THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

OCTOBER 2024: PROFESSIONAL EXAMINATION

PTE II: FINANCIAL / TAX ANALYSIS

WEDNESDAY OCTOBER 16, 2024 **EXAM NO..............**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

TIME: 3 HOURS

SHOW ALL WORKINGS.

QUESTION 1

You are working in the office of the Area Tax Controller as a Financial Analyst. Your responsibility is to carry out analysis of the various financial statements submitted by taxpayers to assist Tax Managers in their desk examination of taxpayers' tax returns. In your analysis, you are also to review the chairmen's statement to highlight areas of the statement that may be of interest to the tax authority.

Recently, the annual report of Bosco Nigeria Limited for 2023 was given to you to analyse.

Extract from the statement of the chairman in 2023 annual report is shown below:

"Following the replacement of many of the directors, which took place in early June, 2023, your new board has worked to expand the group's manufacturing facilities and to replace non-current assets that have reached the end of their useful lives. A new line of storage solutions was designed during the second quarter and was put into production at the beginning of September. Sales efforts have been concentrated on increasing our market share in respect of storage products, and in leading the expansion into the south-eastern region of the country. The growth in the business has been financed by a combination of loan capital and the issue of additional shares. The issue of 300,000 new ₦1 shares was fully taken up on February 1, 2023, reflecting, we believe, market confidence in the group's new management.

Dividends have been reduced in 2023 in order to increase profit retention to fund the further growth planned for 2024. The directors believe that the implementation of their medium- to long term strategies will result in increased returns to investors within the next two to three years."

The principal activity of the company is the manufacture and sale of household and office furniture.

Extracts from the annual report of the Bosco Limited are as follows:
Income statement for the year ended December 31, 2023

	2023	2022
	₦'000	₦'000
Revenue	120,366	121,351
Cost of sales	103,024	102,286
Gross Profit	17,342	19,065
Operating Expenses	(11,965)	(12,448)
Profit from Operations	5,377	6,617
Interest Payable	(1,469)	(906)
Profit before tax	3,908	5,711
Income tax expense	(1,125)	(1,594)
Profit for the year	2,783	4,117

Statement of changes in Equity for the year-ended

	Accumulated profit ₦000	Share capital ₦000	Share premium ₦000	Revaluation reserve ₦000	Total 2023 ₦000	Total 2022 ₦000
Opening balance	20,770	2,800	3,000		26,570	21,311
Surplus on revaluation of properties				2,000	2,000	–
Profit for the period	2,783				2,783	3,676
Issue of share capital		300	1,200		1,500	–
Dividends paid	-155			–	-155	-364
Closing Balance	23,398	3,100	4,200	2,000	32,698	24,623

Bosco Nigeria Limited's statement of financial position (extract) as at December 31

	2023	2022
	₦'000	₦'000
Non-current assets:		
Property, plant and equipment	40,643	21,322
Goodwill	1,928	1,928
Trademarks and patents	1,004	1,070
	43,575	24,320
Current assets:		
Inventories	37,108	27,260
Trade receivables	14,922	17,521
Cash		170
	52,030	**44,951**
	95,605	69,271
Equity:		
Share capital (`1 shares)	3,100	2,800
Share premium	4,200	3,000
Revaluation reserve	2,000	-
Accumulated profits	23,398	20,770
	32,698	26,570
Non-current liabilities:		
Interest bearing borrowings	26,700	16,700
Current liabilities:		
Trade and other payables	31,420	24,407
Income tax	1,125	1,594
Short-term borrowings	3,662	
	36,207	26,001
	95,605	69,271

Required

(a) Produce a report for the tax manager that:

i. Analyses and interprets the financial statements of Bosco Nigeria Limited, commenting upon the company's performance and position; and

ii. Discuss the extent to which the chairman's comments about the potential for improved future performance are supported by the financial statements information for the year ended December 31, 2023 and their tax implications. **(25marks)**

(b) Calculate the working capital cycle of Bosco Nigeria Limited. **(5marks)**

(c) One of the limitations of comparing financial ratios for one company with the that of another company or with the industry average is differences in accounting policies.

