
$\frac{\text{Net profit}}{\text{Sales}} \times 100$	$\frac{2016}{32,000} \times 100$	$\frac{1,843}{32,000} \times 100$
	<u>6.3%</u>	<u>5.76%</u>
(iv) Quick/Acid test ratio		
$\frac{\text{Current asset} - \text{Inventory}}{\text{Current liabilities}}$	$\frac{14,200 - 9680}{3,200}$	$\frac{8,760 - 4,920}{320}$
	<u>1.4:1</u>	<u>12:1</u>
(v) Current ratio		
$\frac{\text{Current asset}}{\text{Current liabilities}}$	$\frac{14,200}{3,200}$	$\frac{8,760}{320}$
	<u>4.44:1</u>	<u>27.38:1</u>
(vi) Rate of inventory turnover		
$\frac{\text{Cost of sales}}{\text{Average inventory}}$	$\frac{22,400}{(5,120 + 9680)/2}$	$\frac{23,360}{(1,280 + 4920)/2}$
	<u>3.03 times</u>	<u>7.54 times</u>
(vii) Sales to non current assets		
$\frac{\text{Sales}}{\text{Non current asset}}$	$\frac{32,000}{20,800}$	$\frac{32,000}{12,800}$
	<u>1.54 or 154%</u>	<u>2.5 or 250%</u>

(viii) Receivable turnover period

<u>Average receivable</u>	x 365	<u>3,720</u>	x 365	<u>680</u>	x 365
Sales		32,000		32,000	
		<u>42.43 or 42 days</u>		<u>7.76 or 8 days</u>	

## **Solution to Question 1(b) Report**

Ref. No. Report/2023/1

The Managing Director,  
Bulldozer Ltd  
Lagos

The Managing Director,  
Caterpillar Ltd  
Lagos.

Dear Sir,

### **RE: PROFITABILITY AND LIQUIDITY PERFORMANCE**

We refer to our discussions with you and your directives to our firm to give advice on the operational performance of your companies with focus on profitability and liquidity using the extract you provided from your financial statements and our ratio calculations:

#### **1. Profitability**

The level of profitability of Bulldozer Ltd is slightly higher than that of Caterpillar when relating both gross and net profit to sales. For gross profit to sales, Bulldozer Ltd has 30% and Caterpillar Ltd is 27%. On net profit to sales, Bulldozer Ltd has 6.3% and Caterpillar Ltd has 5.76%. This showed that the two companies' level of profit to sales trend is very similar. However, in the utilisation of capital employed, indicated by net profit to capital employed, Caterpillar Ltd with 8.68% is better than Bulldozer Ltd (6.34%). This is a reflection that caterpillar Ltd is operating a policy of charging low price for its goods in order to increase the volume of sales while Bulldozer is the company that gives special attention to customers service with a high price for its products.

This fact also reflected in the result of sales to non-current assets where Caterpillar Ltd has 250% as against Bulldozer Ltd, 154%. It showed that despite higher non-current asset figure of Bulldozer Ltd, ₦20,800,000, compared to Caterpillar Ltd,

N12,800,000, Caterpillar still generate the same Revenue of ~~N~~32,000,000 with Bulldozer Ltd.

## **2. Liquidity**

The liquidity level of the two companies are above the industry standard of 2:1 current ratio and 1:1 of acid test ratio which is a reflection that they have good short term solvency. However, Caterpillar Ltd has a better liquidity level with current ratio of 27.38:1 and quick ratio of 12:1 as against that of Bulldozer Ltd of 4.44:1 and 1.4:1 respectively. Rate of inventory turnover of Caterpillar Ltd, 7.54 times, is better than Bulldozer Ltd, 3.03 times. Also, Caterpillar Ltd has a lower receivable turnover period of 8 days while Bulldozer Ltd is 42 days.

All the results of these ratios is also a reflection that caterpillar Ltd is operating a policy of charging low price for its goods in order to increase the volume of sales as against Bulldozer Ltd that gives special attention to customers service with a high prices for its products.

### **Conclusion**

In view of the above facts, the two companies are progressing in terms of their profitability and liquidity. However, our analysis are based and limited to the ratios calculated and information provided which is prepared under historic cost convention. If more information were made available, the analysis may lead to a different conclusion on the performance of both companies.

Thank you.

Yours faithfully,

ABC

For XYZ Consultants.

## **Solution to 1(c)**

### **Private limited company (Ltd)**

A private limited company is a legal entity, separate from those who own it, the shareholders. The limited liability and simplicity of running the private limited liability company makes it the most common of registered business in Nigeria. As a shareholder of a private limited company, the shareholders' personal possessions remain separate (unless they are secured

against the business for borrowing), and the shareholders' risk is reduced to only the money they have invested in the company and any shares the shareholder holds which has not been paid for. The private limited liability company have very few restrictions which makes it simple but yet flexible for many business concern in Nigeria.

The minimum requirements for a private limited company are:

- (i) The company must have a registered office in Nigeria;
- (ii) The company's name must not be exactly identical to any other company's name currently held in the registry of the Corporate Affairs Commission;
- (iii) It must have an article of association and memorandum of association;
- (iv) It must keep proper records as required by Company and Allied Matters Act;
- (v) At least twenty five percent of the authorised shares must be allotted at incorporation;
- (vi) At least two people above the age of 18 must subscribe to the memorandum and articles of association; the companies and Allied Matters Act 2020 has introduced single shareholder private limited liability company.
- (vii) The total number of members in a private limited company must not exceed 50, not including those who are bona fide in the employment of the company; and
- (viii) The authorised share capital shall not be less than ₦10,000.

Advantages of private limited company:

There are several advantages of operating a private limited liability company rather than a business name in Nigeria, a few of which are stated below.

- (i) A private limited company is a separate legal entity and it is a separate person in the eyes of the law.
- (ii) There are laws that govern the internal affairs and contain the objectives of a private company limited by shares, which is enshrined in the articles of association of the company. Unlike the business name which has no laws guiding its activities, all decisions are taken the by proprietor(s) of the business.
- (iii) A private company is a legal entity that can sue and be sued in its name. This means that the company is held separately for any wrongdoing. Any legal action is filed against the company and not its directors.
- (iv) A private company uses the word Limited (Ltd) after the name of the company, which is mandatory for all private companies to use.
- (v) A private company has the advantage of giving the opportunity to an investor who does not wish to be actively involved in the running of the business to invest capital into the business.
- (vi) Unlike a business name whose powers and functions are performed by an individual, a private company limited by shares has checks and balances. Hence,

- the control of a company is in the hands of the board of directors or by shareholders in their shareholding capacity.
- (vii) Another advantage is that for a business name, upon the demise of the sole proprietor or proprietors, the business dies and ceases to exist. But for a private company limited by shares, the company enjoys perpetuity and can outlive the members upon their death.

