THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2024: PROFESSIONAL EXAMINATION

PTE II: TAX AUDIT AND INVESTIGATION

TUESDAY, 16TH APRIL, 2024 **EXAM NO……………..**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

SHOW ALL WORKINGS

QUESTION 1

You work with the Federal Inland Revenue Service, Ikeja Area Office. You are the manager in charge of the food and beverage industry. Recently, three similar companies submitted their annual tax returns for 2023 tax assessment year.

The following information has been extracted from the financial statements of the three companies:

	Accat Nigeria	Docat Nigeria	Limat Nigeria
Income statement	**₦m**	**₦m**	**₦m**
Revenue	200	201	198
Operating costs	(160)	(190)	(170)
Profit from operations	40	11	28
Finance charge			
Statement of Financial Position			
Share capital	50	50	50
Accumulated profits	90	60	50
Revaluation reserve	-	210	-
Finance lease payable			
Capital employed	140	320	100

You thereafter carried out a desk examination of their returns and notice that despite having almost the same level of revenue, their operating profit was widely apart. A further perusal of their financial statements revealed the following:

a. Accat had purchased a non-current asset costing ₦200m 4 years ago. The asset is being depreciated on the straight-line basis over 10 years. Therefore, ₦20m of depreciation has been charged to this year's income statement and the asset has a carrying value of ₦120m in the statement of financial position.

b. Docat and Limat are identical to Accat in all respects and hold a similar asset to Accat but have adopted the following treatments in their financial statements:

i. Docat revalued the asset to its current value of ₦350m at the start of the current year. As a result, a revaluation gain of ₦210m has been recognised and depreciation has been increased to ₦50m per annum i.e. additional depreciation of ₦30m has been charged to the income statement in the current year.
ii. Limat has been leasing the asset under an operating lease agreement, paying an annual rental of ₦30m which has been charged to operating expenses.

Required:

a. Do a comparative analysis of the three companies' financial information, using the following ratios:

i. Operating profit margin
ii. Asset utilisation
iii. Return on capital employed; and
iv. Return on equity. **(12 marks)**

b. Explain what accounted for the wide difference among the three companies' profitability and their computed ratios. **(10 marks)**

c. Explain the effects the three companies' treatment of non-current assets will have on their tax liabilities. **(9marks)**

d. Discuss the effect of IFRS 16 – Leases – on the computed ratios for three companies. **(9 marks)**
(Total 40 marks)

SOLUTION TO QUESTION 1

a.

		Accat	Docat	Limat
(i)	**Operating profit margin:**			
	Operating profit/Revenue%	40/200x100/1	11/201 x 100/1	28/198 x 100/1
		20.00%	5.47%	14.14%
(ii)	**Assets utilisation ratio:**			
	Revenue/Capital employed	200/140	201/320	198/100
		1.43	0.63	1.98
(iii)	**Return on capital employed:**			
	Operating profit/Capital employed%	40/140x100/1	11/320 x100/1	28/100 x100/1
		28.57%	3.44%	28.00%
(iv)	**Return on equity**			
	Operating profit/Equity%	40/140x100/1	11/320x100/1	28/100x100/1
		28.57%	3.44%	28.00%

b. The reason for the wide difference among the three companies' profitability is the treatment of non-current assets of the three companies. This is explained as follows:

Accat: Accat purchased its non-current assets for ₦200m which it depreciates on a straight line basis, given a depreciation charge of ₦20m per annum.

This is ₦30m less than that of Docat, which is ₦50m due to revaluation. If we remove the ₦30m i.e. (₦40 – ₦10m) from Docat's operating profit, it becomes ₦10m, which is almost the same with that of Docat, which is ₦11m.

When compared with Limat lease rental of ₦30m per annum, it is ₦10m (i.e. ₦30 – ₦20) less. If we remove the ₦10m from Accat's operating profit, it becomes ₦30m (₦40m – ₦10m), which is almost the same with the ₦28m of Limat.

Docat: Docat also has a similar non-current assets like that of Accat. Asset purchased 4 years ago for ₦200m and depreciated on a straight-line basis, i.e., ₦20m per annum (₦200/10). But, Docat revalued its non-current asset which increased the value by ₦210m and this has been recognised in its books. The result is an additional depreciation of ₦30m per annum i.e. (₦50m – ₦20m). If the ₦30m is added back to its operating profit, it will become ₦41m i.e. (₦11m + ₦30m), which brings it to the same level to that of Accat.

Limat: Limat also uses the same type of non-current asset, but instead of buying the asset, it leased the asset. The operating lease rental payment is ₦30m per annum. This is charged against profit, as cost of operation. Compared with Accat depreciation of ₦20m, Limat charged extra ₦10m i.e. (₦30m – ₦20m) as lease rental. This is an additional charge of ₦10m. If this is added back to its operating profit, it becomes ₦38m i.e. (₦28m + ₦10m), which will be almost at the same level with that of Accat i.e. (₦40m).
When we compare Limat with Docat, Docat's depreciation is higher by ₦20m than Limat's lease rental of ₦30m. If we add the ₦20m back to Docat's operating profit, it will be ₦31m i.e. (₦11m + ₦20m), which is almost the same with Limat's operating profit of ₦28m**.**

c. Effect of the companies' treatment of non-current asset on their tax liabilities
Accat: The company will still claim its normal capital allowance while its depreciation charge will be added back to taxable profit. This means its treatment of non-current assets has no effect on its tax liability.

Docat: Although Docat has revalued its asset and now charges a higher amount as depreciation in its income statement, it will not have any effect on its capital allowance because the tax authority will not recognise the increase in the value of the asset due to revaluation. The total depreciation of ₦50m will be added back to taxable profit. The company will still claim its normal capital allowance in computing its tax liability. However, the company will maintain an amount equal to the tax payable on the revalued asset if it is sold, as deferred tax liability**.**

Limat: Limat cannot claim capital allowance on its non-current asset because it does not own the asset. However, its lease rental payment is an allowable expense for tax purposes. The company will continue to enjoy this, so its treatment of non-current assets will not change its tax liability.

d. Effect of IFRS 16 on the computed ratios

Accat: The computed ratios will not change as IFRS 16 will not affect the basis of preparing its financial statements.

Docat: The computed ratios will not change as IFRS 16 will have no effect on the basis of preparing its financial statements.

Limat: Some of the computed ratios will change because the provisions of IFRS 16 will affect the basis of preparing its financial statements. First, IFRS 16 has removed the dichotomy between finance and operating leases. All leases must be recognised in the financial statements. This will result in a lease liability and right of use of asset in the company's statement of financial position. And the company is now to depreciate the right of use asset based on the computed liability and its useful life. This will reduce the computed assets' utilisation ratio, return on capital employed and operating profit margin.

QUESTION 2

A tax auditor must examine documentary evidence supporting a taxpayer's financial statements. One method of doing this is vouching.

Required

Explain the meaning of vouching, its importance and objectives in tax audit.

5mks

(Total 15 marks)

SOLUTION TO QUESTION 2

Vouching is an act of examining documentary evidence or vouchers in order to ascertain the accuracy and authenticity of the entries in the books of accounts. When the tax auditor checks the entries in the accounting records using the supporting documents, it is called vouching. A voucher is any document which supports the entries in the book of accounts and establishes its authenticity and arithmetical accuracy. Examples are an invoice, a receipt, , salaries & wages sheets, pay-in-slip book, bank statement, bank pass book, copy of purchase order, counterfoil of a cheque book, goods inward and outward register, agreements, form 'M' etc.

Vouching is important because, it:

a. Enables the auditor to know the nature of transactions, to show that proper accounting procedures are followed;
b. Ensures genuineness of the transactions;
c. Enables detection of frauds and errors;
d. Ensures authenticity of transactions;
e. Ensures proper disclosure;
f. Helps to know relevance of the transaction;
g. To discover whether the transaction complies with laws;
h. To identify whether the transaction is capital or revenue expenditure; and
i. To show that proper accounting procedures are followed.

The objectives of vouching are:

a. To ensure that all the transactions are properly and correctly recorded in the books of accounts;
b. To confirm that proper evidence supports all the transactions recorded in the accounting books;
c. To ascertain that fraudulent transactions are not recorded in the financial books; and
d. To ascertain that all the transactions relating to the business are recorded in the books of accounts.

QUESTION 3

Your firm has been the tax consultants to Hope Nigeria Limited for the past four years. A tax audit exercise covering three accounting years of the company is about to be concluded. Final reconciliation meeting already held with Federal Inland Revenue Service insisting on ₦24million, ₦6million and ₦20million additional assessments of Company Income Tax, Tertiary Education Tax and Value Added Tax respectively.

From the records of the company audited, your firm which you are the manager that participated fully during the tax audit exercise came up with ₦15million, ₦2.5million and ₦13million for the three taxes already assessed by the Service.

You are required to advise your client on the objection and appeal procedures available to resolve the tax disputes following the assessment procedures in Nigeria tax administration.

(15 marks)

SOLUTION TO QUESTION 3

Objection and Appeal Procedures to resolve the disputed assessments

Since the company, through its Tax Consultant, has disputed the assessments for the three taxes, a notice of objection to Federal Inland Revenue Service will have to be given seeking a review or revision of the assessments.

In line with the provision of section 69 of Company Income Tax Act CAP C21 LFN 2004 (as amended to date), for a notice of objection to be valid, it must be:

(i) In writing and addressed to the Chairman, Federal Inland Revenue Service.

(ii) Made within 30 days from the date of service of the notice of assessment, and

(iii) State the ground of objection to the assessment, that is:
   a. The amount of assessable and total profits of the company for the three years of assessment; and
   b. The amount of tax payable for each of the year which is being claimed to be stated on the notice of assessment.

On receipt of the notice of objection, Federal Inland Revenue Service has the following options:-

(i) Review and revise the assessments to the amounts that are mutually agreeable to the company and Federal Inland Revenue Service. If this occurs, the tax authority (FIRS) will have to amend the assessments and serve on the company a notice of revised tax payable; or

(ii) Review and refuse to revise the assessments to the amounts claimed by the taxpayer.

- In a situation where the company fails to agree with Federal Inland Revenue Service on the amount of taxes payable and the FIRS doesn't see any reasons to further revise the assessment, then it will issue a notice of refusal to amend the assessments.
- The company at this stage has the right to proceed to the Tax Appeal Tribunal for the settlement of the dispute.
- The Tax Appeal Tribunal (TAT) will give seven (7) days notice to the company (appellant) and FIRS of the date and place fixed for hearing of the appeal.
- The appeal will be heard by not less than three members of the Tribunal in attendance with Chairman or any other member (in the absence of the Chairman), presiding.
- All appeal before the Tax Appeal Tribunal are heard in public.
- The company (appellant) may be represented by a professional adviser or may give its evidence by written notice.
- The company (Appellant) leads the case, by proving that the assessments are excessive, that is, onus of proof is put on the appellant. If the representative of tax authority (FIRS in this case) can prove to the Tax Appeal Tribunal that:
  (a) The appellant failed to file returns, audited account etc, as required by CITA; or
  (b) The appeal is frivolous, vexation or abuse of appeal process or
  (c) It is expedient to require appellant to pay a security deposit:
    (i) The Tax Appeal Tribunal may make an order that the appellant pay deposit to FIRS on account of tax being disputed before the matter could be heard.
    (ii) The deposit payable, is the lower of:
      - Tax paid in the immediately preceding year; or
      - Half of the tax charged (which is on appeal), plus 10% of the deposit.

The Tax Appeal Tribunal can confirm, reduce, increase or annul the assessment, as deemed necessary.

If the decision of the Tax Appeal Tribunal is not favourable, the company can proceed on its case to the High Court and up to Supreme court.

QUESTION 4

Apart from normal tax audit, a tax authority can call for a tax investigation of any company, where it has strong reasons for doing so. However, before an investigation is called for, the tax authorities must have received some information about the company which were not available to it before.

Required

a. Discuss tax investigation and the different types. **(5marks)**

b. Discuss the triggers that can lead to calling for an investigation of a company. **(5marks)**

c. Discuss five distinctions between tax audit and investigation. **(5marks)**

SOLUTION TO QUESTION 4

a. Tax Investigation is similar to any form of investigation because it is usually not carried out on routine like that of tax audit. Tax investigation would be carried out when tax payer is suspected to have committed tax fraud, tax avoidance & evasion, wilful default, etc and to obtain concrete/admissible evidence so as to enforce criminal aspect of the revenue law through prosecution where necessary.

Type of investigations

There are broadly two types of tax investigations, these are Criminal Tax investigation and Civil Tax Investigation.

Criminal investigation: This is where a company or an individual is being investigated because of criminal tax evasion, such as:

- Criminal violation of tax laws; and
- Where there is suspicion of a tax fraud, willful default or neglect to pay tax (evidence of willful default).