Required

Discuss the problems of accounting policy as a source of limitation of using financial ratios for comparison among firms in the same industry. **(10 marks)**

(Total marks)

Solution 1

a. Report

To: Tax Manager
From: Financial Analyst
Date: October 16, 2024
Subject: Financial analysis of Bosco Nigeria Limited

Introduction

This report will analyse the financial performance and position of Bosco Nigeria Limited. The financial statements consisting of the income statement and statement of financial position for 2023 and the comparative figures for 2022 will be used for this analysis. The accounting ratio calculated are in Appendix 1. I shall also discuss the extent to which the chairman's comments about the potential for improved future performance are supported by the financial statements information for the year ended December 31, 2023 and their tax implications.

Analysis of the financial statements

From the income statement it can be seen that the performance of Bosco has declined. Revenue is down by 1% from 2022. The gross profit has also declined by 9% from 2022 with profit from operations falling by 18.7%. There was an increase in finance cost of 62% and the profit for the year has reduced to ₦2,783,000 a fall of 32% from 2022.

Bosco Nigeria Limited has invested in property plant and equipment which came into use only in September 2023. They have also increased their inventory levels and reduced their trade receivables.

Long term Borrowings have increased by ₦10 million from 2022 and short-term borrowings of `₦3.662 million in 2023 has obviously increased the liabilities of Bosco Nigeria Limited.

The accounting ratios calculated in the Appendix 1 are now reviewed as follows:

Performance

One of the most important accounting ratios -Return on Capital Employed (ROCE)- has shown a
decline of 40.5% compared with 2022.
The ROCE measures profitability and shows how well the business is utilising its capital to generate profits. Capital employed is debt and equity. Equity is shareholders' funds and debt is long term liabilities. However, when interpreting the ROCE, consideration needs to be given to the age of the assets, any new investments and the timing of the new investments. Accounting policies will also affect this ratio (e.g., revaluation policies).
The return on equity (ROE) also shows a decline of 45.1% in comparison to year 2022. This also shows that the company is not utilising the equity well enough to generate profits.

For Bosco Nigeria Limited, the increased investment in the non - current assets will reduce the ROCE initially and hopefully in the future this should increase as the revenue from the new venture of storage solutions increases.
The operating profit margin has also reduced to 4.5% in 2023 a fall of 18.2% from 2022.
The gross profit margin was at 14.4% in 2023 showing a decrease of 8.3%. This suggests that Bosco is having problems in controlling its costs in relation to its core activities. Perhaps the new venture is incurring large costs which bring the overall results down. Other factors to consider include inventory valuation, overhead allocation, bulk discounts and sales mix. It would be very useful to have the breakdown of Bosco revenue.
Although there has been a decrease in the operating expenses margin, the increase in finance cost due to higher borrowings in 2023 has resulted in a decline of the net profit margin of 32.4% to just 2.3% in 2023.
The decline in profitability and the reduction of dividend payout by Bosco will put investors off. Bosco has also increased the financial risk to its shareholders by increasing borrowings, which means more profits will be eaten up with obligatory interest payments. However, it is important to bear in mind that this is short term view to take as with the heavy investment and expansions into new markets, the profitability may increase significantly.

Position

Bosco has invested heavily in non - current assets during 2023. Increase in property, plant and equipment was over ₦19 million. Despite the heavy investment on non-current assets, the investment is not justified as the company could not utilise the assets to generate good return on assets (ROA). The ratio showed a decline 52.51% from 2022. The impact on the ROCE and additional depreciation needs to be considered when assessing the profitability ratios. The impact on the ROCE and additional depreciation needs to be considered when assessing the profitability ratios.

The short-term liquidity position of the group has declined in 2023. The current ratio was 1.44 compared to 1.73 of 2022. Short term borrowings of nearly ₦4 million puts Bosco in difficult position in relation to any further borrowings in the future. Cash flow problems may occur.

The management of working capital seems to have deteriorated suggesting Bosco was not managing its working capital effectively. Inventory levels have increased, and inventory days is now averaging 132 days, which means Bosco is taking longer to sell its inventory.

Trade receivable days have reduced suggesting either less credit is being offered to customers or customers are paying up early. Perhaps a settlement discount is being offered which may explain the decline in the gross profit margin.

Credit suppliers were not being paid quicker as last year, the average credit period being taken was 111.3 days. Bosco could negotiate better terms with its suppliers to take advantage of this free form of credit.