## **QUESTION 2**

Industry analysis involves observation and analysis of factors such as market behaviours, competitive forces, financial and regulatory, socio-economic, and technological trends that influence the domain. Industry analysis delivers insights into business drivers and key success factors relevant to the domain.

### **Required:**

Discuss the following factors that business managers must consider when carrying out industry analysis, as business driver and key success factors:

- a. Market behaviour;
- b. Competitive forces;
- c. Financial and regulatory framework;
- d. Social economic; and
- e. Technological trends.

**(15 Marks)**

## **Solution 2**

### **Market behaviour**

Market behaviour is a broad economic term that refers to the behaviour of consumers, businesses, or the stock market. It is often analysed and used to generate various marketing strategies aimed at boosting sales or brand recognition when dealing with businesses and consumers by analysing their purchasing behaviour. Niche marketing often considers the target demographics, the most likely consumer needs addressed by a product, and the most effective advertising stimuli to begin a successful campaign strategy. The purpose of analysing market behaviour is to understand the consumer behaviour. The company must understand consumer behaviour if it wants to anticipate and react to customer needs and desires, and building an effective marketing strategy rolls around the consumer behaviour, the company's strengths and weaknesses and competition capabilities.

### **Competitive Forces**

Competitive forces describe the five forces that influence an industry. They determine the competitive rules and strategies managers are likely to use. So, analysing the competitive forces' structure provide essential insight for business strategy. Michael Porter identified five forces that are widely used to assess the structure of any industry. Porter's five forces are the:

- Bargaining power of suppliers,
- Bargaining power of buyers,
- Threat of new entrants,
- Threat of substitutes, and
- Rivalry among competitors.

Together, the strength of the five forces determines the profit potential in an industry by influencing the prices, costs, and required investments of businesses—the elements of return on investment. Stronger forces are associated with a more challenging business environment. To identify the important structural features of your industry via the five forces, you conduct an industry analysis that answers the question, “What are the key factors for competitive success?”

## **Financial and regulatory framework**

Regulatory environment consists of laws and regulations that has been developed by federal, state, and local governments to exert control over business practices. Or, simply put, a regulatory environment is the laws, rules, and regulations put into place by federal, state, or other government entities and civilian organisations to control the behaviour and actions of business activities.

Financial regulations are laws and rules that govern the workings of financial markets and financial institutions. Regulations of financial institutions basically focus on providing stability to the financial system, fair competition, consumer protection, and the prevention and reduction of financial crimes. The government has a myriad of agencies in place that regulate and oversee financial markets and companies. Each of these agencies has a specific range of duties and responsibilities that enable them to act independently of each other while they work to accomplish similar objectives. In Nigeria, such agencies include the Central Bank of Nigeria, The Securities and Exchange Commission, etc.

Usually, there are constant change in these regulations and managers must be aware of the changes and take them into consideration when planning for their firms’ activities and crafting strategies. All these are done through industry analysis.

## **Technological trends**

Technology has become a primary catalyst for change in the world. Technological advances give businesses, governments, and social-sector institutions more possibilities to lift their productivity, invent and reinvent offerings, and contribute to humanity’s well-being. While it remains difficult to predict how technology trends will play out, executives can plan ahead better by tracking the development of new technologies, anticipating how companies might use them, and understanding the factors that affect innovation and adoption. Analysing technological trend has become more important as new technology is constantly being invented and are displacing old technology. Understanding technological trend is therefore, a vital part of industry analysis when crafting corporate and business strategies by firms.

Information technology has been the leading force behind major industry shifts and business disruptions in the last half century. Therefore, manager must play an important role in industry analysis. Managers bridge the gap between business and technology by identifying

developments in technology that can address prevailing industry problems and deliver positive outcomes to a business. The range of business outcomes can vary from strengthening existing business capabilities for competitive advantage to transforming a business or industry or ultimately creating new industries.

## **Social Economics**

A social science and branch of economics that focuses on the interrelationship between economic activity and social behaviour. It is the social science and branch of economics that studies the interrelation between economic activity and social behaviour. Social economics analyses how the economy is affected by social norms, ethics, sentiments, and other factors. Social economics attempts to explain how members of certain socioeconomic classes act and how the economy is impacted. Social economics draws upon information from fields such as history, philosophy, sociology, and political science. It uses information from different areas to examine how it influences consumer behaviour, shapes buying trends, and affects other activities within business and economics shapes buying trends and affects other activities within business and economics. Managers must take into consideration their social structure of the market their firms are serving when carrying out industry analysis and crafting business strategies.

## **QUESTION 3**

International accounting standards have been adopted to provide quality accounting information that is comparable and useful for users' decision-making purposes. However, it has been discovered that it is not optimal to use accounting regulation to completely eliminate managerial flexibility. So, some elements of flexibility and managerial judgement have been allowed in some accounting standards, which have also become potential sources of bias in accounting data.

### **Required:**

- a. List seven (7) areas of possible bias in accounting data due to flexibility and managerial judgement. (7 Marks)
- b. Discuss four (4) institutional situations where manipulation of accounting data is more likely. (8 Marks).

**Total (15 Marks)**

### **Solution 3**

- a. There are some potential sources of bias in accounting data, these are:
  - i. Rigidity in accounting rules;
  - ii. Random forecast errors;
  - iii. Manager's accounting choices (systematic reporting choices);
  - iv. Accounting-based debt covenants;
  - v. Management compensation;
  - vi. Tax considerations; and
  - vii. Decisions to influence regulatory outcomes.



- b. Institutional situations where manipulation is more likely are:
- i. The firm is in the process of raising capital or renegotiating borrowing: When a firm is in the process of raising new capital, there may be a lot of manipulations in the account so as to convince the lender that the company is doing well. This is particularly common among some private firms that normally have different sets of financial statement for different purposes;
  - ii. Debt agreements are likely to be violated: When debt agreement terms are not honoured, manipulation of accounts may take place to present to the lender that the company is not in a position to pay as and when due;
  - iii. A change in management: Management may bring likely manipulation when a new management want to present that they are doing well than the former management, whereas they are not. Also, a change in auditor is likely to cause some manipulation if the change is due to the fact that previous auditor fails to connive with management to manipulate the financial statements;
  - iv. Asset impairment decisions is another source of manipulation. Asset impairment decision may be used to intentionally manipulate the asset figures as may be desired by the management of the company;
  - v. Good corporate governance is very important for a company: A weak corporate governance structure where inside management dominate the board and there is a weak audit committee, or none at all will also lead to possible manipulation of financial statements; and
  - vi. Transactions are with related parties rather than at arm's length is another source of possible manipulation in a company. To avoid this, transactions should as much as possible be carried out at arm's length.