Civil investigation: This type of investigation focuses on abusive tax avoidance schemes and or evidence of artificial transactions. It is usually conducted when a taxpayer is suspected of tax evasion.

b. Tax Investigation triggers

The following are the major triggers that can lead to calling for an investigation of an individual or a company:

i. Referral from law enforcement agencies;
ii. Media reports on the activities of a taxpayer that may involve excessive spending, etc.;
iii. Poor tax ratios;
iv. Incorporation in tax heavens;

v. Non-filing of tax returns;
vi. Sanctions by Securities and Exchange Commission (SEC), Central Bank of Nigeria (CBN) and other financial regulators;
vii. Cheques conversion/diversion;
viii. Abusive tax avoidance schemes;
ix. Discovery of tax fraud;
x. Suspicion of tax fraud with credible evidence;
xi. Whistle blowers;
xii. Petition for tax evasion;
xiii. Refusal to honour FIRS invitation;
xiv. Denial access to tax auditor;
xv. Non-remittance of withholding tax and value added tax; and
xvi. Public outcry.

c. Distinction between tax audit and tax investigation

S/N	**Tax audit**	**Tax investigation**
1	Tax audit is a routine exercise	Tax investigation is usually triggered by suspicion of fraud and other forms of evasion. (it is required under certain circumstances)
2	Tax audit is not hundred percent (100%) vouching	Tax investigation is more intensive because of the need to gather sufficient evidence or facts to prove an offence
3	Tax audit has essentially tax recovery as the outcome	Tax investigation has tax recovery as the outcome. Tax investigation has prosecution as an expected outcome .
4	There is materiality concept in tax audit exercise	There is no materiality concept in tax investigation exercise
5	Tax audit has statute bar	Tax investigation has no statute bar i.e. no time limitation. Tax investigation may be carried out beyond statutory period of six (6) years (it is wider in scope).

QUESTION 5

(a) Explain briefly the tax audit Procedures in respect of imported goods by a tax payer.

(9 marks)

(b) State the tax audit procedures for excise duties verification.

(6 marks)

(Total 15 marks)

SOLUTION TO QUESTION 5

Tax audit procedures in relation to imported goods are as follows:

- Ask for and collect the following documents:
- The bill of entry file for all imports in the year;
- The treasury receipt issued by the Nigerian Customs Service, together with the bank payment tellers;
- The approved "Form M" used in importing the goods, this will give the rate of exchange used;
- The attested invoice issued by the manufacturer or the supplier or exporter of the goods as the case may be – the commercial invoice;
- There are some companies that maintain separate files for all import, if that is the case, ask for all the files for imports during the year. The file will contain documents in respect of each import, therefore, check that the following are complete for each import:
  - The approved "Form M" together with the proforma invoice, duly signed by the bank;
  - The good in transit insurance certificate for the goods covered by the Form M;
  - The Customs Bill of Entry for the import, showing duty, surcharge and VAT payable on the goods;
  - The bank tellers for the payment of the amount payable to the customs together with the treasury receipt issued by the customs; and
  - The attested invoice or commercial invoice, issued by the overseas supplier of the goods.

Summarise the imports during the year on the basis of the following:

- The cost, and freight based on the amount on the commercial invoice multiplied by the exchange rate on the approved Form M;
- The goods in transit insurance premium paid for the goods;
- Port charges on the goods;
- Clearance charges and transport expenses for bringing the goods into the company's warehouse;
- Total of all the above, which represents the total cost of all imported goods during the year under review; and
- Goods imported must not be a contraband.

(B) Excise duty is the duty paid by manufacturer of some selected goods in Nigeria. Excise duty is paid per unit of goods manufactured. Therefore, the volume or quantities manufactured of the good is very critical to excise duty. The following procedures are necessary for the verification of excise duty:

- Check the monthly production report of goods manufactured;

- Determine the value of goods manufactured per month;
- Trace the above to the taxpayer finished goods inventory records;
- Determine the excise duty payable on the cost of goods manufactured;
- Apply the rate of excise duty to the cost of goods manufactured which gives the excise duty payable per month;
- Determine the total excise duty payable in the year;
- Collect the taxpayer's excise duty payment file;
- Check the treasury receipts for the excise duty paid per month;
- Summarize the excise duty paid with the excise duty payable; and
- The difference is excise duty liability outstanding for the year.

QUESTION 6

The end product of a tax audit exercise is the production of an audit report.

Required

a. Discuss seven (7) qualities of a good tax audit report. **(7marks)**

b. Discuss the contents of the final tax audit report. **(8marks)**

SOLUTION TO QUESTION 6

a. Qualities of a good tax audit report

A good audit report must:

i. Be accurate;
ii. Be clearly written;
iii. Be prepared timely;
iv. Avoid overstatement;
v. Be devoid of subjective comments. It should contain factual information;
vi. Disclose relevant computations;
vii. Be professionally written;
viii. Avoid the use of offensive Language;
ix. Be presented in a logical and concise manner;
x. Ensure that conclusions and recommendations stated in the report are based on facts that could be substantiated; and
xi. Be duly signed.

b. Contents of the final tax audit report

The final audit tax audit report will be written based on the minutes and outcome of the reconciliation meetings. The report which should be addressed to the audit department headquarter will state in details:

i. Background information of the company;
ii. Company taxation history;
iii. Work done;
iv. Findings;
v. Details of all the tax liabilities (i.e final position of the audit exercise) the additional assessments agreed at the reconciliation meetings as well as those disputed. The additional assessments agreed should be separated from those disputed. These

would be analysed in tabular form into various taxes (CIT, WHT, CGT, EDT, VAT, PAYE, etc.) for each year of assessment concerned. The report should indicate details of how each additional assessment were arrived at; and

vi. Recommendation. **(8 marks)**

QUESTION 7

(a) Briefly explain the qualities of a VAT Auditor. **(8 marks)**

(b) Briefly explain the circumstances when a tax investigation could be terminated. **(7 marks)**

(Total 15 marks)

SOLUTION TO QUESTION 7

(a) The ideal VAT auditor must be a complete revenue officer with the following sterling qualities:

(i) He must be courteous: This will endear him to the VAT payers such that they would be ready to trust him;

(ii) He must be helpful: He should be ready to assist the taxpayer where they are ignorant or where they have made genuine mistakes;

(iii) He must be informative: He should be very versed in the subject of VAT. He cannot afford to be ignorant of the Law or the rules and regulations. He would not be respected if he cannot answer their questions intelligently;

(iv) He must be positive: He does not need to dance around the aim of his visit. He needs to put the taxpayer in the proper frame of mind regarding his visit. Otherwise they will start thinking of tempting him thereby insulting his personality; and

(v) He must be sincere: Where he does not have an answer or where he has made a mistake in his presumption, he should have the courage and sincerity to own up to his error and apologise. This will enhance his image in the estimation of the taxpayer. **(8 marks)**

(b) Termination of Tax Investigation

Tax investigation into a tax fraud or tax evasion could be terminated at any stage under the following conditions:

-Where there are insufficient evidences to make a strong case against the suspect;

-Where taxpayer agrees with tax authorities on issues raised and has agreed to pay;

-Where continuation of tax investigation can no longer be sustained under the provision of the law;

-Where criminality is not involved e.g. tax planning/avoidance wrongly taken as tax evasion;

-Where the suspect has medical or legal insanity; and

-Where the suspect dies. **(7 marks)**

Total (15 marks)

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PTE II: INTERNATIONAL TAXATION

TUESDAY, APRIL 16, 2024 **EXAM NO......................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

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

QUESTION 1

Under the Nigerian tax laws, a resident person (individual or company) is assessable to tax on the global income. Globally, the concept of residence is very significant because it determines the extent to which the income of a taxpayer is liable to tax under a tax jurisdiction.

Broad Corporation is an international power plant company based in Germany. The company is well known all over the world for its expertise in power solutions. It has subsidiary outlets in many parts of the world, especially in many African countries with major challenges in power generation and distribution. In 2012, a subsidiary of Broad Corporation was established in Nigeria with the name Broad Nigeria Limited having its head office in Benin, Edo State.

As a result of the quest of the Federal Government of Nigeria to improve the power supply throughout the federation, the Nigerian government awarded the following contracts to Broad Corporation in 2022:

i. Contract A for the sum of $7million to generate 10 megawatts in the Northern part of Nigeria; and
ii. Contract B for the sum of $8million to generate 15 megawatts in the Southern part of Nigeria.

The management of Broad Corporation was of the opinion that with minor assistance from it, especially in the area of certain category of technical personnel, its Nigerian subsidiary company, Broad Nigeria Limited, has the capacity to execute the contracts. Therefore, Broad Nigeria Limited, was given the mandate to execute the two contracts.

In executing the contracts in 2022, the following expenses were incurred by Broad Nigeria Limited:

	₦'000
ials and other direct inputs	4,250,000

f special equipment	450,000
n personnel costs	225,000
stic personnel costs	145,000
ling expenses	27,000
istrative expenses	75,000
ciation of property, plant and equipment	125,000
ainment	3,600
duty PAYE tax to State Internal Revenue Service	21,500
ture interests	4,860
s and maintenance	13,500
o engineers	45,000
g and stationery	3,700
e charges	14,200
fees	7,500
nd oil	6,500
laneous expenses	38,600
	5,455,960

Other relevant information:

(i) The exchange rate was ₦450 to US $1.

(ii) Similar special equipment could be hired from Hag Nigeria Limited for ₦420 million.

(iii) The cost of foreign personnel in carrying out similar assignments in the other parts of Nigeria has been established to be an average of ₦210 million.

(iv) Included in administrative expenses was ₦35 million transferred to revenue reserve.

(v) Repairs and maintenance was made up of:

	₦'000
Maintenance of vehicles	1,500
Expansion to the office building	9,000
Repairs of site equipment	2,370
Servicing of office air conditioners	630
	13,500

(vi) Legal fees were made up of:

	₦'000
Defence of title to land	4,500
Debt recovery	300

Tax dispute	1,500
Others (allowable)	1,200
	7,500

(vii) Miscellaneous expenses included ₦8.5million, being loss on exchange for import payment of materials and other direct inputs used for the contracts.

(viii) Capital allowance agreed with the tax authorities was ₦125 million.

Required:

(a) Explain the following:

i. International dual residence of individuals **(3 marks)**

ii. International dual residence of companies **(3 marks)**

(b) Discuss FIVE circumstances under which a non-resident company will be assessable to tax in Nigeria. **(10 marks)**

(c) Explain the implications of Finance Act, 2021 on non-resident companies supplying digital services to Nigeria. **(4 marks)**

(d) Compute the tax liabilities of Broad Corporation for the relevant year of assessment. **(20 marks)**

(Total 40 marks)

SOLUTION TO QUESTION 1

(a)

(i) International dual residence of individuals

It is possible for an individual to be resident for tax purposes in more than one country at the same time. This is known as dual residence.

Individuals may have problem of dual residence since definition of the term "residence" differs from one country to the other. For instance, in Nigeria, the length of stay to qualify a taxpayer as a resident is reckoned within a 12month period. In some countries, this is reckoned within an assessment year - allowing for a qualifying period of stay to split over two years of assessment. In some other countries (e.g. the USA), the citizen is regarded as resident in the home country whatever the length of stay abroad. This creates the problem of dual residence for the individual who is regarded as resident in more than one country. For example, he is regarded as resident at the same time in country A where nationality is the basis of residence, in country B where he has stayed for more than 183 days in a 12-month period and, may be, in his home country where he is away for less than 183 days in that assessment year.

(ii) International dual residence of companies

A dual resident company is a company that is resident in one country under its laws and is also resident in a foreign company under the country's laws because it is subject to a different 'residence' test in that jurisdiction.

A company may also have the problem of dual residence. For instance, the definition of the residence of a company in Nigeria is the place of incorporation. In some other countries, the relevant criterion may be the "place of management" or the "place of residence of the directors". In this instance, the Nigerian tax authority would treat the company as resident in Nigeria on the basis of the place of incorporation while the tax authority of the other country would regard the same company as resident in that other country on the basis of "place of management". The Nigerian tax treaties (where applicable) govern the treatment of such cases and the affected companies can claim tax credit for the Nigerian tax in their home countries to avoid double taxation.

(b) A non-resident company will be assessable to tax in Nigeria under the following circumstances:

(i) <u>Fixed base of business</u>

If a non-resident company has a **"fixed base"** from which it carries on its business or trade in Nigeria, the profits from such activities would be deemed to be derived from Nigeria and liable to tax in Nigeria.

The term **"fixed base"** implies that the place must be easily identifiable and must possess some degree of permanence. It includes:

- facilities such as a factory, an office, a branch, a mine, gas or oil well, etc;

- activities such as building, construction, assembly, or installation; and
- furnishing of services in connection with the activities mentioned above.

However, two cases are specifically exempted and these include:

- facilities used solely for storage or display of goods or merchandise; and
- facilities used solely for the collection of information.

(ii) <u>Operation of a dependent agent</u>

A non-resident company can have two types of agents in Nigeria – an independent agent or a dependent agent. An agent is regarded as possessing independent status when he acts on behalf of a non-resident company in the ordinary course of his business. The status may, however, change if he devotes his activities wholly or almost wholly on behalf of the company.

Where a dependent agent makes an isolated sale of goods on behalf of a principal, that may not necessarily constitute the income from such an operation, the deemed profit is not liable to Nigerian tax. However, where the facts show that the sale of goods on behalf of the principal or of any company associated to it by the agent is on a regular pattern, this arrangement will conform with the intention of the term **"habitually"**.