Overall, the working capital cycle has increased by 4% to 65.4 days. This means the average time taken from purchase of goods to cash received from customers was 65.4 days compared to only 62.9 days in 2022. This also explains the cash flow problem of Bosco.

The gearing ratio has increased to 81.7% a rise of 29.9% from 2022. The interest cover was now 3.66 times compared to 7.30 times. This has increased the financial risk for shareholders who will not be too happy about this.

In conclusion, the position of Bosco is not good with increased liquidity problems and inefficient

management of working capital. The company could face real cash flow problems in the future unless it starts generating more revenues and runs more efficiently.

ii. Chairman's comments

The Chairman states that Bosco has shown growth which is not entirely true. It can be seen from the statement of financial position that Bosco has indeed increased its investment and inventories, but this has not materialised into increased revenues and profitability by the end of 2023.

The successful issue of shares during 2023 suggests that the investors are confident in the organisation and believe that good growth prospects are possible. However, from the financial statements, the income statements show performance which is declining, and the statement of financial position shows ineffective management of working capital with high gearing levels. So, the company really has to perform very well in 2024 and 2025 for the Chairman's comments to become true.

Conclusion

Usually, investments through expansion are a sign that organisations are growing and if the expansion is managed effectively then Bosco should achieve increasing profitability in the future. However, the short-term position needs to be addressed urgently. The working capital management and increase gearing may cause investors to go elsewhere unless profitability increases significantly. And this will reduce the company's tax liability in the future.

Appendix

	2023	**2022**	**% Change**
ROCE (Return on Capital Employed) = Profit before Interest & Taxes (PBIT)/Capital employed X100	**5,377 / (30,428 + 2,270 +,26,700)** **= 9.05%**	**6,617 / (24,623 + 1,947 + 16,700** **= 15.29%**	**-40.81%**
Return on Equity (ROE) = Net Income / Shareholders' Equity × 100	**2783 / 32,698 × 100** **= 8.51%**	**4117 / 26,570 × 100** **= 15.50%**	**-45.1%**
Operating profit margin PBIT / turnover	**5,377/120,366** **= 4.47%**	**6,617/121,351** **= 5.50%**	**-18.73%**
Asset turnover Turnover/Total asset	**120,366/95,605** **= 1.26 times**	**121,351/69,271** **= 1.75 times**	**-28%**
Return on Assets (ROA) = Net Income / Total Assets × 100	**2783 / 52,030 × 100** **= 5.35%**	**4117 / 44,951 × 100** **= 9.16%**	**-41.59%**
Gross profit (GP) margin GP / Turnover x 100	**17,342/120,366** **= 14.41%**	**19,065/121,351** **= 15.71%**	**-8.27%**
Operating expenses (OE) margin OE / Turnover x 100	**11,965/120,366** **= 9.94%**	**12,448/121,351** **= 10.26%**	**-3.12%**

Net profit (NP) margin NP / turnover x 100	**2,783 / 1,20,366 = 2.31%**	**4,117/121,351 = 3.39%**	**-31.86%**
POSITION			
Current ratio Current Assets (CA) Current Liabilities (CL)	**52,030/36,207**	**44,951/26,001**	
	1.44:1	**1.73:1**	**- 16.76%**
Quick ratio (CA - inventory) / CL	**(52,030-37,108)/ 36,207**	**(44,951-27,260)/ 26,001**	
	0.41:1	**0.68:1**	**- 39.71%**
Inventory days [Inventory / COS (Cost of Sales)] x 365 days	**37,108/103,024x365 131.5 days**	**27,260/102,286x365 97.3 days**	**35.15%**
Trade receivables (TR) days TR / sales x 365 days	**14,922/120,366x365**	**17,521/121,351x365**	
	45.2 days	**52.7 days**	**- 14.23%**
Trade payable (TP) days TP / COS x 365 days	**31,420/103,024x365 111.3 days**	**24,407/102,286x365 87.1 days**	**27.78%**
Interest cover PBIT / Interest	**5,377/1,469**	**6,617/906**	
	3.66 times	**7.30 times**	**- 49.86%**
Gearing Debt / Equity	**26,700/ (30,428 + 2,270) 81.65%**	**16,700/(24,623 + 1,947) 62.90%**	**29.91%**

a. Working capital cycle

Inventory days + trade receivable days - trade payable days:

	2023	2022
Inventory days	132	97
Trade receivable days	45	53
	177	150
Trade payable days	111	87
	66 days	**63** days

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

Another important thing the analyst should note when comparing different companies' ratios is that although the companies might have adopted the same accounting policy, their application of the policy might be different.
One of the uses of financial ratios is to compare the financial position and performance of one company with those of similar companies for the same period.
Comparisons between companies might not be reliable, however, when companies use different accounting policies, or have different judgements in applying accounting policies or making accounting estimates. For example:

i. Each company might have different policies about the revaluation of non-current assets.
ii. Each company might use different methods of depreciation.
iii. Each company might have used different rates of depreciation for the same group of non - current assets;
iv. Each company might use different judgements in estimating the expected profitability on incomplete construction contracts.
v. Each company might use different judgements in assessing whether a liability should be treated as a provision or a contingent liability.
vi. Companies within the same industry may have different business models, strategies or customer bases, which can distort ratio comparisons even if they operate in the same.
vii. Financial ratios may reflect different periods. For example, a company may report quarterly while the other reports annually, the ratios might not be directly comparable.

viii. Comparing ratios across companies in different economic condition e.g., one in its boom period and another in recession. This will give misleading assessment of performance.

EXAMINER'S REPORT:

The question tests candidates' knowledge of financial statement analyses and their interpretation. Being a compulsory question, all candidates attempted the question and performance was very woeful. Only about 20% understood how a report should be presented and the need to properly address the report. Over 40% could not interprete the results obtained in the ratios calculation. More than 70% of the candidates made no reference to the Chairman's statement. Performance here was generally disappointing.

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

QUESTION 2

In accordance with IASB Conceptual Framework, discuss the following:

(a) Conditions that make recognition of liability, acceptable. **(9 Marks)**

(b) The situations that can give rise to liability distortion. **(6 Marks)**

(Total 15 Marks)

SOLUTION 2

(a) RECOGNITION OF LIABILITY

According to IASB conceptual framework, a liability is "a present obligation of the entity to transfer an economic resource as a result of past events". For a liability to exist, three criteria must all be satisfied:

(i) The entity has an obligation;
(ii) The obligation is to transfer an economic resource; and
(iii) The obligation is a present obligation that exists as a result of past events.

Obligation

An obligation is a duty or responsibility that an entity has no practical ability to avoid. An obligation is always owed to another party (or parties) but it is not necessary to know the identity of the party (or parties) to whom the obligation is owed. Obligations might be established by contract or other action of law or they might be constructive. **A constructive**

obligation arises from an entity's customary practices, published policies or specific statements when the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements.

Transfer of economic resource

An obligation must have the potential to require the entity to transfer an economic resource to another party (or parties). An obligation can meet the definition of a liability even if the probability of a transfer of an economic resource is low. However, low probability might affect decisions about what information to provide about the liability and how to provide that information, including decisions about whether the liability is recognised and how it is measured. Present obligation as a result of past events.

A liability is an obligation that already exists. An obligation may be legally enforceable as a result of a binding contract or a statutory requirement, such as a legal obligation to pay a supplier for goods purchased. Obligations may also arise from normal business practice, or a desire to maintain good customer relations or the desire to act in a fair way. For example, an entity might undertake to rectify faulty goods for customers, even if these are now outside their warranty period. This undertaking creates an obligation, even though it is not legally enforceable by the customers of the entity.

Past transactions or events

A liability arises out of a past transaction or event. A present obligation exists as a result of past events only if:

(i) The entity has already obtained economic benefits or taken an action; and
(ii) As a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. For example, a trade payable arises out of the past purchase of goods or services, and an obligation to repay a bank loan arises out of past borrowing.

Recognition Criteria of Liabilities

If the entity financial statements are prepared according to IFRS, then those liabilities should meet the recognition criteria of liabilities in the conceptual framework.
Liabilities are classified into two main headings: current liabilities and non-current liabilities.
As per the definition above, the entity could recognise the liabilities in statement of financial position only if:

(i) The liabilities result from past event or transaction;
(ii) The entity has a legal obligation on those transactions or event; and
(iii) There will be economic outflow from an entity when they are settled.

That means the entity could not recognise the liabilities in the statement of financial position just because they have the future obligation and economic outflow when they are settled. These liabilities need to be as a result of past transactions.