#### **QUESTION 4**

Ladot Nigeria Limited and Datco Nigeria Limited are planning to merge their businesses, with Ladot Nigeria Limited becoming the surviving company after the merger. The management of the two companies have approached you to give them advice on the status of Nigerian tax laws on the following:

- a. Taxes and deductibility of merger related expenses;
- b. Unabsorbed losses and un-utilised allowances brought forward;
- c. Capital gains tax on shares or cash received; and
- d. Tax issues in mergers and acquisitions

#### **Required:**

Write your advice in form of brief notes to be forwarded to the management of the two companies. **(15 Marks)**

## **Solution 4**

### **a. Taxes and deductibility of related expenses**

- (i) Stamp duties  
Duty payment will arise on the share capital of the new company, subject to the provisions of Section 104 of the Stamp Duties Act, in relation to capital and duty relief.
- (ii) Consolidated expenses  
Fees paid to statutory bodies such as SEC, NSE, CBN, Land Authorities etc., including professionals like accountants, stockbrokers, issuing houses, and solicitors are regarded as capital in nature and will therefore not be allowed as deductible expenses by virtue of Section 27(a) of CITA.
- (iii) Taxation of consolidation fees:  
Fees paid to professionals for services rendered in connection with consolidation will be subject to VAT and WHT at the rates of 5% (changed to 7.5% under the Finance Act 2019) and 10% respectively.

### **b. Unabsorbed losses and un-utilised allowances brought forward**

The new company may also not be permitted to inherit the unabsorbed losses and capital allowances of the absorbed companies, except under the following circumstance:

Where a reconstituted company is carrying on the same business previously carried on by this company and it is proved that the losses have not been allowed against any assessable profits or income of that company for any such year; in that case the amount of unabsorbed losses shall be deemed to be a loss incurred by the re-constituted company in its trade or business during the year of assessment in which the business commenced.

### **c. Capital gains tax on shares or cash received**

Section 32A of Capital Gains Tax Act (CGTA) Cap 121LFN 2004 provides that a person shall not be chargeable to tax under the Act, in respect of any gains arising from the acquisition of the shares of a company, either merged with, or taken over or absorbed by another company, as a result of which the acquired company has lost its identity. However, where shareholders are either wholly or partly paid in cash for surrendering their shares in the ceased business, the gains arising from the cash payment will be subject to CGT.

It is a possibility that one of the merging companies survives and its old name or a new name to inherit the assets, liabilities, reserves and entire operations of the merging parties. Where this happens, the following points must be noted:

- (i) The surviving company must file its returns in line with the provisions of section 55(3)(a) of CITA;

- (ii) Commencement rules under section 29(3) of CITA will not apply to the surviving company, as it will be regarded as an existing company;
- (iii) The surviving company will not be allowed to claim investment allowance on the assets which were transferred to it and will also not claim initial allowance on such assets;
- (iv) The surviving company may however claim annual allowance only on the tax written down values (TWDV) of the assets transferred to it;
- (v) The surviving company may not inherit the unabsorbed losses and capital allowances of the merging companies, except it is proved that the new business is a reconstituted company; and
- (vi) All fees payable on merger bids or consolidation will be liable to VAT and WHT just like it is applicable on the emergence of a new company. Stamp duties will be paid on the increase in share capital and the company will have to obtain its own staff pension scheme approval from the JTB.

#### **d. Tax issues in mergers and acquisitions**

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

#### **ii. Rendition of annual returns**

Where a new company emerges from a merger process, then, the new company is expected to file its returns, in line with the provisions of Section 55(3)(b) of CITA. The section provides that “every new company shall file with the Service, its audited accounts and returns within eighteen (18) months from the date of its incorporation or not later than six (6) months after the end of its first accounting period as defined in section 29(3) of this Act, whichever is earlier”.

It should however be understood that a mere change of name does not make an existing business entity a new company. Such companies will continue to be treated as old businesses on an on-going concern basis

#### **iii. Basis of assessment**

Commencement rule as provided under Section 29(3) will apply to the new company, except where any of the under-listed circumstances arise:

- Where the merging parties are connected parties, the Service may direct that commencement rule be set aside, in which case, the new company will file its returns as an on-going concern and its assessment will be determined on preceding year basis; and

- Where the new business is a reconstituted company, taking over the trade or business formerly run by its foreign parent company.

iv. **Claim of allowances**

Companies Income Tax Act (CITA) did not categorically address the value at which assets may be transferred for the purpose of capital allowances claims. However, International Accounting Standard 22 prescribes that in merger accounting, the assets, liabilities and reserves must be recorded at their carrying balances, implying that merger process does not permit the recording of assets at their fair value in the event of consolidation. The new company will therefore not be entitled to any investment allowance claim or initial allowance on the transferred assets; it will only be entitled to claim annual allowance on the tax written down values (TWDV) of the transferred assets.

## QUESTION 5

There are basically two sources of finance open to every company, be it a sole proprietorship or a public limited liability company.

**Required:**

- Discuss entity's financing decision and the two types of financing open to an entity and their tax implications. (6 Marks)
- Apart from outright cash purchases, discuss three ways a company may acquire assets. (9 Marks)

**Total: (15 Marks)**

## Solution 5

- Financing decision can be defined as "when, where, from and how to acquire funds to meet the firm's investment needs".  
The focus of the finance manager here is determination of the appropriate proportion of equity and debt. Financing describes the sourcing of all funds a company uses for acquiring assets and paying expenses.  
There are only two kinds of sources of funds - equity and debts funding. The company's financial structure describes the fraction of total funding that comes from each source. Equity comes from two source - paid up share capital and retained earnings - the after tax profits retained by the company in the business after paying dividends to shareholders.  
Debts are funds acquired through debt financing and come primarily from bank loans and sales of loan notes. The company's debts, however, also includes short term obligation such as short terms loan notes payable, account payable, etc.

Capital structure is the mix of debt and equity in financing a firm's assets. In other words, capital structure describes the source of funds a company uses for acquiring income - producing assets. It can also be referred to as the way a company finance its assets through combination of equity and debt.

Every firm should strive to achieve an optimum capital structure, i.e., the best financing mix, when the market value of the firm's shares is maximised.

- b. Asset finance is a type of finance used by businesses to obtain the equipment they need to grow, apart from outright purchase in cash. It usually involves paying a regular charge for use of the asset over an agreed period of time, thus avoiding the full cost of buying outright. The most common types of asset finance are leasing and hire purchase”.