(iii) <u>Profits on a turnkey project</u>

A turnkey project is defined as a "single contract involving survey, deliveries, installation or construction." The profit on a turnkey project is liable to tax in Nigeria. Such a profit should not be split between the so-called "Nigerian source" and "off-shore" profits but taxed wholly in Nigeria.

(iv) <u>Transactions not at arm's length</u>

The legislation allows the Board to make appropriate adjustment to the profits of Nigerian companies where the following circumstances prevail:

- where there is a controlling interest in the Nigerian company;
- the presence of a control of a Nigerian company may be exercised directly or indirectly by a parent company or any other company associated to it;
- the imposition of conditions in the financial and commercial relationship by the controlling interest;

- the conditions imposed must be different from what would obtain between independent parties or in an open market situation;
- Such relationship and conditions lead to the transfer of goods and services at prices not at arm's length; and
- Consequently, the profits declared for the Nigerian tax are understated.

The 'imposition of conditions' or control and influence as mentioned above can move in various appearances like over-invoice of goods and services, packaging of the terms of payment of interest on loans, frivolous charges for management fees, royalty, patent and rent, convenient shifting of profits between companies or in the allocation of expenses, all with the objective of minimising, avoiding or evading the Nigerian tax.

When the conditions analysed above hold, the profit deemed to be derived from Nigeria shall be as determined by the Board. In such circumstance, the Board will carry out comparative cost and price to establish the true market prices and make necessary adjustments to determine the true profit for tax purposes.

(v) <u>Sales outlet</u>

The law has excluded:

- "facilities used solely for storage of goods or merchandise"; and
- "facilities used solely for the collection of information" from the facilities that would constitute a fixed base. The use of the word "solely" in the law implies that facilities used exclusively as a representative office would be exempted. Where, however, a facility is so exempted, but, qualifies as a "sales' outlet" it will be treated as a fixed base for the non-resident company. The profit arising from such a sales outlet is taxable.

(vi) Income derived by non-resident company from professional consultancy, management and technical services rendered in Nigeria.

(vii) Income derived by a non-resident company from investment, such as dividend, interest, rent and royalties. The withholding tax deducted from these incomes is taken as the final tax.

(viii) Income derived from a contract awarded to a Nigerian company, but subcontracted to a non-resident company.

(c) **Implications of Finance Act 2021 on non-resident companies supplying digital services to Nigeria**

Non-resident Companies (NRCs) that have significant economic presence in Nigeria by virtue of providing digital services in Nigeria whose taxable income cannot be ascertained, or whose income from a trade or business produces either no assessable profits or produces assessable profits which in the opinion of the FIRS are less than might be expected to arise from such trade or business, will be assessed on the basis of their turnover.

A fair and reasonable percentage of the turnover will be attributed to the significant economic presence for the purpose of tax assessment. This amendment empowers the Federal Inland Revenue Service to assess non-resident companies supplying digital services to tax on turnover basis.

(d)

d Corporation		
putation of tax liabilities for 2023 year of assessment		
	₦'000	**₦'000**
over :		
act A ($7m X ₦450)	3,150,000	
act B ($8m X ₦450)	3,600,000	
		),000
ct allowable expenses :		
ials and other direct inputs	4,250,000	
f special equipment (₦450m - ₦30m)	420,000	
n personnel costs (₦225m - ₦15m)	210,000	
stic personnel costs	145,000	
ling expenses	27,000	
istrative expenses (₦75m - ₦35m)	40,000	
ainment	3,600	
ture interests	4,860	
s and maintenance (₦13.5m - ₦9m)	4,500	
paid to engineers	45,000	
g and stationery	3,700	
e charges	14,200	

fees (₦7.5m - ₦4.5m - ₦1.5m)	1,500	
nd oil	6,500	
laneous expenses	38,600	
		5,214,460
ted/Assessable profit		1,535,540
d capital allowance		(125,000)
profit		1,410,540
anies income tax @ 30% of total profit		**423,162**
ry Education Tax @ 2.5% of Assessable profit		**38,389**
Trust Fund Levy (See computation as working 1)		**65**
king 1		
putation of Police Trust Fund Levy		
		N'000
revenue		6,750,000
otal expenses		5,455,960
before tax		1,294,040
trust fund levy @ 0.005% of before before tax		65

QUESTION 2

Transfer price is the price charged for goods or services supplied or transferred between related or associated companies. Transfer price may be determined based on market-based transfer price, cost-based transfer price, and negotiated transfer price. The rule for transfer pricing implementation in Nigeria is governed by The Income Tax (Transfer Pricing) Regulations, 2018 which replaced the Income Tax (Transfer Pricing) Regulations No.1, 2012. This implies that although transfer pricing is not new in Nigeria but the laws regulating it were first put together in 2012.

In implementing transfer pricing regulations in Nigeria, one of the fundamental issues that taxpayers are expected to take note is the arm's length principle by ensuring that transactions between them and their related entities are conducted at arm's length.

Required:

(a) Explain **two (2)** guiding actions which companies in Nigeria must follow with respect to transactions between them and their related entities. **(4 marks)**

(b) Discuss the provisions of Transfer Pricing Regulations, 2018, as they relate to advance pricing agreement. **(5 marks)**

(c) Discuss **three (3)** fundamental areas to be noted and complied with by taxpayers and tax practitioners. **(6 marks)**

(Total 15 marks)

SOLUTION TO QUESTION 2

(a) Arm's length 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 companies in Nigeria are expected to be guided with the following to assess transactions between them and their related entities:

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.

(b) In line with Income Tax (Transfer Pricing) Regulations, 2018, connected persons may request that the Federal Inland Revenue Service enter into an advance pricing agreement with it in order to determine arm's length price in controlled transactions. The request should detail:

i. Description of the activities of the taxable persons, including description of the transactions to be covered by the agreement, analysis of functions to be performed, assets to be employed and risks to be assumed by parties covered by the transaction as well as duration of the agreement;

ii. Proposal by the taxable person on how to determine the transfer prices for transactions to be covered by the agreement, including analysis of comparability factors, selection of appropriate transfer pricing method and assumptions as to future events affecting the transaction;
iii. Identification of any other country(ies) that would participate in the agreements;
iv. Minimum threshold for advance pricing agreement is transaction value of N250m per annum;
v. The advance pricing agreement may be unilateral, bilateral or multilateral and shall be valid for a period of 3 years only; and
vi. The advance pricing agreement is cancellable by either the taxpayer or the FIRS under specified circumstances.

(c) In the administration of Income Tax (Transfer Pricing) Regulations, 2018, the following areas are to be noted and complied with by the taxpayers and tax practitioners in Nigeria:
i. **Annual transfer pricing returns:** A connected taxable person must submit Transfer Pricing document annually to FIRS not later than six months after the end of each accounting year or eighteen months after the date of incorporation, whichever is earlier. Transfer Pricing disclosure and declaration forms are to be attached to the annual tax returns;
ii. **Extension of filing annual transfer pricing returns:** A connected person may apply in writing, to the Service for an extension of time within which to file returns and where the Service is satisfied with the reasons stated in the application made, it may grant the extension. Where the taxable person fails to meet the extended submission date granted by the Service, the administrative penalty shall apply as if no extension of period was granted;
iii. **Administrative procedures:** Transfer Pricing department of FIRS shall review all transfer pricing documents submitted to it and carry out a review of transactions verifying the appropriateness of transfer pricing methods adopted; and
(iv) **Burden of proof:** Transfer pricing document must demonstrate sufficient information and analysis to verify consistency of the taxable profits derived from its controlled transactions with the arm's length principle.

QUESTION 3

Digital economy is the worldwide network of economic activities, commercial transactions and professional interactions that are enabled by information and communications technologies (ICT). Also, digital economy refers to an economy that is based on digital computing technologies, that is, conducting business through markets based on the internet and the World Wide Web.

Required:
Discuss the following in relation to digital economy:

a) The essential elements of the digital economy **(2marks)**

b) Advantages that could be derived from digital economy **(4 marks)**

c) Disadvantages associated with digital economy **(4 marks)**

d) Tackling the challenges associated with taxing digital economy in Nigeria **(5 marks)**

(Total 15 marks)

SOLUTION TO QUESTION 3

a] The essential elements of the digital economy include:

i. Digitalisation and intensive use of information and communication technologies (ICT);
ii. Codification of knowledge;
iii. Transformation of information into commodities; and
iv. New ways of organizing work and production.

b] Advantages that could be derived from digital economy include:

i. **Greater information:** The internet has enabled consumers to have greater information and choice;
ii. **Saves time:** Before digital economy, if you need office supplies, you would have to make a journey into town and purchase;
iii. **Reduced costs:** Firms can save on renting expensive buildings by running most of business through the internet;
iv. **Personalisation:** A digital economy allows greater personalization than would be possible under traditional economy;
v. **Lower barriers to entry:** In some markets, aspects of the digital economy make it easier for new firms to enter;
vi. **Creates significant data which can give new insights:** The mass production of data can help inform governments and charities about what is happening in the economy;
vii. **Benefits for developing world:** The digital economy is opening up opportunities for the developing world; and
viii. **Enables people to work from home.**

c] Disadvantages associated with digital economy include:

i. **Monopoly power:** Despite the potential for new start-ups, many aspects of the digital economy have become dominated by firms with monopoly power;
ii. **Less community:** A traditional bookshop can act as a focal point for local community. It may hold events, book signings and individuals may enjoy the experience of browsing physical books;
iii. **Addictive nature of technology;**
iv. **Privacy issues:** Harvesting and using data has become big business. Facebook collects a large range of data on its users;

v. **Bypassing of labour laws:** The digital economy has created a trend towards using self-employed freelancers, who are not protected by the same labour laws;

vi. **Social media has led to more graphic content:** The anonymous and distant nature of social media has exacerbated trends to personal attacks and the posting of conspiracy theories or posting of violent/sexual images;

vii. **Disruption patterns:** The economy has always faced disruption from new technology – from the period of the Luddites to the assembly line. However, the digital economy is increasing the pace of change, causing many traditional firms (high street retailers) to go out of business;

viii. **Environmental costs:** It is a mistake to think that the digital economy implies a 'green solution.' Data centres use electricity and cause CO_2 emissions; and

ix. **The probability of fraudulent activities is high.**

d] Tackling the challenges associated with taxing digital economy in Nigeria

i. Review of the scope of a "fixed base"

it is important that the scope of "fixed base" under Section 13 of the CITA be expanded to ensure that the Nigerian digital economy is effectively captured for tax purposes. The introduction of a digital fixed base in Nigeria will certainly increase the tax base, thereby sharing the collective tax burden of taxpayers while ensuring an increase in government revenue.

ii. Adoption of creative approach through innovative tax legislation

It has become expedient for the Nigerian tax authorities to explore a more creative approach to ensure taxation of the digital economy. Nigeria will need to borrow a leaf from other nations who have taken bold steps to tackle the non- taxation of the digital economy to plug revenue leakages through innovative tax legislation rather than seeking to extend the interpretation of obsolete legislations that are not sufficient to bring cross border digital transactions into the tax net.

iii. Automation of tax administration

Presently, FIRS has adopted the ITAS, an electronic filing platform as an indication of its seriousness to implement the aspirations lucidly expressed in the National Tax Policy (NTP) regarding the automation of the tax system. The NTP expects that "all processes starting from registration of taxpayers, filing of returns, audits and investigations, payment of taxes including correspondence with taxpayers will become automated.

iv. Data Handling

Another critical success factor in a digital economy is data handling. Elsewhere, data is treated with something akin to reverence but Nigeria's data gathering and storage processes must be fully integrated.

v. Strategic partnership with digital economy service providers

The FIRS should form a strategic partnership with institutions which provide platforms to consummate digital transactions in Nigeria. This would ensure that the objective of minimizing and reducing tax leakages especially from the digital economy is achieved at a faster pace.

vi. Ratification of multilateral Conventions

Ratification of multilateral conventions on tax related treaties to end profit shifting and tax evasion by multinational companies. The treaty ratification will address abuse of tax laws, raise government tax revenue, promote transparency and check illicit financial flows.

vii. Capacity Development

There is need for capacity development for tax administrators so they can implement a seamless interface with the different payment systems available in Nigeria.

QUESTION 4

International organisations are organs of institutional agreements amongst members of an international system for the purpose of achieving objectives that will meet the aspirations and concerns of its members.

They are important factors in international politics, with power in mediation, dispute resolution, peace keeping, etc.

Required:

a) Explain any five limitations to the functions of international organisations. **(7 ½ marks)**
b) Explain any five attributes of international organisations. **(7 ½ marks)**

(Total 15 marks)

SOLUTION TO QUESTION 4

a) Limitations to the functions of international organisations include:
   i. The structure and operations of these organisations;
   ii. The independence of these organisations;
   iii. The State can limit or extend their autonomy;
   iv. The State from time to time interferes in their activities;
   v. The State has enough capacity to restructure or dissolve them; and
   vi. They sometimes collide with the sovereignty of a State when they create new structures for regulating cross-border relationships.

b) Attributes of international organisations
   i. Facilitating negotiations;
   ii. Implementing agreements;
   iii. Dispute resolution;
   iv. Offering technical assistance and developing rules;

v. Neutrality: this enables organisations to act as mediators among States and to implement their decisions;
vi. Impartiality: this suggests that neither party to a dispute is favoured; and
vii. Independence: this means that international organisations can take decisions for themselves that are binding on member States.