Summary of Recognition criteria:

The following are the recognition criteria of liabilities from the conceptual framework: Statement of financial position when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses.

(b) LIABILITY DISTORTION

Distortions in liabilities generally arise because there is ambiguity about whether an obligation has really been incurred or the obligation can be measured. Can the obligation be measured? In most of the cases it is very clear but for example if a company is responsible for an environmental clean-up clearly has incurred an obligation, but the amount is highly uncertain. And post-employment benefits for employees are very uncertain as well. Of course, there are accounting rules but as mentioned before, accounting rules are imperfect. The most common forms of liability understatements arise when the following conditions exist:

(i) Unearned revenues are understated through aggressive revenue recognition;
(ii) Provisions are understated;
(iii) Loans from discounted receivables are off-balance sheet;
(iv) Non-current liabilities for leases are off balance sheet; and
(v) Post-employment obligations, such as pension obligations, are not fully recorded.

EXAMINER'S REPORT:

This is a very straight forward question on the IASB Conceptual Framework on what qualifies for liability and what may give rise to distortion.

Most candidates attempted the question and were able to navigate their way through the question especially the (b) part on situations that may give rise to liability distortions.

The commonest pitfall of the candidates was their inability to properly identify criteria for liability recognition.

Candidates are advised to ensure adequate coverage at the syllabus when preparing for future examination.

QUESTION 3

Organisation must plan and manage their affairs for optimum performance. Part of the issues to be managed and planned by every organisation is their tax issues. An organisation must manage and plan these tax issues for optimisation of tax exposure.

Required

(a) Differentiate between tax planning and tax management. **(12 marks)**

(b) Discuss the objective of effective tax planning. **(3 marks)**

Solution 3

Tax planning is a logical analysis of a financial situation or plan from a tax perspective, to align financial goals with tax efficiency planning. Tax planning can also be viewed as all the exercise undertaken to minimise tax liability through the best use of all available allowances, deductions, exclusions, exemptions etc., to reduce income and/or capital gains taxes. It is handling tax proactively and not reactively. Understanding the impact taxes will have on the corporate financial well – being is essential. We must remember that taxes are the single largest recurring expenses that individuals and corporate organisations must have throughout their lifetime.

Tax planning affects different aspects of financial management, including the timing of both income and purchases and other expenditures, selection of investment types of retirement plans, as well as filling status and common deduction. It is an arrangement of business or financial dealings in such a way that complete tax benefit can be availed by legitimate means.

Tax management

Tax management on the other hand is the management of finance for the purpose of paying the minimum tax payable. Tax management deals with the filing of various tax returns on time, compliance with the appropriate provisions of laws and making timely payment of taxes so as to avoid payment of penalties and interest. It also includes compiling and preserving data and supporting documents evidencing transactions, claims, etc. Furthermore, tax management deals with responding to notices received from tax authorities, within the appropriate time limit.

Income tax management provides the following differences between tax planning and tax management:

Tax Planning	**Tax Management**
The objective of tax planning is to minimise the tax liability within the provision of income tax law and its allied rules.	The objective of tax management is to comply with tax laws.
Tax planning also includes tax management.	Tax management deals with filling on time, and accurately, getting the accounts audited, deducting tax at source, etc
Tax planning relates to future.	Tax management relates to past, present, future. Past – assessment proceedings, appeals, revisions etc. Present – filling of returns, payment of advance tax etc. Future – to take corrective action
Tax planning helps in minimising tax in short – term and long term.	Tax management helps in avoiding payment of interest, penalty prosecution etc.
Tax Planning is optional.	Tax management is essential for every taxpayer

b. Objective of tax planning

It aims to discover how to accomplish all of the other elements of a financial plan in the most tax – efficient manner possible. Tax planning thus allows the other elements of a financial plan to interact more effectively by minimising tax liability. The objective of corporate tax planning is to minimise corporate or personal tax exposure and it forms an integral part of corporate financial planning activities.

Taking control of your taxes and saving tax Naira is what tax planning is all about.

EXAMINER'S REPORT:

Another straight forward question on tax planning and tax management. Candidates were expected to highlight the differences between the two and discuss the objective of tax planning in the (b) part.

The question was well understood by the candidates though only a few could actually marshall their points in the (b) part. Performance was above average as most of the candidates that attempted the question scored above average marks.