#### **i. Leasing**

This is a form of asset finance where a leasing company (called the lessor) buys and sometimes, owing the asset on behalf of the customer (called lessee). The lessor pays a rental for the use of the asset over a pre-determined period.

There are two types of lease:

- **Finance Lease:** Under finance lease, the lessee owns the asset and the asset appears on the statement of financial position of the lessee. The lessee pays rental, which is the addition of the principal amount and the interest element over a period of time. In finance lease, the lessee is responsible for all the risks of ownership and also maintains the asset. At the end of the lease period, the lessee will pay a token to the lessor and the asset becomes that of the lessee permanently. It is almost like taking a loan to buy the asset needed. Under the Nigerian tax laws, the lessee will claim capital allowance for the cost of the asset while the interest element is charged to the income statement, the cost of the asset is treated as a non-current asset in the statement of financial position of the lessee.
- **Operating Lease:** This is a situation where the lessee does not own the asset but is allowed to use the asset over a period of time by paying a regular rental to the finance company. The asset does not appear on the statement of financial position of the lessee and rental paid is charged into the income statement against profit. Under the Nigerian tax laws, the lessee cannot claim capital allowance on the asset, since he does not own the asset. However, the rental payment is an allowable expense for tax purpose. The lessee does not assume risk for the asset and may not be responsible for maintaining the asset.

## **ii. Hire purchase**

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

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

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

## **QUESTION 6**

Discuss FIVE (5) techniques of financial analysis

**(15 Marks)**

## **SOLUTION 6**

### **FIVE (5) Techniques for financial analysis**

A number of techniques are normally employed in analysing a business entity's financial statements. These include:

- (i) **Comparative financial statements:** This involves a comparison of an entity's financial statements over a period of time, say at least over a two-year period. It compares the entity's income statement and statement of financial position over the period. It provides meaningful information when compared to similar data of prior periods. The comparison of the income statement enables a review of the operational performance of the entity over a period of time so as to draw conclusions as to the direction of the entity's performance. So also, a comparison of the statement of financial positions during the period will reveal the effects of operations on the assets and liabilities of the entity. This is carried out by determining the absolute and percentage changes in the compositions of the Income statements and statement of financial positions within the periods chosen.
- (ii) **Common size statements:** This analysis is done by converting the figures of the financial statements to percentages. For the income statement, the figure for revenue is taken as 100 percent and the figures of the other items of the income statement are expressed as a percentage of the revenue figure. Also, for the statement of financial position, the figure for the total assets is taken as 100 percent while the other items of the statement of financial position are expressed as a percentage of the total assets.

- (iii) Statement of changes in working capital: The statement of changes in working capital provides information in relation to working capital between the financial periods. The amount of working capital for each period is determined by deducting the total of current liabilities from the total of current assets. The explanation for this change is expressed by breaking the changes into the makeup of the total current assets.
- (iv) Trend analysis: Under this analysis, ratios of different items of the financial statements for various periods are calculated and then comparison made accordingly. This analysis reveals the trend or direction of the company. Trend analysis is used to determine whether the financial health of a business entity is improving or deteriorating and whether the results of its operation is improving or on a downward trend.
- (v) Ratio analysis: This is the most popular way of carrying out a financial analysis. It is a widely used tool for analysing financial statements. Financial ratios show the relationship between the individual items or group of items of the entity's income statement and statement of financial position. Ratios can be grouped under the five major headings – profitability ratios, liquidity ratios, activity/efficiency ratios, leverage ratios and shareholders – return or investment ratios. Ratios therefore highlight the key performance indicators, such as profitability, efficiency, liquidity, solvency, etc. of a business entity. It also reveals a lot about the changes in the financial condition of a business entity.

## QUESTION 7

Total elimination of taxes is not a goal that people and organisations normally pursue, but often invest significant amounts of time and resources in implementing tax-reducing strategies through tax planning. The ultimate goal is to reduce taxes while not excessively intruding on the organisation's overall operations. Tax planning strategies are usually based on taking advantage of either the time value of money (e.g., paying taxes later) or differences in tax rates (i.e., tax-rate arbitrage). The following tax planning strategies have been used by organisations:

- a. Creation;
- b. Conversion;
- c. Shifting; and
- d. Splitting.

### Required:

Discuss each of the above tax planning strategies with practical examples. **(15 Marks)**

## Solution 7

The following are the tax planning strategies:

- a. **Creation:** Creation involves plans that take advantage of tax subsidies, such as moving an operation to a jurisdiction that imposes lower taxes.
- b. **Conversion:** Conversion entails changing operations so that more tax-favoured categories of income or assets are produced. This strategy is based on the fact that:
  - Tax rates can vary across different activities; ordinary income is taxed at ordinary rates; long term capital gains are taxed at preferential rates. Some income are exempted; and
  - The conversion strategy is based on the understanding that tax laws do not treat all types of activities in the same way.**Conversion strategies:** These involve adjusting specific activities (for example between wages and dividends or between individual expenses and investment and business expenses). Another example is, advertising to sell inventory results in ordinary income, which is usually taxed immediately and at the highest rates. However, equally successful image advertising generates an increase in a firm's goodwill, which is not taxed until the goodwill is sold, if at all, and then would likely be taxed at lower capital gains rates.
- c. **Shifting:** Shifting involves techniques that move amounts being taxed (also called the tax base) to more favourable tax-accounting periods. A good example is accelerated depreciation, which allows more of an asset's cost to be a tax-deductible expense in early years, thus deferring the payment of taxes until later. Another example is an individual retirement account (IRA).
- d. **Splitting:** Splitting techniques entail spreading the tax base among two or more taxpayers to take advantage of differing tax rates. Income shifting strategy exploits the difference in tax rates across taxpayers by shifting income from high – taxpayers (jurisdictions) or shifting deductions from low rate tax payers to high – rate taxpayers. This includes transactions between owners and their business such as:
  - Incorporating a business and thus shifting incomes from an individual to the company which may result in lower current taxation of the business;
  - Shifting income from a company to an owner through tax deductible expenses (e.g compensations, interest, rent, allows the owner to avoid double taxation on corporate profits); and
  - **Transaction across jurisdiction:** Income earned in different jurisdiction is often taxed differently. With a proper understanding of the differences in tax laws across jurisdictions, taxpayers can use these differences to maximise their after-tax wealth.





# THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

## OCTOBER 2023: PROFESSIONAL EXAMINATION

### PTE II: TAX AUDIT AND INVESTIGATION

**ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.**

**TIME: 3 HOURS**

#### QUESTION 1

You have been chosen by the management of FIRS to lead a team to conduct tax audit of Dandatee Nigeria Limited. As part of the audit, you have planned to hold an initial meeting with the management and tax consultant of the company.