QUESTION 5

Hollanda Ltd, resident in Holland, has two limited liability companies in Nigeria – Ijoko Ltd and Idofin Ltd, both into manufacturing activities and are regarded as fixed bases.

The following information were extracted from Idofin Ltd's financial statements for 2020 year of assessment:

Assessable profit	₦800,000
Interest on loan paid to Hollanda Ltd	₦800,000
Interest paid to other creditors	₦400,000.
₦200,000 out of the amount paid to third parties was in respect of loan obtained in generating tax-exempt profits.	
Depreciation	₦300,000

Required:

Compute the interest qualifying for deduction in the assessment year. **(15 Marks)**

SOLUTION TO QUESTION 5

Restriction provided in CITA will apply to Idofin Ltd because the company has made interest payment to a foreign connected person.

Consequently, the amount of interest allowable for tax purposes in 2020 year of assessment shall be restricted to 30% of its EBITDA, as computed thus in line with the provision of Finance Act, 2019:

A	gs before interest, tax, depreciation and amortisation ion
able profit	00
t deducted	,000
A	00 + ₦1,200,000 +300,000 (depreciation) = ₦2,300,000

f EBITDA (30% of ₦2,300,000)	₦690,000

ıterest deductible (before restriction):	₦	
loan from Hollanda Ltd		800,000
loan from others		400,000
ıterest exp.		1,200,000
ıt. for tax exempt profit		200,000
;t qualifying for deduction		1,000,000

Amount of interest deductible in 2020 tax year is ₦690,000 which is the lower of:

i. 30% of EBITDA (₦2,000,000) ₦690,000 and;

ii. Total interest on qualifying debts ₦1,000,000

Treatment of excess interest not allowed in current tax year;

The allowable interest is ₦690,000.

The excess interest which is ₦310,000 (i.e. ₦1,000,000 – ₦690,000) will be carried forward to 2021 YOA and added to the interest expense for that year for the purposes of computing the restriction for that year.

The excess interest of ₦310,000 may only be carried forward for a period not exceeding 5 years, i.e. to 2025 YOA.

Any amount (out of the ₦310,000 carried forward in 2020) not deducted after 2025 year of assessment shall no longer be deductible.

Candidates are advised to adequately cover the topics in the syllabus in their preparations for subsequent examination.

QUESTION 6

Taxation constitutes a major stumbling block to international trade. However, the provisions of relevant conditions, rules and regulations serve to soften the burden of taxation on trade relationship amongst different nations of the world.

Required:

Within the Nigerian tax laws:

a) Discuss the treatment of expenses between residents and non-residents **(5 Marks)**
b) Discuss the benefits of double taxation agreement **(10 Marks)**

(Total 15 Marks)

SOLUTION TO QUESTION 6

a) Treatment of expenses [relevant points for discussion]
   i. The Nigerian tax laws do not discriminate between residents and non- residents in the allowance of expenses for the purpose of determining the taxable income.
   ii. All expenses proved to be incurred for the production of the income are allowable as deductions.
   iii. Rent, interest, royalties, management fees, head office expenses and similar expenses are deductible if proved that they are "wholly, exclusively, necessarily and reasonably" incurred for the purpose of the trade or business.

b) Benefits of double taxation agreement [Relevant discussion points]
   i. Avoidance of double taxation;
   ii. Clarification of taxing rights of each contracting State;
   iii. Encouragement of economic cooperation between States;
   iv. Prevention of fiscal evasion with anti-avoidance provision; and
   v. Lowering of compliance cost.

QUESTION 7

African Continental Free Trade Area Agreement (AfCFTA) is a free trade area founded in 2018, with commencement of trade on January 1, 2021. One of the fundamental objectives of AfCFTA is to create a single market to deepen the economic integration of the African continent.

Required:

a) Discuss the benefits of AfCFTA to African economy. **(5 marks)**
b) Explain the possible challenges to implementation of AfCFTA in Africa. **(5 marks)**
c) Discuss likely advantages of AfCFTA to Nigerian economy. **(5 marks)**

(Total 15 marks)

SOLUTION TO QUESTION 7

(a) The following are the benefits of African Continental Free Trade Area Agreement (AfCFTA) to the economy of Africa:

   i. Creation of a liberalized market for goods and services;
   ii. Contribution to the movements of capital;

iii. Facilitation of investments through the creation of a large market;
iv. Catalyzes to the introduction of new technology to boost productivity;
v. Enhancement of competitiveness of members' economies;
vi. Promotion of industrial development through diversification;
vii. Development of value addition systems for products;
viii. Elimination of tariffs on intra-Africa trade, making it easier for businesses to trade within Africa and benefit from their own growing market;
ix. Introduction of regulatory measures such as sanitary standards and eliminating non-tariff barriers to trade; and
x. Establishment of a Common Continental Market in the future.

(b) Possible challenges to implementation of **AfCFTA** in Africa include:

i. Harmonisation of Africa's heterogenous economies, despite their considerable variation in size, levels of economic development and diversification and it is hard to ensure broad-based gains for all members States;
ii. The greatest levels of income disparity of any continental free trade agreement by AfCFTA. Many countries, especially the 32 least developed countries, face challenges to create jobs, develop their industrial sectors and diversify their production capacity;
iii. Weak infrastructures in some countries, low technological uptake and conflicts will threaten the implementation of the agreement. A general fear of losing control and loss of identity across segments of the population has also been expressed; and
iv. Government bureaucracies.

(c) The following are the likely advantages of **AfCFTA** to Nigerian economy:

i. Expansion of market access for Nigeria's exporters of goods and services, spur growth and boost job creation;
ii. Elimination of barriers against Nigeria's products;
iii. Provision of a dispute settlement mechanism for stopping the hostile and discriminatory treatment directed against Nigerian natural and corporate business persons in other African countries;
iv. Establishment of rules-based trade governance in intra-African trade to invoke trade remedies, safeguard the Nigerian economy from dumping and unfair trade practices;
v. Support for the industrial policy of Nigeria through the negotiated and agreed "Exclusion and Sensitive category lists" to provide space for Nigeria's infant industries;
vi. Improvement of competitiveness and the ease of doing business;
vii. Provision of a platform for Nigeria's continued leadership role in Africa;
viii. Consolidation and expansion of Nigeria's position as the number 1 economy in Africa;

ix. Stimulation of an increase in Nigeria's total exports, with a small structural shift in Nigeria's economy towards manufacturing and services. Changes would result from tariff reduction, ease of doing business and trade facilitation;
x. Provision of a platform for Small and Medium Enterprises (SMEs) integration into the regional economy and accelerate women's empowerment; and
xi. Provision of an expanded platform for Nigerian manufacturers and service providers for connection to regional and continental value chains.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2024: PROFESSIONAL EXAMINATION

PTE II: FINANCIAL/TAX ANALYSIS

WEDNESDAY, APRIL 17, 2024 **EXAM NO......................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

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

QUESTION 1

Datsound Nigeria Limited has just submitted its 2024 annual returns to Apapa Area Office of the Federal Inland Revenue Service, where you work as a Tax manager. In your desk review, you discovered that the company's computed tax liability has drastically reduced from that of 2023. You have, therefore decided to carry out an analytical review of the company's financial statements, using ratios. Your purpose is to compare the company's ratios for 2023 financial year with that of 2022 and industry average for 2023 you collected from the industry association office.

The company's 2023 financial statements, with the 2022 comparative figures and the industry average ratios are shown below.

Datsound Nigeria Limited

Statement of profit and loss

Year ended December 31:		**2023**	**2022**
	Notes	**₦'000**	**₦'000**
Revenue	1	10,900	8,560
Cost of sales	2	7,630	5,821
Gross Profit		3,270	2,739
Administrative expenses	3	(1,566)	(1,135)
Distribution expenses	4	(1,089)	(805)
Operating profit		615	799
Finance costs		(480)	(480)
Profit before tax		135	319
Tax expense		(40)	(96)
Profit for the year attributable to equity shareholders		95	223

Statement of financial position	**Notes**		
As at 31 December		**2023**	**2022**
		₦'000	**₦'000**
ASSETS			
Non-current assets			
Property, plant & equipment		24,260	20,560
Intangible assets		3,000	3,000
Investment property	4	7,500	7,500
		34,760	31,060
Current assets			
Inventories	5	2,485	1,950
Trade and other receivables		5,300	1,375
Cash and short-term deposits		40	2,300
		7,825	5,625
Total assets		**42,585**	**36,685**
EQUITY AND LIABILITIES			
Equity			
Ordinary share capital	6	20,000	20,000
Retained earnings		600	505
Total shareholders' equity		20,600	20,505
Non-current liabilities			
Financial liabilities – Long-term borrowings	7	12,520	13,000
Deferred tax liability		2,750	1,200
Total non-current liabilities		15,270	14,200
Current liabilities			
Trade payables		5,830	1,115
Tax liability		885	865
Total current liabilities		6,715	1,980
Total shareholder's equity and liabilities		**42,585**	**36,685**

Statement of Changes in Equity

December 2023	Ordinary Shares ₦'000	Share Premium ₦'000	Retained Earnings ₦'000	Total Equity ₦'000
As at 31 December 2022	20,000	-	505	20,505
Issue of Share Capital	-	-	-	-
Profit for the year	-	-	95	95
Revaluation of PPE	-	-	-	-
Dividends	-	-	-	-
				-
31 December 2023	20,000	-	600	20,600

December 2022				
As at 31 December 2021	20,000	-	282	20,282
Issue of Share Capital	-	-	-	-
Profit for the year	-	-	223	223
Revaluation of PPE	-	-	-	-
Dividends	-	-	-	-
				-
31 December 2022	20,000	-	505	20,505

Notes to the Financial Statements

1 Revenue

	2023 ₦'000	2022 ₦'000
Gross Revenue	12,674	9,407
Returns	(1,774)	(847)
Net Revenue	10,900	8,560

2	Cost of sales	2023	2022
		₦'000	₦'000
	Inventory at 1 Jan	1,950	3,120
	Purchases	8,165	4,651
	Inventory at 31 Dec	(2,485)	(1,950)
	Cost of Sales	7,630	5,821

3	Administrative Expenses	2023	2022
		₦'000	₦'000
	Personnel costs	650	600
	Depreciation & Amortisation Amortisation	450	140
	Rent & Rates	312	280
	Repairs & Maintenance	65	43
	Internet and Telephone	39	22
	Insurance	50	50
		1,566	1,135

4	Distribution Expenses	2023	2022
		₦'000	₦'000

Sales commission	769	605
Other distribution costs	320	200
	1,089	805

5	Investment Property	2023	2022
		₦'000	₦'000
		7,500	7,500

Investment Property is accounted for under the fair value model under IAS 40-Investment Property.
At year end, the value of investment property had fallen by 30%. This has not been reflected in the financial statements as management is of the view that the fall in value is only temporary and it is expected to reverse in the next accounting period.

6	Inventories	2023	2022
		₦'000	₦'000
	Raw materials & Consumables	1,740	1,365
	Finished goods	745	585
		2,485	1,950

7 Share Capital

The ordinary share capital is represented by 40 million ordinary shares at 50 kobo per share. There were no new issues during the year.

8 Financial Liability

The financial liability is represented by the 6% ₦8m Corporate Loan Notes issued during the year. The issue was at a discount of ₦500,000. The effective interest rate was determined to be 8%.