The following is the statement of Profit or Loss and other comprehensive income of Dandatee Nigeria Limited for the year ended December 31, 2022:

<b>Dandatee Nigeria Limited</b>		
<b>Statement of profit or loss and other comprehensive income</b>		
<b>for the year ended December 31, 2022</b>		
	2022	2021
	₦	₦
Turnover	51,911,612	45,283,683
Less: Cost of sales	<u>(36,844,571)</u>	<u>(35,850,619)</u>
	15,067,041	9,433,064
Loss on sale of Motor Vehicle	<u>(13,034)</u>	<u>--</u>
Gross profit	15,054,007	9,433,064
Less: Admin expenses		
Staff salaries & allowances	3,255,785	1,605,977
Repairs & maintenance	762,755	496,580
Transport & travelling	320,810	180,840
Printing, postage & stationery	1,200	62,000
Telephone expenses	306,916	33,340
Office rent	238,000	140,000
Motor running expenses	421,910	337,430
Electricity	68,355	39,400
Advertising	35,750	50,000
Medical expenses	55,000	24,000
Subscriptions & donations	513,045	71,324
Insurance	21,500	27,500
Legal & professional fee	—	10,000
Entertainment	17,655	10,960
Sundry expenses	363,800	642,640

Audit fee	100,000	50,000
Bank charges & interest	1,656,484	900,000
Depreciation	781,400	758,400
Prov. For bad & doubtful debts	<u>149,084</u>	<u>(43,818)</u>
Total expenses	9,069,449	5,396,573
Profit before taxation	<u>5,984,558</u>	<u>4,036,491</u>
Taxation	<u>(897,684)</u>	<u>(1,009,123)</u>
PAT transferred to General Reserves	<u>5,086,874</u>	<u>3,027,368</u>

### Required:

- State the areas/matters that you will discuss with the company's management and its tax consultant during the initial meeting before the commencement of the field audit. 8 Marks
  - What objectives do you hope to achieve by touring the company's premises immediately after the initial meeting (7 Marks)
  - State the tax audit programme to be adopted to confirm the accuracy of turnover and cost of sales figures disclosed by the company. (5marks)
  - Perform analytical tests on the figures given. (11marks)
  - Identify areas you will focus upon during your field audit (4marks)
  - State further detail/information you will request for to assist you in forming an opinion on some of the figures on the income statement. (5marks)
- (Total 40 Marks)**

### SOLUTION TO QUESTION 1

- Pre-audit meeting.  
The team Leader will use the opportunity to:
  - Introduce the audit team members.
  - Brief the taxpayer on the purpose of the audit.
  - Obtain background information about the company or confirm background information earlier obtained from the company's file in the tax office or other sources of information. Such information may include: nature of the business, corporate structure, branch network, auditors or tax consultants, bankers, solicitors, secretaries, directors, related companies, shareholding structure, date of incorporation, date of commencement of business, registered address, Taxpayer's Identification Number (TIN) etc.
  - Solicit the co-operation of the taxpayer in terms of provision of necessary information, books, records etc promptly.
  - Enquire about the accounting and operational systems of the company.
  - Respond to questions from the company's representatives on matters that they need clarification, e.g. the purpose of audit, period covered, duration of the field audit exercise, books/documents/information required for the audit, etc.
  - Update the relevant taxpayers file and tax audit database as appropriate.
  - Where the form is partly completed agree on a date the taxpayer will provide the missing information.

- (ix) Ensure that the pre-audit minutes are reviewed and signed by all parties present.
- b. You should conduct a tour of the taxpayer's premises as the final step on your initial meeting.
- The objectives of touring the taxpayer's premises are:
- (i) To allow the tax auditor to see the taxpayer's business in operation.
  - (ii) To provide a visual picture of the business and gives an opportunity to validate information received during the initial interview.
  - (iii) If Non-current assets reported on the tax return are not found on the tour, enquire as to their location or disposal, i.e. check Non-current assets randomly for existence.
  - (iv) Are there as many time cards in the factory as people working?
  - (v) Observe equipment used for post-production process such as packaging, haulage etc. ask if any of these services are performed elsewhere if not seen on the premises.
  - (vi) Allow the auditor to ask relevant questions and be a keen observer of that which is specific to taxpayer's business. An effective tour will allow you to observe:
    - The size and scales of taxpayer's operation.
    - The way the taxpayer's conduct their business.
    - The manner in which the taxpayer processes work.
  - (vii) The tour will also:
    - Show the taxpayer that the tax auditors are interested in conducting a professional audit.
    - Enable the tax auditors to confirm and clarify information received during the interview.
    - Assist the tax auditor in risk assessment of the tax file.
    - Enables the auditors to look for indications of the business success e.g. if it is observed that the taxpayer or his place of business has luxurious assets, this may suggest that the business is very profitable. This could have a direct relationship to the amount of taxes that should be paid and the types of audit tests that should be conducted.
  - (vii) Make new discoveries about the business and those not in business records, e.g. machine(s) and expatriates.
  - (ix) Discuss directly with operatives so as to gather more information and data.
- c. (i) The following are the audit programme to be adopted to confirm the accuracy of turnover disclosed by the company:
- Obtain the revenue ledgers of the company
  - Obtain copies of revenue invoices issued to the customers during the years under review.
  - Obtain the trade debtors or Trade receivable ledgers for the years under review.
  - Where it is the policy of the company to allow a discount, the discount should be verified and reconciled with the cash receipt.

- Reconcile the transaction in the trade receivable ledgers with the revenue ledgers.
  - Obtain the bank statements and extract the inflow from the customers.
  - Reconcile the inflows in the bank statements with trade receivable ledgers.
- (ii) The following are the audit programme to be adopted to confirm the accuracy of cost of sales disclosed by the company
- Obtain trade payable ledger for the years under review,
  - Obtain purchases ledger for both local and imported purchases,
  - Obtain copies of invoices received from trade suppliers
  - For imported goods, obtain import documents such as form M, custom duty payment evidence, marine insurance, etc,
  - Obtain inventory ledgers and reconcile the figure with purchases ledgers
  - Obtain the bank statements and reconcile the outflow with purchases ledger.
- d. Analytical test

**Dandatee Nigeria Limited**  
**Analytical procedures on the figures of the Statement of Profit or Loss and other Comprehensive Income**