Industry Information- Industry Mean Ratios

ROE	7.10%
Return on capital employed	3.50%
Return on Assets	1.50%
Gross profit margin	43.00%
Net profit margin	9.60%
Current ratio	1.9:1.0
Acid test ratio	0.7:1.0
Inventory turnover period	62
Payables' turnover period	50
Gearing ratio (Debt/Equity)	30%

Required:

a. Carry out an analytical review of the company's financial statements for the two years, showing at least four ratios each to assess the company's:
   i. Performance;
   ii. Position;
   iii. Management efficiency; and
   iv. Future prospect. **(20 Marks)**

b. Do an industry comparison of the ratios with appropriate commentary. **(10 Marks)**

c. What areas of the company's financial statements will you require further information to convince yourself that the company is not involved in tax evasion tendencies and state the reason why the areas are important. **(10 Marks)**

(Total 40 Marks)

SOLUTION TO QUESTION 1

a. Datsound ratio analysis for 2022 and 2023

analysis	2023	2022
rmance		
i. Gross margin		
profit/Revenue%	3,270/10,900%	2,739/8,560%
	30%	32.00%
ii. Net profit margin		
before tax/Revenue	135/10,900%	319/8,560%
	1.24%	3.73%
iii. Return on capital employed		
Capital employed	615/35,870%	799/34,705%

	1.71%	2.30%
iv. Return on equity		
after tax/Equity	95/20,600%	223/20,505%
	0.46%	1.09%
urn on assets		
before tax/Total assets	135/42,585%	319/36,685%
	0.32	0.87
ion		
i. Total Liabilities/Total assets	21,985/42,585%	16,180/36,685%
	51.63%	44.11%
ii. Debt/Equity	20/20,600x100	00/20,505x100
urrent liabilities/Equity	60.78%	63.40%
iii. Current ratio		
nt assets/Current liabilities	7,825/6,715	5,625/1,980
	1.17:1.0	2.84:1.0
iv. Acid test		
nt assets - Inventory/Current liabilities	5,340/6,715	3,675/1,980
	0.80:1.0	1.86:1.0
gement Efficiency		
i. Assets turnover		
nue/Total assets	10,900/42,585	8,560/36,685
	0.26	0.23
ii. Rate of inventory turnover		
of sales/Average stock	7,630/2,218	5,821/2,535
	3.44 times	2.30 times
iii. Days of inventory outstanding		
ge inventory/Cost of sales X 365	2,218/7,630 X 365	2,535/5,821 X 365
	106 days	159 days
iv. Receivable days		
ge receivables/Revenue X 365	3,338/10,900 X 365	1,375/8,560 X 365
	112 days	59 days
v. Average payable days		
ge payable/Purchases X 365	3,473/7,630x365	1,115/5,821x365

	166 days	70 days

b. Industry comparison

	Datsound		Industry average
	2023	2022	
ROE	0.46%	1.09%	7.10%
Return on capital employed	1.71%	2.30%	3.50%
Return on assets	0.32	0.87	1.50%
Gross profit margin	30.00%	32.00%	43.00%
Net profit margin	1.24%	3.73%	9.60%
Current ratio	1.17	2.8	1.9
Acid test ratio	0.8	1.86	0.7
Inventory turnover period	106	159	62days
Payables' turnover period	279	70	50days
Gearing ratio (Debt/Equity)	74.13%	69.25%	30%

Industry Comparism Comments

ROE: Datsound's returns on equity of 0.46% and 1.09% in 2023 and 2022 were much less than the industry average of 7.10%. This shows that the shareholders of Datsound are receiving returns much less than shareholders of companies in the same industry. Also, the returns of equity of Datsound gradually reduced from 2022 in 2023.

Return on capital employed: The returns on capital employed of Datsound was less than that of the industry average of 3.50%. Its return on capital employed in 2022 was 2.30% and that of 2023 was 1.71%, which was a reduction of 0.59%. This shows that the company was not using its capital to generate enough returns like that of the other companies in the industry.

Return on assets: Datsound's returns on assets of 0.32% and 0.87% in 2023 and 2022 respectively were less than the industry average of 1.50%. It shows that the company's assets are not generating enough returns applicable in the industry.

Gross profit margin: The industry average gross margin is 43%, whereas Datsound's gross margin in 2022 was 32% and in 2023, it was 30%. These were lower than the gross margin in the industry, it shows that the company's cost of sales was higher than the other companies in the industry or that the company's selling prices do not accommodate enough margin on costs.

Net profit margin: The industry average net profit margin is 9.60%, whereas Datsound has a net profit margin of 3.73% and 1.24% in 2022 and 2023 respectively. Datsound 's operating expenses were likely more than that of the average company in the industry.

Current ratio: The average industry current ratio is 1.9 compared with Datsound's current ratio of 2.8 in 2022 and 1.17 in 2023. Datsound has a better current ratio in 2022 than the industry average, but it declined below that of the industry average in 2023. This shows that the company's working capital has reduced drastically in 2023.

Acid test ratio: Dasound's acid test ratio in 2022 was 1.86 which was higher than that of the industry average of 0.7. However, its acid test ratio in 2023 reduced to 0.8 which was still more than the industry average of 0.7.

Inventory turnover period: The industry average inventory turnover period is 62 days, whereas for Datsound, it was 159 days and 106 days in 2022 and 2023 respectively. This means that Datsound could not be able to sell its inventory as quickly as other companies in the industry.

Payables' turnover period: The industry average payable period is 50 days, whereas for Datsound, it was 70 days in 2022 and worsen to 166 days in 2023. This shows that Datsound may be having a serious liquidity problem and its supplier may not be willing to continue to supply to it on credit, which will affect the company's continued operation.

Gearing ratio (Debt/Equity): The industry's gearing ratio is 30% but for Datsound it was 63.40% and 60.78% in 2022 and 2023 respectively. This shows that the company is relatively high geared, compared with companies in the industry. The company depends on debt more than other companies in the industry and it reflects its liquidity problem given that the debt needs to be serviced.

c. The areas of the company's financial statements that requires further information, from the tax authority's point of view are:
   i. **Cost of sales:** The company's gross margin was 32% and 30% in 2022 and 2023 respectively, compared with the industry average of 43%. The tax authority will require more information on the reasons why the company's gross margin is much lower than the industry average. The purpose is to check whether the company is trying to increase its cost of sales by inventory manipulation, to reduce gross profit which will eventually reduce profit before tax and tax liability. The tax authority will call for a schedule of the cost of sales with supporting documents and its inventory check and valuation report, to convince the tax authority that there have been no manipulation.
   ii. **Operating costs (Administrative and Distribution expenses):** Datsound net profit margin in 2022 and 2023 were 3.73% and 1.24% respectively, when compared with the industry average of 9.60%, we have a wide gap. This shows that

the company operating expenses were much higher than that of the average companies in the industry. This could be an indication that the company is trying to increase its operating expenses to reduce its profit before tax and so evade tax. The tax authority will need to call for schedule of the company's administrative and distribution expenses with supporting documents to convince the tax authority otherwise.

iii. **Inventory turnover period:** Datsound's inventory turnover period for 2022 and 2023 was 159 days and 106 days respectively, whereas for industry average it is 62 days. This shows that the company could not turnover its inventory as quickly as possible, as other companies in the industry. The tax authority may call for further information to assure itself that this is not due to manipulation of the company's inventory to reduce profit and tax liability.

iv. **Non-current assets:** Datsound's non-current assets increased in 2023 from that of 2022 level. The tax authority will need to call for further information on the additions to non-current assets during the year and determine that capital allowances claimable by the company during the year.

QUESTION 2

Organisations make use of both financial and non-financial information to manage their business and ensure improved performance and growth. The purpose of accounting is to generate accounting related data that can assist organisations to monitor, evaluate and manage their businesses, therefore, accounting information must be of high quality.

Required

Discuss the factors that are necessary to ensure quality accounting information.

(15 Marks)

SOLUTION TO QUESTION 2

Accounting information is very essential for effective and efficient management of organisation, most especially, business organisations. Therefore, there is a need for such information to be of high quality. The following are the factors that determine the quality of accounting information:

a. **Management commitment**

Everything in an organisation depends on the commitment of the management of the organisation. Commitment by management allows management's behaviour to be self-regulated rather than controlled by sanctions and external pressures. The commitment of top management to quality information will dovetail downwards and it will become the norm in the organisation. Therefore, development of quality information systems is influenced by the participation of the top management, middle management and lower management in goals formulation, development of information systems, and clear commitment to documenting the work plan and performance, in order to direct, approve, measure, and support the organisation's activities. Characteristics of strong management commitment include top management advocating change and empowering employees to make changes, performance measures are aligned with corporate goals, investment in, and realised return on technology and systems development and retention of human capital, communication of goals and results.

b. Organisational culture

Organisation culture is a pattern of assumptions which is learned by management and staff to solve problems of external adaptation and internal integration. Culture is a social norm that is existing within a group or in an organisation. Organisation value and norms are key component of organisation culture. Value is the basis of faith, and is a source of inspiration and motivation in moving and controlling human behaviour to the formation of corporate culture while norms are members' behaviour in guiding an organisation in the form of unwritten rules.

Therefore, the cultural values and norms that exist within an organisation will have great influence on the characteristics of the organisation. Production of quality accounting information, therefore, greatly depends on the culture of accountability, truthfulness, accuracy, etc. that exist in the organisation.

c. Organisational structure

Organisational structure is the arrangement of divisions or work units within an organisation. It is the framework which describes the distribution and coordination of job tasks between the individuals and groups within the organisation. It involves relationships, responsibilities and authority that controls and integrates employees' actions and performance in achieving the goals of organisation. Organisation structure must be done in such a way that it will allow production and free flow of information within the divisions and departments that made up the organisation.

d. Internal control system

Internal control is the process and policies designed and adopted by the management to achieve the organisational mission and objectives. An effective internal control system is needed for business success and to generate reliable and relevant information for both internal management use and external stakeholders who need the information. An effective internal control should provide relevant and reliable financial information, comply with the relevant laws and regulations as well as ensure an effective and efficient operation of the organisation. Therefore, a good and effective internal control is necessary if an organisation wants to have a good accounting system and also provide relevant and reliable information to the management for carrying out the business activities effectively. With the existence of an effective internal control system, the effectiveness and efficiency of accounting information system can be enhanced through appropriate recording and processing of data, safeguarding of assets, and reliability and accuracy of accounting information generated. An effective internal control system is also necessary to prevent frauds and reduce the likelihood of errors and material misstatements resulting from ineffective information system.

QUESTION 3

(a) Explain the role of financial reporting in capital market. **(8 Marks)**

(b) Discuss the quality of financial data. **(7 Marks)**

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) The role of financial reporting in capital market

The capital market refers to interactions among firms or organisations with funding needs and investors with surplus funds for investments whereby firms raise debt and equity capital for their operations and investors make funds available to firms either in the form of debt or equity investments at a return. Therefore, capital market participants depend on financial information to make various decisions. Firms usually provide financial information through the financial reports they publish. The financial reports often comprise:

- financial statements,
- management discussion of those financial statements
- other regulatory filings.

Some firms engage in additional voluntary communication, such as:

- management forecasts,
- analysts 'presentations,
- other corporate reports and press releases on key issues.

It has been said that no perfect stock market exists anywhere in the world, and that most stock markets exhibit weak form market efficiency. Weak form efficiency implies that the market uses historical corporate financial information in making investment decisions. Capital market participants are provided with information that forms a basis for making fair decisions regarding stock prices in order to make and execute reasoned investment and financing decisions. The financial information are useful to investors for the following reasons:

(a) Capital market participants are provided with information that forms a basis for making fair decisions regarding stock prices in order to make and execute reasoned investment and financing decisions;

(b) Financial statements prepared using global financial reporting benchmarks help investors to be better equipped and appreciate risk associated with decisions about flows of economic capital;

(c) Market participants use financial information to make general investments decisions to reduce financial risks and optimise returns on investments;

(d) Financial reporting by corporate entities aids the functioning and development of the capital market; and

(e) Financial statements measure and summarise the economic consequences of business activities.

It should be noted that information by entrepreneurs to investors is not completely credible because entrepreneurs have an incentive to inflate the value of their idea to encourage investors. (8 Marks)

(b) **Quality of financial data**

Quality is defined as the standard measure of something or a certain level of excellence. Quality is good if the information used is relevant and reliable, and the relevant information is that which can be used for decision-making. The quality of accounting information indicates the good performance of the accounting information system and the appropriateness of the accounting system applied, in order to reach efficiency and effectiveness in the operations of an organisation to reach its objectives, protect its assets, serve senior management and help it achieve the maximum productivity. The dimensions of the accounting information quality are determined by:

(i) **Appropriateness:** This means the efficiency of financial statements and reports, and their success in serving their users through their ability to provide adequate and appropriate information to make appropriate decisions, so that this information is recognised for being suitable for decision-making and is presented properly besides its timely availability;

(ii) **Reliability:** This is associated with the information integrity and the ability to rely on it. Accounting information is characterised as being reliable or can be relied on if it has the ability to express the veracity of the information, to be free from error and bias, and to represent it fairly and honestly;

(iii) **Consistency:** This characteristic is realised when the company uses the same accounting treatment for the same event from one period to another without any change;

(iv) **Understandability:** it is a qualitative accounting information characteristic that helps a prudent wise user to identify the meaning and importance of financial reporting; and

(v) **Comparability:** This characteristic enables users of financial reports to identify similarities and differences between economic phenomena and events. The use of an incomparable accounting standard results in increased differences in the expression of economic phenomena and events.

However, accounting information system (AIS) has a great impact on the quality and effectiveness of accounting information which leads to the organisational performance of a firm. Research indicate that the quality of accounting information is influenced by the quality of accounting information system, determined by four key factors: service quality; information quality; data quality; and system quality.

QUESTION 4

(a) Examine the grouping of companies and its tax rates in accordance with Finance Act 2020 and its main benefit to small companies. **(6 Marks)**

(b) Discuss the old commencement of trade rule as contained in CITA 2004 and the new commencement rule as amended by Finance Act 2020 and analyse the main difference between the two requirements. **(9 Marks)**

(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) Classification /Group of companies according to Finance Act 2020

Based on the provisions of the Finance Act, 2019, tax shall be levied and paid on total profits of every company, in respect of each assessment year, as follows:

S/N	Classification	Threshold (gross turnover)	Tax rate
1.	Small company	₦25,000,000 and below	0%

For the income to be exempted from tax, the company must have registered for tax purposes, filed its tax returns on or before the due date and complied with all other provisions and obligations stipulated under CITA, including provisions relating to penalties for breach of statutory duties.