	2022 (a)	2021 (b)	Difference [c= a-b]	Change [d= $\frac{c \times 100}{b}$ ] %
	₦	₦	₦	
Turnover	51,911,612	45,283,683	6,627,929	14.64
Less: Cost of Sales	(36,844,571)	(35,850,619)	(993,952)	2.77
	15,067,041	9,433,064		
Loss on sale of Motor Vehicle	(13,034)	—		
Gross profit	15,054,007	9,433,064		59.59
Less: Admin expenses				
Staff Salaries & Allowances	3,255,785	1,605,977	1,649,808	102.73
Repairs & Maintenance	762,755	496,580	266,175	53.60
Transport & Travelling	320,810	180,840	139,970	77.40
Printing, Postage & Stationery	1,200	62,000	(60,800)	(98.06)
Telephone Expenses	306,916	33,340	273,576	820.56
Office Rent	238,000	140,000	98,000	70.00
Motor Running Expenses	421,910	337,430	84,480	25.04
Electricity	68,355	39,400	28,955	73.49
Advertising	35,750	50,000	(14,250)	(28.50)
Medical Expenses	55,000	24,000	31,000	129.17
Subscriptions & Donations	513,045	71,324	441,721	619.32
Insurance	21,500	27,500	(6,000)	(21.82)
Legal & Professional Fee	—	10,000	(10,000)	(100.00)
Entertainment	17,655	10,960	6,695	61.09

Audit Fee	100,000	50,000	50,000	100.00
Bank Charges & Interests	1,656,484	900,000	756,484	84.05
Depreciation	781,400	758,400	23,000	3.03
Prov. for Doubtful Debts	149,084	(43,818)	192,902	(440.23)
	9,069,449	5,396,573		
Profit Before Taxation	5,984,558	4,036,491	1,948,068	48.26
Taxation	(897,684)	(1,009,123)	(111,439)	(11.04)
PAT transferred to General Reserves	5,086,874	3,027,368	2,059,506	68.03

S\N	2022	2021
1. Gross Profit Margin	$= \frac{\text{Gross profit}}{\text{Turnover}} \times 100$ $= \frac{15,054,007}{51,911,612} \times 100$ $= \underline{29.0\%}$	$= \frac{\text{Gross profit}}{\text{Turnover}} \times 100$ $= \frac{9,433,064}{45,283,683} \times 100$ $= \underline{20.83\%}$
2. Net Profit Margin	$= \frac{\text{Net profit}}{\text{Turnover}} \times 100$ $= \frac{5,984,558}{51,911,612} \times 100$ $= \underline{11.52\%}$	$= \frac{\text{Net profit}}{\text{Turnover}} \times 100$ $= \frac{4,036,491}{45,283,683} \times 100$ $= \underline{8.91\%}$
3. Cost of sales to Turnover	$= \frac{\text{Cost of sales}}{\text{Turnover}} \times 100$ $= \frac{36,844,571}{51,911,612} \times 100$ $= \underline{70.98\%}$	$= \frac{\text{Cost of sales}}{\text{Turnover}} \times 100$ $= \frac{35,850,619}{45,283,683} \times 100$ $= \underline{79.19\%}$
4. Total Expenses to Turnover=	$= \frac{\text{Total expenses}}{\text{Turnover}} \times 100$ $= \frac{9,069,449}{51,911,612} \times 100$ $= \underline{17.47\%}$	$= \frac{\text{Total expenses}}{\text{Turnover}} \times 100$ $= \frac{5,396,573}{45,283,683} \times 100$ $= \underline{11.91\%}$
5. Tax % of Turnover	$= \frac{\text{Tax}}{\text{Turnover}} \times 100$ $= \frac{897,684}{51,911,612} \times 100$ $= \underline{1.72\%}$	$= \frac{\text{Tax}}{\text{Turnover}} \times 100$ $= \frac{1,009,123}{45,283,683} \times 100$ $= \underline{2.23\%}$
6. Tax % of Gross profit	$= \frac{\text{Tax}}{\text{G.P}} \times 100$ $= \frac{897,684}{15,054,007} \times 100$ $= \underline{5.96\%}$	$= \frac{\text{Tax}}{\text{G.P}} \times 100$ $= \frac{1,009,123}{9,433,064} \times 100$ $= \underline{10.69\%}$

- e. Using the growth in gross profit of 59 percent as benchmark, the following exhibit unusual features and must be areas of focus:
- (i) Staff Salaries & Allowances
  - (ii) Transport & Travelling
  - (iii) Printing, Postage & Stationery
  - (iv) Telephone Expenses
  - (v) Office Rent
  - (vi) Electricity
  - (vii) Medical Expenses
  - (viii) Subscriptions & Donations
  - (ix) Bank Charges & Interests
  - (x) Legal and Professional fees
- f. Other information/documents to ask for are:
- (i) The schedule of the non-current assets;
  - (ii) Bank reconciliation statements;
  - (iii) Age analysis of accounts payable;
  - (iv) Age analysis of accounts receivables;
  - (v) Other schedules of accounts with material balances; and
  - (vi) Terms/agreement with major suppliers.

## QUESTION 2

Your firm has been appointed to audit the financial statements of Emiloju Nig. Ltd. covering a period of one year. During the course of audit of the company's financial statements for the year ended December 31, 2021, one of your staff that was recently engaged requested from you what constitutes audit evidence. As a seasoned and experienced auditor, you are required to explain to the staff:

- i. Audit evidence. (3marks)
- ii. Identify four characteristics of audit evidence. (4marks)
- iii. State the factors that would enable the auditor assesses the reliability of such evidence. (4marks)
- iv. List the factors which may influence the auditor's judgment in relations to sufficiency of evidence so obtained. (4marks)

**(Total 15marks)**

## SOLUTION TO QUESTION 2

- 2 (i) Audit evidence:  
Audit evidence consists of information, oral, electronic, written, that auditors come across in the course of an audit so as to assist in the process of forming an independent opinion on the enterprise financial statement.
- (ii) Characteristics of a good tax audit evidence  
The qualities of a good tax audit evidence are:
- It must be reliable
  - It be precise and accurate
  - It must be time bound, i.e, relevant to time of the tax issue being tested.
  - It must be relevant so as to enable the auditor to draw conclusion on items being tested.
  - The sources must be that could be verified if there is need for it in future.
  - It must be well documented such that it could be acceptable in the court of law or tax tribunal (if there is need for it later)
  - Sufficiency.
- (iii) Reliability of evidence  
The auditor considers the following factors when assessing the reliability of the evidence.
- Reliability of the source and his previous experience about that source; the independence, objectivity, qualification and experience of the evidence.
  - The form of the evidence e.g.
    - Documentary evidence is more reliable than oral evidence.
    - Externally generated evidence is better than internally generated one.
    - Evidence generated by the auditor through physical inspection
    - Auditor generated evidence is more reliable than evidence presented by client staff
    - Original document are more reliable than photocopies.
    - Where one evidence conflicts with other related evidence for example, more evidence will be required to prove the reliability of each source of the evidence.
- (iv) Sufficiency of audit evidence  
The sufficient of audit evidence can be effected by the following factors:-
- The relevance of the evidence collected
  - The reliability of the evidence collected
  - The materiality and nature of the items being checked
  - The auditor's experience of the reliability of management, staff, accounting records as well as the effectiveness of the internal control system.
  - The possibility of management bias and the accompanying risk of statement

- f. The time and cost of collecting the evidence in relation to the value of the evidence
- g. The auditor's knowledge of the client's business and the operation industry.