2.	Medium-sized company	Above ₦25,000,000 but less than ₦100,000,000	20%
3.	Large company	₦100,000,000 and above	30%

The main benefit to small companies is that their tax rate is 0% which mean that they are charged at 0% for companies' income tax and Education Tax

(b) **(i) The old commencement rule as contained in CITA 2004 states that the first three year of business should be assessed as follows:**

First Year of Assessment: The assessable income is the amount of income of that year. In other words, the assessment is based on the actual income from the date of commencement to 31st December, of the same year.

Second Year of Assessment: The assessable income of one year from the date of commencement in Nigeria of trade, business etc. In other words, the assessment is based on the income of the first twelve months from the date of commencement.

Third Year of Assessment: The assessable income is the amount of income of the year immediately preceding the year of assessment. In other words, the assessment is based on the income of the normal accounting period of twelve months ending in the year preceding year of assessment.

Right of Election: The Tax Payer can choose in writing to be assessed on actual year basis during the second and third years of assessment

(ii) The new commencement rule according to Finance Act 2020.

Assessable Profits of First, Second and Third Years shall be determined as follows:

- First Year – From Commencement to the end of the accounting period.

- Second Year – From the first day after the First Accounting Period till the end of the Second Accounting Period (eg 1st January – 31 December)
- Third Year and subsequent years - from the day after the Accounting Period just ended. (1st January --)

The main difference between the CITA 2004 and Finance Act 2020 requirements under the Commencement period is that the problem of overlapping, coincidental and double taxation which usually occur during assessment under the commencement period has been eliminated under the Finance Act 2020.

(9 Marks)
(Total = 15 Marks)

QUESTION 5

The business environment can be viewed as internal and external. There are four environmental influences that impact on business activities and its performance.

Required:

Identify and discuss the model that can be used to analyse the four environmental influences that affect firm's operations and performance. **(5 marks)**

Explain how a company can use the model to analyse it internal and external environment to grow its business. **(10 marks)**

(Total 15 Marks)

SOLUTION TO QUESTION 5

An understanding of the external environment, in terms of the opportunities and threats and the internal environment, in terms of the strengths and weakness, is crucial for the existence, growth and profitability of any organisation. A systematic approach to understanding the environment is the strengths, weaknesses, opportunities and threats (SWOT) analysis.

The environment in which an organisation exists can, therefore, be described in terms of the strengths and weakness existing in the internal environment and the opportunities and threats operating in the external environment.

The four environmental influences could be described as follows:

Internal environment

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

Weakness: *This* is an inherent limitation or constraint which creates strategic disadvantages.   Examples of weakness are gaps in capabilities, financial deadlines, low morale and overdependence on a single product line.

External environment

Opportunity: *These are* favourable conditions in the organisation's external environment which enables it to consolidate and strengthen its position Examples of opportunity are economic boom, favourable demographic shifts, arrival of new technologies, loosening of regulations, favourable global influences and unfulfilled customer needs.

Threat*:* These are unfavourable conditions in the external organisation's environment which creates a risk for, or causes damage to, the organisation. Examples of threat are: economic downturn, demographic shifts, new competitors, unexpected shifts in consumer tastes, demanding new regulations, unfavourable political issue or legislation, and new technology.

SWOT analysis

Strength, weaknesses, opportunities and threats (S'WOT) analysis is a very popular strategic planning technique having applications in organisation's strategic decisions. Organisations perform a SWOT analysis to understand their internal and external environments. Through such an analysis, the strengths and weaknesses existing within an organisation can be matched with the opportunities and threats operating in the environment so that an effective strategy can be formulated. An effective, organisational strategy, therefore, is one that capitalises on the opportunities using strengths, protects itself from threats and minimising the impact of weaknesses, to achieve pre-determined objectives.

A simple application of the SWOT analysis technique involves the following steps:
Setting the objectives of the organisation or its unit;
Identifying its strengths, weaknesses, opportunities and threats;
Asking four questions

- How do we maximise our strengths?
- How do we minimise our weaknesses?
- How do we capitalise on the opportunities in our external environment?
- How do we protect ourselves from threats in our external environment?

Recommending strategies that will optimise the answers from the four questions

The SWOT analysis is usually done with the help of a template in the form of a four-cell matrix, each cell of the matrix representing the strengths, weaknesses, opportunities and threats. The analysis for preparing the SWOT matrix could be done by a group of managers in a workshop session. The session could use the brainstorming technique for generating ideas about the SWOT factors. An example of SWOT analysis matrix for an organisation is as follows.

STRENGHTS	WEAKNESSES
Favourable location	Uncertain cash flow
Excellent distribution network	Weak management information system
Established R & D centre	Low worker commitment

Good management reputation	
OPPORTUNITIES Favourable industry trends Low technology options available Possibility of niche target market Availability of reliable business partners	THREATS Unfavourable political environment Obstacles in licensing new business Uncertain competitors' intentions Lack of sustainable financial backing

QUESTION 6

In accordance with IASB conceptual framework, Discuss the following:

(a) Conditions for recognition of assets. **(8 Marks)**

(b) The situations that can give rise to asset distortion. **(7 Marks)**

(Total 15 Marks)

SOLUTION TO QUESTION 6

(a) RECOGNITION OF ASSETS

According to IASB conceptual framework, an asset is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.

Rights

Rights can take many forms including the right to receive cash, exchange resources on favourable terms, rights over physical objects and rights to use intellectual property. Many rights are established by contract, legislation or similar means. However, rights might be obtained in other ways (e.g. developing know-how that is not in the public domain). Some goods or services are received and immediately consumed (e.g. employee services).

The right to obtain the **economic benefits** produced by such goods or services exists momentarily until the entity consumes the goods or services. In order to be an asset, rights must both have the potential to produce economic benefits for the entity beyond those available to all other parties and be controlled by the entity. Therefore, not
all rights are assets (e.g. right to use public infrastructure is not an asset).

Potential to produce economic benefits

An economic resource is a right that has the potential to produce economic benefits.

A right can be an asset, even if the probability that it will produce economic benefits is low. However, low probability might affect decisions about what information to provide about the asset and how to provide that information, including decisions about whether the asset is recognised and how it is measured.

Control

Control links an economic resource to an entity. Control is the ability to obtain economic benefits from the asset, and to restrict the ability of others to obtain the same benefits from the same item. Therefore, if entity financial statements are prepared based on IFRS, the recognition of assets in the statement of financial position need to meet their definition as provided in the conceptual framework. Based on the definition, the entity would recognise assets in its statement of financial position only if those resources meet these conditions:

(i) Assets are the resources to which the entity has right;

(ii) Assets are expected to provide economic inflow into the entity in the future; and

(iii) Assets are the resources that are controlled by the entity.

That means that, though assets are controlled by the entity, but they are not expected to have future economic inflow, then the asset could not be recognised. (8 Marks)

(b) ASSETS DISTORTION

Assets distortion can arise due to the following situations:

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

(i) Provision for depreciation on PPE;

(ii) Provision for inventories, due to loss in value as a result of obsolescence, slow moving items, etc.;

(iii) Provisions for prepaid expenses and revenue not yet earned; and

(iv) Bad debt allowance on receivables.

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

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

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

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

Leased assets: If the entity uses substantial leased assets and these are not brought into the financial statements, it will lead to reduction in the value of the entity's assets which will result in distortion.

QUESTION 7

(a) What is merger and acquisition? Discuss the type and reasons that are commonly adduced for mergers and acquisition. **(7 Marks)**

(b) Explain due diligence in mergers and acquisition with particular reference to tax due diligence. **(8 Marks)**
(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) MERGERS AND ACQUISITIONS

There are two principal ways by which a business organisation can achieve growth. Growth can be achieved organically through product and service innovation or inorganically through external growth by mergers and acquisition. Mergers and acquisitions have become a commercial phenomenon, being one of the famous external corporate restructuring options utilised by companies globally.

Mergers and acquisition (MA) have become a veritable tool increasingly utilised not only within the national landscape, but also consistently on a cross-border basis. Mergers and acquisitions are generally defined as forms of business combinations that either result in formation of new companies or assimilation of existing business by others.

MERGER

The term "merger" may be defined as an arrangement whereby the assets of two companies become vested in, or come under the control of one company, (which may or may not be one of the original two companies), which has as its shareholders all, or substantially all the shareholders of one or both of the merging companies, who exchange their shares (either voluntarily or as a result of legal operation) for shares in the other or a third company (Sanpath, 2010).

This leads to the amalgamation of the undertakings or part of the undertakings of two or more independent and autonomous entities under the identity of one of the combined entities or, in other cases, under the identity of a new corporate entity. Mergers can be three types:

(i) Horizontal merger,

(ii) Vertical merger

(iii) Conglomerate merger

Horizontal Merger: A merger is horizontal if it involves the combination of two or more companies offering the same product or services.

Vertical Merger: A vertical merger occurs where two or more distinct enterprises engaged in the same market but operating at different levels of the market combined.

Conglomerate Merger: A conglomerate is a situation whereby two companies, in different industries which have no vertical or horizontal relationship, come together.

ACQUISITION

An acquisition may be defined as a transaction or a series of transactions where an entity acquires control over assets, either directly or indirectly (Speechley, 2008). Viewed broadly, an acquisition may generally be achieved through

(i) Share sale;
(ii) Asset sale; or
(iii) Business

The regulatory frameworks for mergers and acquisitions in Nigeria are:

(i) Companies and Allied Matter Act (CAMA), 2020;
(ii) Investment and Securities Act, 2007; and
(iii) Other sector specific laws.

The reasons that are commonly adduced for mergers and acquisition are:

(i) The creation of more wealth for shareholders;
(ii) The quest for increased market pioneer and reduced competition;
(iii) The building drive of business managers; and
(iv) The prevailing local economic situations in a country can also create favourable conditions for mergers and acquisition activities.

(b) **DUE DILIGENCE IN MERGERS AND ACQUISITION AND TAX DUE DILLIGENCE**

Due Diligence

Regardless of the form of business combinations, it is quite fundamental to conduct due diligence. This will enable the merging parties (in case of acquisition, the buyer) to ascertain the nature and the extent of existing liabilities and other potentials legal and commercial risks. There is a need to ensure that there is accuracy of information supplied to the acquiring company by the company to be acquired. The reason for this is to ensure that the acquisition is not made on the faulty assumptions or inaccurate information (Bhadmus, 2013).

Tax due diligence

The major due diligence issues are tax consequences of the divestment by the seller such as capital allowance recoupment and capital gains tax, which may be factored into the pricing of the asset because the buyer is able to claim tax benefits on the amount paid to acquire such assets. Due to the enormous tax costs of some of these types of transactions, investors often use complex structures to obtain tax reliefs. On asset deals, the historical tax issues for the seller are not too important except to model any incremental costs for changes in compliance after acquisition.

For share deals, the tax issues are usually more complex. This requires a detailed tax diligence to be undertaken to anticipate and mitigate tax liabilities through indemnities and warranties. Buyers have to understand the attitude of the target entity towards tax compliance, since most tax due diligence issues result from the target's existing approach to tax compliance. This is important in view of the relatively low level of tax compliance in Nigeria, which is partly due to weak tax enforcement on the part of the authorities. It is also useful to evaluate the effectiveness of the tax function, quality of tax personnel, and competency of tax advisers and overall attitude of management to corporate governance assessing potential tax risk.

Assessing compliance challenges

Oftentimes there are challenges around incomplete and poor record keeping by target companies. These businesses are sometimes unable to substantiate their claims of tax compliance, especially filling of returns and remittances of tax liabilities. This stems in part from the difficulty of obtaining evidence of tax paid both from third parties and tax authorities. In assessing tax exposures of a target, investors should consider industry – specific issues that may affect the target's tax position.

An example of this could be an aggressive industry position on a tax matter or class action on industry-specific tax issues. A purchaser may also need to evaluate the risk associated with ambiguous tax rules that might create uncertainties in the interpretation and application of tax laws as well as variances between the letters of law and what occurs in practice.

Common risk areas are transaction taxes such as VAT and withholding tax where compliance is generally low or sometimes overlooked by taxpayers. In group situations, transaction taxes on inter-company transactions are often taken for granted or treated wrongly. There are also noncompliance issues associated with employee taxes (and social security contributions), especially with expatriate staff.

The motives of a business combination and the risk appetite of the investor will usually drive the focus and approach of the due diligence exercise. An investor who is willing to take on the liabilities of the target would generally prefer an asset deal to share deal. In some cases, however, an asset deal may not totally shield an acquirer from the tax liabilities of the target. For instance, under the PPT Act, the tax authority is empowered to recover tax liabilities relating to assets transferred from the acquirer if in its view the transaction was consummated for the purpose of avoiding tax.

With respect to the acquisition of government – owned enterprises the need for a thorough due diligence is even more important as most government corporations are not diligent in matters of tax compliance. A common remedy is to seek an indemnity to cover identified and potential tax liabilities as a pre-condition to the acquisition. When carrying out a tax due diligence on the proposed target, answer to the following specific questions should be sought:

What is the target's level of tax compliance with respect to companies income tax (CIT), tertiary education tax (TET), capital gains tax (CGT), information technology levy and payroll related tax? What are the available tax assets (e.g. unrelieved capital allowances, unabsorbed tax losses, unutilised WHT credits, etc.) on the target book? What is the quantum of non-allowable tax expenses and/or deductions in the target's tax position e.g. filling fees, stamp duties, etc.? What are the prospects for the application of the commencement and/or cessation rules post – combination given potential double taxation?