### QUESTION 3

Essentially, audit is about evidence. The essence of the auditor's work is to obtain, evaluate and document audit evidence to support events and transactions that took place in the company in the course of the year and also, to ascertain the correctness of balances in the company's accounting record at the end of the year.

**Required:**

Discuss briefly the three audit procedures auditors normally use to gather evidence and form an opinion on the company's financial transactions during the year and balances at the end of the year. **(15 Marks)**

### SOLUTION TO QUESTION 3

The auditor must obtain audit evidence to be able to draw reasonable conclusions on which to base the audit opinion. The auditor is required to perform the following three audit procedures so as to obtain sufficient and appropriate audit evidence:

- (a) Risk assessment procedures:** These are procedures that will help the auditor obtain an understanding of the entity and its environment, including its internal control, so as to assess the risks of material misstatements. The purpose of risks assessment procedures is to provide a satisfactory basis for the assessment of risks at the financial statements and relevant assertion levels. However, it has to be borne in mind that risks assessment procedures by themselves do not provide sufficient appropriate audit evidence upon which to base audit opinion.

The auditor must supplement the risks assessment procedures with further audit procedures, such as, tests of controls and substantive procedures.

- (b) Tests of controls:** This is the audit procedure to test the reliability of the entity's internal control systems in preventing or detecting material misstatements at the relevant assertion level. Tests of controls procedures are necessary under two situations:
- (i) When the auditor's risk assessment includes an expectation of the operating effectiveness of the internal controls, the auditor is required to test those controls to support the risk assessment; or
  - (ii) When the substantive procedures alone do not provide sufficient appropriate audit evidence.



**(c) Substantive procedures:** These are the audit procedures aimed at detecting material misstatements at the relevant assertion level. These include tests of details of classes of transactions, accounts balances and disclosures, and substantive analytical procedures. The auditor is required to carry out substantive procedures for two reasons, these are:

- (i) First, because the auditor's risks assessment is judgemental and may not be sufficiently precise to identify all risks of material misstatements; and
- (ii) Secondly, because of the inherent limitations in internal control due to the risk of management override, the possibility of human error and the effect of system changes.

#### **QUESTION 4**

In line with the ongoing redeployment of personnel of the Federal Inland Revenue Service to various departments, some officers of the Service from various tax offices have been redeployed to tax audit department. It is a laid down practice that newly deployed staff to the tax audit department must undergo certain orientation programme. As a team lead in tax audit department, you have been selected to be a facilitator during the upcoming orientation programme for the newly deployed staff.

You are required to explain the following areas assigned to you for presentation during the orientation programme:

- a. The objectives of tax audit 5marks
- b. The benefits of tax audit programme in tax audit management. 5marks
- c. Distinguish between tax audit and tax investigation 5marks

**(Total 15marks)**

#### **SOLUTION TO QUESTION 4**

- a. The following are the objectives of tax Audit exercise:
  - i. To confirm that adequate accounting books and records exist for the purpose of determining the taxable profits or loss of the tax payers and consequently the tax liability.
  - ii. To ascertain if or not tax payers are complying with the provision of tax laws.
  - iii. To ascertain if tax computations submitted by the taxpayers agree with the underlying records.
  - iv. It is an avenue to educate tax payers on the various provisions of the tax laws.
  - v. It could be used to discourage tax evasion.
  - vi. To detect and correct accounting or arithmetical errors in tax returns submitted by taxpayer
  - vii. To encourage voluntary compliance which is one of the strong reasons in supporting of self – assessment scheme.

- viii. To provide feedback to the tax authority management on various provision of the tax laws and recommend possible changes
  - ix. To forestall taxable person's failure to render tax returns.
- b. Audit programme is a schedule of audit work expected to be performed on each item of the audit check list. The following are the benefits of audit programme:
- i. It provides details of the work which the team leader requires individual members of the team to perform.
  - ii. It provides information as to how much of the tax audit work has been computed as at a particular date, and how much is outstanding (Audit monitoring and control)
  - iii. It provides a record of tax audit responsibility by providing a record of the audit staff members responsible for each part of the completed work.
  - iv. It facilitates audit supervision and control giving senior members of the audit team information and knowledge regarding the progress of the work done to date.
  - v. It is a time management tool
  - vi. It provides an avenue for the team leader to allocate his available staff in the most productive and efficient manner possible. (Staff resource management)
  - vii. It ensures continuity in the tax audit work, should there be a change in the personnel constituting the audit team, with new members being able to see at a glance the outstanding work to date, thus providing a basis for planning and staffing the audit team.

c. The following are the differences between tax audit and tax investigation

	Tax Audit	Tax Investigation
1	It involves review of taxpayers record to ascertain the level of compliance with tax laws	It is usually conducted to recover unpaid tax, e.g due to tax fraud, delay in payment, etc.
2	It requires no special triggers to be carried out	It is usually triggered by fraud or wilful default of taxpayer or whistle blower/third party or external.
3	It is a routine exercise	It is not routine exercise and carried out only when needed.
4	It does not cover more than six (6) financial years preceding the audit request	It could extend beyond six (6) financial years preceding the audit request.
5	Evidence obtained in tax audit are <b>persuasive</b>	Evidence obtained in an investigation are <b>conclusive</b> except there is additional information.
6	Covers the whole business transaction	May not cover all business transaction, i.e may be restricted or specific.

## QUESTION 5

The auditor is required to document matters, which are important in providing evidence to support the work done, the audit opinion and evidence that the audit was carried out in accordance with acceptable standards. Nothing enhances the efficiency with which an audit may be conducted more than the careful compilation and maintenance of audit files and working papers.

### Required:

- a. List 5 factors that will determine the content of audit documentation. 5 marks
- b. Give 5 examples of audit working paper. 5 marks
- c. List 5 importance of audit working paper. 5 marks

**(Total 15 marks)**

## SOLUTION TO QUESTION 5

- a. The factors that determine the contents of audit documentation are:
  - (i) The nature of the audit or assurance engagement;
  - (ii) The nature and complexity of the business activities of the entity being audited;
  - (iii) The status of the client;
  - (iv) The form of the auditor's report;
  - (v) The entity's reporting format;
  - (vi) The legal frameworks under which the entity is operating;
  - (vii) The nature of accounting records being maintained by the entity;
  - (viii) The client's internal control systems;
  - (ix) The quality of the auditor's audit assistants working on the assignment and the need for supervision; and
  - (x) The methodology and technology the auditors use.
- b. Audit working papers  
The use of standardized working papers, such as, check list, specimen letters, standard organization's working papers, may improve the efficiency with which such working papers are prepared and reviewed. To improve audit efficiency, the auditors may also use schedules, analyses and other documentation prepared by the entity. However, in such circumstances the auditors require evidence that such information is properly prepared.

### Working papers include the following:

- (i) Information concerning the incorporation documents, legal and organisational structure of the client; (permanent audit working papers);
- (ii) Extracts or copies of important legal documents, agreements, and minutes of board meetings, committees of the board meetings, tender board meetings, etc.;

- (iii) Evidence of the audit planning process including audit programmes and any changes thereto during the audit;
  - (iv) Evidence of the auditors understanding of the accounting and internal control systems of the client;
  - (v) Evidence of the inherent and control risk assessments and any revisions thereof in the course of the audit;
  - (vi) Evidence of the auditor's consideration of the work of internal audit and their conclusions thereon;
  - (vii) Analyses of transactions and accounts balances;
  - (viii) Analyses of significant ratios and trends;
  - (ix) A record of the nature, timing and extent of auditing procedures undertaken and the results of such procedures;
  - (x) Details of procedures regarding companies whose financial statements are audited by other auditors;
  - (xi) Copies of communications with other auditors, expert and other third parties including replies to circularization letters to the client's bankers; customers, suppliers and lawyers;
  - (xii) Copies of correspondence with the entity, reports to management and note of discussions with the entity's management;
  - (xiii) A summary of the significant aspects of the audit including details of the information available, the amounts involved, management views, the conclusions reached and how these matters are resolved or treated; and
  - (xiv) Copies of the approved financial statements and the auditor's report.
- c. Importance of working papers are:
- (i) Assist in the planning and performance of the audit;
  - (ii) Assist in the supervision and review of audit work;
  - (iii) Enable the audit team to be accountable for its work;
  - (iv) Retain a record of matters of continuing significance to future audits; and
  - (v) Enable quality control reviews to be performed

## **QUESTION 6**

Every vatable person is required by VAT Act to register with the Federal Inland Revenue Service. The vatable person is also required to have a VAT invoice with the vatable person's VAT identification number on it. The vatable person is expected to keep proper records of all transactions, such records should be made available to VAT officers on inspection.

The objective of VAT audit is to ensure that a vatable person pays the amount of VAT legally payable.

**Required:**

- a. List five (5) things that will help a tax auditor to achieve the objectives of VAT audit. (5 marks)
- b. Identify ten (10) documents required for an effective VAT audit and investigation. (10 marks)

**Total 15 marks****SOLUTION TO QUESTION 6**

- a. To achieve this objective, VAT auditors are required to:
- Confirm the taxable person is correctly registered;
  - Understand the business activities of the taxable person;
  - Note the accounting records used by the taxable person;
  - Ensure records correctly reflect the business activities;
  - Assess the level of risk posed by the taxable person and determine the appropriate audit procedures to reduce the identified risks;
  - Educate the taxable person and give him the opportunity to ask questions which the auditor either answers on the visit or seeks guidance at the office; and
  - Ensure that unsatisfactory details discovered on a previous visit have been corrected and that return and other statutory filings are timely done.
- b. Document required for VAT audit and investigation  
The VAT auditor would have to ask for and collect the following documents for a

VAT audit and investigation:

- (i) Relevant documents to verify input and **output VAT** for **local purchases** and sales to customers:
- The copy of the taxpayer's VAT ledger, both for the input and output VAT;
  - The suppliers' ledger (payable ledger) and invoices file;
  - The cash book or bank accounts' ledgers;
  - The customers' ledger (receivable ledger) and copies of customers' invoices file;
  - The suppliers' ledger (payable ledger) and suppliers' invoice files;
  - The VAT returns file;
  - The sales daybook and sales ledger;
  - The purchases daybook;
  - Returns inward and outward books or registers; and
  - The taxpayer's financial statements and management accounts.
- (ii) Relevant documents to verify **input VAT** on **imports** are:
- The bill of entry;
  - The treasury receipt issued by the Nigerian Customs Service; together with the bank payment tellers;
  - The approved "Form M" used in importing the goods, this will give the rate of exchange used; and

- The attested invoice issued by the manufacturer or the supplier or exporter of the goods as the case may be -the commercial invoice.

## QUESTION 7

What are the powers open to tax authorities in Nigeria to recover outstanding tax liabilities?  
**15 Marks**

## SOLUTION TO QUESTION 7

The power of tax authorities in Nigeria to recover outstanding tax liabilities are:

1. **Power of Distraint.**

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

Distraint is an effective method of enforcement which is using carried out where all administrative procedures have failed.

The provisions of power of distraint are contained in;

- i. Federal Inland Revenue Establishment Act, LFN 2007, section 33 and the fourth schedule of the Act.
- ii. Company Income Tax Act Cap LFN 2007, section 86 subsection 1 to 2 and the fourth schedule of the Act.
- iii. Personal Income Tax Act LFN 2007 as amended by The Amendment Act 2011, Section 104; and
- iv. Casino Taxation Act Cap c3, section 16.

2. **Power to Prosecute tax defaulters for recovery of tax.**

Tax may be sued for and recovered in a court of competent jurisdiction with full cost of action from the taxpayer as a debt due to the government. Section 87 (2) Company Income Tax Act provides that a court of competent jurisdiction shall include a magistrate's court which court is hereby vested with the necessary jurisdiction, provided that the amount claimed in any action does exceed the amount of the jurisdiction of the magistrate concerned with respect to action for debt.

However, the Federal Inland Revenue Service (establishment) Act, 2007 establishes the Tax Appeal Tribunal under section 59 to settle disputes arising from the operations of the Act as well as the administration of the legislations listed in the first Schedule to the Act. The tribunal has power to adjudicate on disputes and controversies arising from the following legislation.

- a. The company Income Tax Act
  - b. Personal Income Tax Act
  - c. Petroleum Profit Tax Act
  - d. Capital Gain Tax Act
  - e. Stamp Duties Tax Act and
  - f. Value Added Tax Act.
  - g. Any other law contained in or specified in the First schedule to this Act or other laws made or to be made from time to time by the National Assembly.
- Either the Tax Authority or the taxpayers may appeal to the tribunal. The tax authority can appeal to the tribunal for the non-compliance of the taxpayer with the provisions of the tax laws, while the taxpayer can appeal on the assessment, demand notice or any action made against him by the tax authority with respect to payment of tax.