An acquiring party may be able to take advantage of the tax benefits available under Nigeria's tax laws in relation to interest payments if it finances the business combinations through loan facilities. Interest expenses are specifically allowable as tax deductions under the relevant tax legislation. The above assessment assists counterparties to forestall inheriting unwieldy tax burdens in the surviving and/or resulting company after the ink has dried on the nuptial papers. It is the responsibility of the counterparties to ensure that the M&A process is executed in such a manner that ensures that available tax benefits or assets in the target's books can be utilised by the surviving or resulting company after completion of the business combination.

This inevitably implies that competent and/or trusted advisors must be engaged and their inputs sought throughout the M&A value chain. For instance, loss reliefs may be preserved and utilised by the surviving and/or resulting company depending on the manner the M&A is conducted otherwise, the parties may be exposed to challenge by tax authorities for "loss trafficking".

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2024: PROFESSIONAL EXAMINATION

PTE II: INCOME TAX FOR SPECIALISED BUSINESS

WEDNESDAY 17TH APRIL, 2024 **EXAM NO..................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

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

QUESTION 1

1. Warrih Global Oil and Gas Nigeria Limited, was granted an oil prospecting licence on January 1, 2002. The company has been involved in petroleum prospecting and exploration of oil and gas in onshore and shallow water.

At the expiration of its operating licence in December 2021, the company opted for automatic conversion to the petroleum mining lease (PML) in line with the provisions of the Petroleum Industry Act, 2021. The approval for conversion was conveyed to the Managing Director of the company by the Nigerian Upstream Petroleum Regulatory Commission (NUPRC) on December 21, 2021, with commencement date of January 1, 2022.

The following details were extracted from the financial statements of the company for the year ended December 31, 2023:

	s	**lion**	**lion**
ne:			
of crude oil sold (export)			140,400
of crude oil sold (local)			11,400
of condensate from associated gas sold			64,800
quid from associated gas sold			5,400
revenue			222,000

nses:			
ction cost		55,800	
ssion rentals		18,300	
naling cost		1,200	
g cost		4,240	
ty incurred and paid		31,800	
al administrative expenses		15,200	
rs of plant, machinery and fixtures		2,700	
duties		2	
ciation		1,950	
charges and other finance costs		13	
ms duties on essentials		3	
hree wells appraisal costs		330	
of gas reinjection wells		360	
community costs		450	
d rent paid to the State government		35	
rs of production and implement utensils		400	
Delta Development Commission charge		25	
tions		250	
onmental remediation fund		1,300	
ne tax provision		9,100	

y education tax provision		2,280	145,738
ofit			76,262

The following additional information was provided:

(i) Income:

ory of product	ity	price ($)	price ($)
oil sold (export)	on barrels		
of condensate from ated gas sold	on MMBtu		
uid from associated gas sold	illion MMBtu		

The prices at each measurement point for both the local crude oil and export sales have been approved by the (NUPRC).

(ii) Drilling cost incurred:

₦'million

Tangible cost incurred on first exploration well 3,000
Intangible cost incurred on first exploration well 1,240
4,240

(iii) Royalty incurred and paid:

₦'million

Crude oil sold (export) 21,060
Crude oil sold (local) 210
Condensate and gas liquid 10,530
31,800

(iv) General administrative expenses:

₦'million

Salaries and personnel emoluments 14,100
Cost incurred in seeking information for oil deposits 350
Gas flaring fee 750
15,200

(v) Donations

₦'million

Registered old peoples' home 30
Host community's children welfare home 70

State Government Flood Relief Fund	150	250

(vi) Agreed capital allowances for the year was ₦2,850m.

(vii) Production allowances after commencement of the Petroleum Industry Act:

	₦'million	
Onshore operations	420	
Shallow water operations	950	1,370

(viii) Assume that ₦600 is equivalent to US $1 and tax liabilities payable will be in local currency (Naira).

Required:

(a) In line with the provisions of the Petroleum Industry Act 2021, compute for the relevant assessment year, the company's:

(i) Hydrocarbon tax **(20 Marks)**

(ii) Companies income tax **(10 Marks)**

(iii) Tertiary education tax **(1 Mark)**

(b) Section 17 of the Finance Act 2023, specifies the documents/particulars in respect to any accounting period of the company that is engaged in petroleum operations that are to be delivered to the FIRS for purpose of determining petroleum profits tax; the due dates for filing of returns and penalty for non-compliance.

You are required to state:

(i) FOUR of the documents/particulars that are to be delivered to FIRS for purpose of tax assessment **(4 Marks)**

(ii) The time limit for submission of documents/particulars and filing of returns **(3 Marks)**

(iii) The penalty for non-compliance with the provisions of the Act **(2Marks)**

(40 Marks)

SOLUTION TO QUESTION 1

(a) (i) Warrih Global Oil and Gas Nigeria Limited

Hydrocarbon Tax

For 2023 Assessment Year

	lion	lion
me:		
of crude oil sold (export) (3 million barrels x $80 x)		144,000
of crude oil sold (local)		11,400
of condensate from associated gas sold (2 million u x $55 x ₦600)		66,000
quid from associated gas sold (1.5 million MMBtu x $6 0)		5,400
revenue		226,800
able deductions (Section 263 of PIA)		
ction cost	55,800	
ssion rentals	18,300	
naling cost	1,200	
g cost	4,240	
y incurred and paid	31,800	
s of plant, machinery and fixtures	2,700	
duties	2	
wo wells appraisal costs (2/3 x ₦330)	220	
of gas reinjection wells	360	
community costs	450	

d rent paid to the State government	35	
rs of production and implement utensils	400	
Delta Development Commission charge	25	
onmental remediation fund	1,300	
allowable costs	116,832	
costs subject to CPR limit (Wk. 1)	(67,807)	(67,807)
s allowable cost carried forward	49,025	
ption costs incurred (Wk. 1)		(51,875)
ted profit		107,118
Loss relief		NIL
sable profit		107,118
Section 266 and 6th Schedule deductions:		
l allowances		2,850
		104,268
Production allowances		1,370
eable Profit		102,898
carbon tax @ 15%		**15,434.70**

Workings 1: CPR Limit

	lion	lion
income		226,800
num allowable costs @ 65%		147,420
operating cost incurred		116,832
al allowances		2,850
eligible costs		119,682
Exempted costs (Section 263):		
essional rentals	18,300	
ty paid	31,800	
community fund	450	
charge	25	
onmental remediation fund	1,300	
exemption costs	51,875	(51,875)
otal costs to be subject to CPR		**67,807**

Maximum allowable cost:

The lower of:
Net total costs to be subjected to CPR ₦67,807 million
And
CPR @ 65% of Gross income ₦147,420 million

This is **₦67,807 million**

(a) (ii) **Warrih Global Oil and Gas Nigeria Limited**

Companies Income Tax

For 2024 Assessment Year

	lion	**lion**
; income		00
Allowable deductions (Section 263 of PIA):		
allowable cost	116,832	
CITA allowable deductions:		
charges and other finance costs	13	
ms duties on essentials	3	
al administrative expenses:		
es and personnel emoluments	14,100	
ions:		
ered old peoples' home	30	
community's children welfare home	70	
Government Flood Relief Fund	150	131,198
sable profit		95,602
Losses relief		NIL
		95,602
Capital allowances		2,850
profit		92,752
anies income tax @ 30%		**27,825.60**

(a) (iii) Warrih Global Oil and Gas Nigeria Limited
Tertiary Education Tax
For 2024 Assessment Year

	₦'million
sable profit	95,602
y education tax @ 3% of ₦95,602	**2,868.06**

(b) (i) The documents/particulars that are to be delivered to FIRS for purpose of tax assessments

In line with the provisions of Section 17 of the Finance Act 2023, every company engaged in petroleum operations shall for each accounting period of the company make up accounts of its profits or losses and prepare the following particulars for the purpose of determining petroleum profits tax:

- A statement of accounts of its profits or losses;
- Computation of its actual adjusted profit or loss and actual assessable profits of that period;
- In connection with the Second Schedule to the Principal Act, a schedule showing:
  - The residues at the end of that period in respect of its assets;
  - All qualifying petroleum expenditure incurred by it in that period;
  - The value of any of its assets disposed off in that period; and
  - The allowances due to it under that schedule for that period.
- A computation of its actual chargeable profits of that period;
- A statement of amounts repaid, refunded, waived or released to it, referred to in Section 10(2) of the Principal Act, during that period;
- Duly completed self-assessment form attested to by the principal officer of the company; and
- Evidence of payment of the final instalment.

(b) (ii) The time limit for submission of documents/particulars and filing of returns:

- Every company engaged in petroleum operations shall with respect to any accounting period of the company within 5 months after the expiration of that period deliver to the FIRS the documents/particulars needed for the purpose of tax assessments;

- Every company which is yet to commence bulk sales or disposal of chargeable oil, shall file with the FIRS its audited accounts and returns:
  - Within 18 months from the date of its incorporation, in the case of a newly incorporated company; and
  - Within 5 months after any period ending on 31st December of the following year, in the case of any other company, provided that where there is an interval between 31st December of the preceding year and the date on which the company commences the bulk sale or disposal of chargeable oil or condensate, the interval shall be deemed to form part of the preceding period.

(b) (iii) The penalty for non-compliance with the provisions of the Act

The company is liable to pay as penalty for late filing:

- Ten million naira (₦10,000,000) on the first day the failure occurs and Two million naira (₦2,000,000) for each and every subsequent day in which the failure continues; or
- Other sum as may be prescribed by the Minister of Finance by order published in the Federal Government Gazette.

QUESTION 2

Nature Farms Limited commenced operations on April 1, 2020 as a primary agricultural produce company. It produces arable crops, such as cassava, maize, yam and millet. Its products are sold locally to both households and agro-allied companies, for consumption and conversion to finished industrial products, respectively.

The company's financial records for the year end September 1, 2023 revealed the following:

₦'000 ₦'000

Gross turnover

56,250

Deduct:

Cost of inputs	22,140
Salaries	2,400
Maintenance of agricultural equipment	750

Repairs of vehicles		490	
Finance cost and other bank charges		1,850	
Preliminary expenses written off		1,300	
Depreciation of assets		5,500	
Professional charges	2,700		
Cost of drilling water bore hole		1,500	
Administrative expenses		1,700	
Power and other utility costs		2,900	
Penalty for late filing of returns to FIRS		100	43,330
Net Profit			12,920

The following additional information was made available:

(i) Cost of inputs related to money expended in weeding, purchase of pesticides, chemicals, fertilizers, ploughing, planting, harvesting of crops and wages of personnel that worked in the farm.

(ii) Professional charges included:

		₦'000
Auditors' fees	1,500	
Legal fees paid to a law firm for acquisition of land	1,200	
2,700		

(iii) The under listed qualifying capital expenditure (QCE) were deemed to have been incurred on the day of commencement of business operations. The tax written down values of these assets as at September 30, 2022 were:

QCE	Amount ₦'000
Agricultural plant equipment (3)	350
Motor vehicles (3)	1,200
Furniture and fittings (6)	360
Non-industrial building (1)	2,800

(iv) Additional assets acquired during the financial year ended September 30, 2023:

QCE	Date of acquisition	Amount ₦'000
Motor vehicles (2)	November 15, 2022	3,000
Furniture and fittings (2)	July 1, 2023	140

(v) Unutilised capital allowances as at September 30, 2022 was given as ₦2,600,000.

Required:

Compute, in line with the provisions of Companies Income Tax Act 2004 (as amended), for the relevant assessment year, the company's:

(a) Adjusted profit **(4 Marks)**

(b) Tax payable **(11 Marks)**

(15 Marks)

SOLUTION TO QUESTION 2

(a)

Nature Farms Limited
Adjusted Profit
For the year ended September 30, 2023

	₦'000	₦'000
Net profit as per accounts		12,920
Add back:		
Preliminary expenses written off	1,300	
Depreciation of assets	5,500	
Cost of drilling water bore hole	1,500	
Penalty for late filing of returns	100	
Legal fees paid to a law firm	1,200	9,600
Adjusted profit		22,520

(b)

Nature Farms Limited
Computation of tax liabilities
For 2024 Assessment Year

	₦	₦	
Adjusted profit			22,520,000
Deduct:			
Capital allowances:			
Unutilised b/f	2,600,000		
For the year (appendix 1)	5,135,970		
Total available for utilisation	7,735,970		
Utilised	(7,735,970)	(7,735,970)	
c/f	NIL		
Total profit			14,784,030
Companies income tax @ 20% of ₦14,784,030			2,956,806
Tertiary education tax @ 3% of ₦22,520,000			675,600
Total tax payable			3,632,406

NOTE: Agricultural business is exempted from minimum tax computations.

Appendix 1: Capital allowances schedule

	ltural equipment	e	ure and s	dustrial g	l nces
	%	% %	% %	% %	
A/Y					
	00	000	00	000	
ons	000	000	00		
	,000) w1	,000) w2	0) w3		000
		,970)	00) w5	00) w6	970

					,970
/ **2025**	)0	030	)0	000	

Workings

(1) IA of agricultural plant equipment

IA = 95% of ₦1,500,000 = ₦**1,425,000**

(2) IA of motor vehicles

IA = 50% of ₦3,000,000 = ₦**1,500,000**

(3) IA of furniture and fittings

IA = 25% of ₦140,000 = ₦**35,000**

(4) AA of motor vehicles

AA (old) = $\frac{₦1,200,000}{4 - 3 \text{ years}}$ = ₦1,200,000 less ₦30 = ₦1,199,970

AA (new) = $\frac{₦3,000,000 - ₦1,500,000}{4}$ = 375,000

1,574,970

(5) AA of furniture and fittings

AA (old) = $\frac{₦360,000}{5 - 3 \text{ years}}$ = ₦180,000

AA (new) = $\frac{₦140,000 - ₦35,000}{5}$ = 21,000

201,000

(6) AA of non-industrial building

AA (old) = ₦2,800,000 = ₦**400,000**

10 – 3 years

TOTAL 15 MARKS

QUESTION 3

Trivial Telecommunication Limited (TTL or the Company) operates as a United Kingdom-based telecommunications entity with an economic presence in Nigeria, facilitated through its established representative office. This strategic extension into Nigeria allows the company to engage with the local market actively, leveraging on its expertise and services to cater for the specific telecommunications needs of the region.

The records of the company during the year ended December 31, 2023 were as follows:

(a) The number of minutes of Telecommunication transactions:

tion	**tes**
o other parts of the world	4,310,000
Nigeria	1,500,000
a to UK	1,000,000
a to South Africa	900,000
South Africa	2,000,000
a to Turkey	800,000
	10,510,000

(b) The average charge for calls applicable during the year under review is £0.65 per minute. The applicable rate of exchange is ₦1,025.75/£1.

(c) The global expenses incurred include:

nse	**unt (₦)**

es and wages	600,000,000
ciation	1,000,000,000
nistrative expenses	980,765,000
	620,000,000
bishing of assets	105,000,000
non-allowable expenses	110,560,000
	3,416,325,000

You are required to compute the tax payable in Nigeria by Trivial Telecommunication Limited.

(15 Marks)

SOLUTION TO QUESTION 3

Trivial Telecommunication Limited

Computation of Tax Liability for the 2024 Year of Assessment (1Mark)

	Workings	Amount ₦
an Income		800,191,125.00
Adjusted Profits	,191,125.00 x 68.86%	239,611,699.75

ciation Allowance	,191,125.00 x 14.27%	256,887,291.38)
le profit		982,724,408.37
ability	24,408.37 @ 30%	294,817,322.51
um tax @ 2%	,191,250	36,003,825.00
ayable	**er of minimum tax or tax on normal**	**94,817,322.51**

Workings

N	Item	Working	Amount ₦'000
	l Income	0,000 x 0.65 x 1,025.75	7,007,411,125
	a Income	relates to income from calls made out of a. 0,000 + 900,000 + 800,000) x 0.65 x .75	1,800,191,250
	l Adjusted Profit	<table><tr><th>Item</th><th>₦'000</th></tr><tr><td>l income (wk 1)</td><td>7,007,411,125</td></tr><tr><td></td><td></td></tr><tr><td>es and wages</td><td>(600,000.00)</td></tr><tr><td>istrative expenses</td><td>(980,765.00)</td></tr></table>	

		(620,000.00) **sted Profit** **,806,646,125**	
	ted Profit Ratio	sted Profit x 100% al Income ,646,125 x 100% = 68.86% ,411,125	
	ciation Relief Ratio)	al Depreciation x 100% bal Income ,000,000 x 100% = 14.27% ,411,125	

QUESTION 4

The activities of operators in the mining of solid mineral resources in Nigeria, of recent, have reached a stage that the Federal Government has threatened to withdraw all operators' licences. According to the government, most of the operators in the sector have questionable licences and the mode of operations are inconsistent with the extant enabling laws and regulations that guide it.

Blaqqy Mining Company Limited is engaged in the business of mining coal in the Eastern part of Nigeria. The company has been in business for over twenty years. The financial statements of the company for the year ended December 31, 2022 revealed the following:

₦'000 ₦'000

Income:

Turnover (export)			350,700
Turnover (local)		120,300	
Other operating income		3,800	
Gross revenue		474,800	

Deduct:

Mining cost	170,200	
Salaries and wages	33,640	
Transportation expenses	2,500	
Finance costs	1,260	
Legal and professional fees	6,700	
Depreciation	25,200	
Donations and subscriptions	3,100	
Allowance for doubtful debts	14,150	
Repairs and maintenance	5,630	
Other operating expenses	13,400	275,780
Net profit		199,020

The following additional information was provided:

(i) Both the mining cost and transportation cost have been established to be direct costs.

(ii) Included in other operating income was ₦1,620,000 dividend received (net) from shares acquired from a Nigerian listed company.

(iii) Legal and professional fees:

		₦'000
Auditors' remuneration	2,500	
Legal- reacquisition of mining lease	4,200	
6,700		

Donations and subscriptions:

		₦'000
Subscription:		
Miners Association of Nigeria		800
Ogaju Social Klub (the General Manager's club)	300	
Donation-National Library	2,000	
3,100		

(iv) Allowance for doubtful debts:

	₦'000
General provision	6,600
Specific provision	9,900

Bad debts written off recovered		(2,350)
		14,150

(v) Repairs and maintenance

		₦'000
Repairs of mining equipment	1,380	
Maintenance of delivery vehicle	500	
Improvement to industrial building shed	3,750	
5,630		

(vi) Other operating expenses:

		₦'000
Traveling and voyages	3,900	
Power and lightning	5,740	
Stamp duty on increase in share capital	1,250	
Fines for traffic offences	200	
Others (allowable)	2,310	
13,400		

(vii) Capital allowances agreed with the Federal Inland Revenue Service for the relevant assessment year was ₦29,750,000.

Required:

(a) Compute the tax liabilities of the company in line with the provisions of Companies Income Tax Act 2004 (as amended) **(11 Marks)**

(b) State the applicable penalties in accordance with the provisions of the principal Act for the understated offences:

(i) A person who conducts exploration or mines minerals or carries out quarrying operations otherwise than in accordance with the provisions of the Act **(2 Marks)**

(ii) A person who falsely represents that he obtained the grant of an exploration licence, temporary title mining or other mining title and by that representation induces or attempts to induce any person to invest capital in a company or syndicate connected with the company before he actually obtains the grant of the mining title. **(2 Marks)**

(15 Marks)

SOLUTION TO QUESTION 4

(a)

Blaqqy Mining Company Limited

Adjusted Profit

For the year ended December 31, 2022

₦'000 ₦'000

Net profit as per accounts 199,020

Add back:

Depreciation		25,200	
Legal- re-acquisition of mining lease		4,200	
Subscription- Ogaju Social Klub		300	
Allowance for doubtful debts (general provision)		6,600	
Repairs and maintenance- improvement to Industrial building		3,750	
Other operating expenses:			
Stamp duty	1,250		
Fines for traffic offences	200	41,500	
240,520			
Deduct: Non-taxable income			
Dividend received (net)			1,620
Adjusted profit			**238,900**

Blaqqy Mining Company Limited
Computation of tax liabilities
For 2023 Assessment Year

₦'000	₦'000		
Adjusted profit			238,900
Less: Capital allowances:			
For the year	29,750		
Utilised	(29,750)	(29,750)	
Carried forward	NIL		

Total profit	**209,150**
Companies income tax @ 30% of ₦209,150	62,745
Tertiary education tax @ 2.5% of ₦238,900	597.25
Total tax payable	63,342.25

Minimum tax computations

₦'000	
Gross turnover	474,800
Less: Franked investment income (dividends)	1,620
473,180	
Minimum tax @ 0.5% of ₦473,180	2,365.9

Since the companies income tax payable (₦62,745) is greater than the minimum tax (₦2,365.9), the company will pay the companies income tax as well as the tertiary education tax (₦63,342.25).

(b)

(i) **Offence**: A person who conducts exploration or mines minerals or carries out quarrying operations otherwise than in accordance with the provisions of the Act.

Penalty: A mineral title holder who is guilty of the offence is liable to have his licence revoked and on conviction at the first instance, to a fine not less than ₦20 million and imprisonment of not less than 5 years; and

If the offence is a continuing one, whether or not it is a first offence, the person convicted shall, in addition, be liable to a fine of ₦20,000 in respect of each day during which the offence continues.

(ii) **Offence**: A person who falsely represents that he obtained the grant of an exploration licence, temporary title mining or other mining title and by that representation induces or attempts to induce any person to invest capital in a company or syndicate connected with the company before he actually obtains the grant of the mining title.

Penalty: A mineral title holder who is guilty of the offence shall forfeit any claim to the grant of the mining title.

TOTAL 15 MARKS

QUESTION 5

The Industrial Development (Income Tax Relief) Act (Pioneer Act) specifies the circumstances under which the pioneer status granted to a company may be cancelled.

Required:

a) State these circumstances. **(4 marks)**

b) Discuss the taxation of dividend and rental income of real estate investment company (REIC) under the real estate investment scheme (REIS). **(11 Marks**)

Total (15 marks)

SOLUTION TO QUESTION 5

a. 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 indicated 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.

b. The tax treatments of dividend and rental income of REIC earned under a REIS are as follows:

a) Section 19 of CITA (as amended)

- This section relates to dividends as a basis for computing companies' income tax due to no total profits or total profits which are less than the amount of dividend paid. Rental and dividends made by REIC distributed to its shareholders under a REIS are exempt from tax in the hands 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 REIC received the rental or dividend income.

b) 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 hands of the company. Simply put, the gross amount of each of these incomes is treated as non-taxable income because the income is regarded as received on behalf of its shareholders.

- In computing the assessable profit of a company, rental and dividend income will be deducted from the profits if already included in the 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
  - 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 taxable income if the condition stated in Section 23 (1)(5) of the act is not met.

c) 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. Therefore, such payment shall not be regarded as franked investment income unless when such payment is made to a REIC, not under a REIS.

QUESTION 6

A. Lion Nig. Ltd contacted you as a tax expert to educate him and make him know the contents of a tax return as provided by section 55 of the Companies Income Tax Act (CITA) **(5 Marks)**

B. Your friend who is interested in insurance business requested you to explain the content and meaning of gross income for minimum tax purposes for non-life and life insurance businesses based on the Finance Act 2020 and **(5 marks)**

C. Explain investment income for a life insurance company in line with the provisions of section 16 of CITA as amended by the Finance Act 2021? **(5 Marks)**

Total (15 Marks)

SOLUTION TO QUESTION 6

A. Contents of a tax return as provided by section 55 of the Companies Income Tax Act (CITA)

1. The audited accounts
2. Tax and capital allowances computation for the year of assessment.

3. A true and correct statement in writing containing the amount of profit from every source computed.
4. A duly completed self-assessment form as may be prescribed by the Service, from time to time, attested to by a director or secretary of the company.
5. Evidence of payment of the whole or part of the tax due into a bank designated for the collection of the tax.

B. Content and meaning of gross income for minimum tax purposes for non-life and life insurance businesses based on the Finance Act.

1. Under a non-life business, gross premium for the purpose of minimum tax means the total premium written, received, and receivable, excluding unearned premiums and premiums returned to the insured.
2. Under a life business, gross income for the purpose of minimum tax means total income earned by a life business, including all investment income (excluding franked investment income), fees, Commission and income from other assets but excluding premiums received and claims paid by re-insurers**.**

C. Investment income for a life insurance company in line with the provisions of section 16 of CITA as amended by the Finance Act 2021?

Investment income for the purpose of taxation of a life insurance business is income derived from the investment of shareholders' funds.

QUESTION 7

Investment is the acquisition of assets by an individual or firm. It requires the outflow of fund that eventually leads to subsequent benefits inform of returns - dividend, rent etc.

With all its benefits, it is only those that have adequate knowledge of investment points that can actually take advantage.

Required

a. What are the reliefs available to the mining company that are capable of attracting investors, both foreign and local **(10 Marks)**
b. What is the composition of the national stakeholders working group [NSWG] as it affects the mining business in Nigeria. **(5 Marks)**

Total (15 Marks)

SOLUTION TO QUESTION 7

a. Reliefs available to companies in the mining industry are as follows:

i. Tax holiday for an initial period of three (3) years;

ii. Exporters of mineral products may be permitted to retain part of their foreign exchange earning in a domiciliary account for the acquisition of spare parts;
iii. Exemption from custom and import duties in respect of plant, machinery and equipment;
iv. Free transferability of foreign currency through the CBN;
v. Tax free personal remittance quota to expatriates;
vi. Accelerated capital allowance on mining expenditure at 95% initial allowance;
vii. Grant of investment allowance of 10% on qualifying plant and machinery;
viii. Approved infrastructure cost are capitalised;
ix. Royalty payable can be deferred as approved; and
x. Payment out of reserves for mine rehabilitation, reclamation are allowed.

7(b) Composition of NSWG

i. Representatives of extractive industry company
ii. Representative of civil societies
iii. Representation of labour union
iv. Experts in the extractive industries
v. One member from each of the geo-political zones