QUESTION 4

Analysis of an organisation's financial statements by an analyst could be an accounting analysis or a financial statement analysis. Both are required to determine the organisation's performance, position and future prospect.

Required

a. Differentiate between accounting analysis and financial statements analysis. **(8marks)**
b. Discuss the steps involved in accounting analysis. **(7marks)**

Solution 4

The purpose of accounting analysis is to assess the degree to which the firm's accounting reflects the underlying business reality. An analyst will be required to identify any accounting distortions and evaluate their impact on profits and the sustainability of profits. When these accounting distortions have been identified, the analyst will adjust the entity's financial statements to remove the distortions.

The purpose of accounting analysis is to evaluate the degree to which the firm's accounting captures its underlying business reality. The basic issue in carrying out accounting analysis is the consideration of whether the accounting numbers match the firm's business reality.

To carry out a quality accounting analysis, the analyst must understand the:

(i) Business;

(ii) activities of the business;

(iii) accounting policy;

(iv) Business areas where accounting quality is most needed; and

(v) Situations in which management are particularly tempted to manipulate**.**

Financial analysis includes the experienced based process of interpreting and translating the past figures into current and future suggestions, actions or activities to achieve the organisation's desired goals. Financial analysis focuses on the financial performance, fund management, cash flow, leverage, equity, loan etc. The purpose of financial statements analysis is to evaluate the entity's performance, position and future prospects.

To properly understand the difference between accounting and financial analyses, one must understand the difference between accounting and finance. Accounting is more focused on the past while finance is more focused on the future. Accounting is a system for the delivery of financial information. The purpose of accounting analysis is to ensure that the entity's accounting reflects the business reality of the entity and that it complies with relevant accounting standards, while eliminating any management bias.

On the other hand, the purpose of financial statements analysis is to analyse and interpret the entity's accounting figures so as to determine its performance, position and its future prospects. Financial statements analysis aims at providing information about the entity's financial state to its management, shareholders and prospective shareholders or investors for decision making. Because financial analysis deals with the future, it must deal with risk and uncertainty, anticipating, evaluating, and providing information on how to manage the identified risks and uncertainties in the financial statements.

b. **Steps in performing accounting analysis**

The following are the steps necessary to carry out an effective and efficient accounting analysis:

- Identify the entity's key accounting policies: Accounting policies have effect on figures presented in a financial statement. The way each organisation treats issue like material, depreciation, capitalisation of some expenses contribute to variation in profit to be reported in a financial statement. In carrying out accounting analysis, some of these issues would be looked into to ensure that the accounting policies are still within the normal acceptable for financial reporting;
- Identify and evaluate the policies and estimates the entity uses to measure critical business factors and key risks. It is very pertinent in carrying out accounting analysis to identify and evaluate the policies as well as estimates an organisation is using to measure critical business factors and risk. Such evaluation will inform the analyst on how these policies effect the organisation;

- Assess the accounting flexibility used by the entity. Financial reporting provides that the organisation can be flexible in the preparation of their financial statements as long as it is within the normal accounting practices. In performing accounting analysis, this understanding of flexibility and resulting information contents are very necessary;
- Evaluate the accounting strategy. This is necessary because if managers have accounting flexibility, they can use it either to communicate their firm's economic situation or to hide true performance;
- Evaluate how the firms accounting policies compare to that of the industry in which the organisation operates. In some industry they practice uniform costing and accounting system. In performing accounting analysis, how much a firm has conformed with the industry practice should be assessed;
- Evaluate the quality of disclosure. This also requires determining the adequacy of such disclosure. It should be determined that all necessary disclosures are made in the financial statements; and
- Identify potential red flags (accounting distortions). This is necessary because all these distortions must be corrected when performing accounting analysis.

EXAMINER'S REPORT:

The question tests the candidates' understanding of the difference between accounting analysis and financial statements analysis, including steps involved in carrying out accounting analysis.

About 40% of the candidates attempted the question and their performance was very poor.

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

Candidates are enjoined to ensure complete coverage of the syllabus when preparing for future examination.

QUESTION 5

Sole Trader, Partnership and Limited Liability Companies are three main types of business entity.

Required
(a) Compare their tax and other related differences of the various business entity.
(10 marks)

(b) Explain the aims which make countries agree to Tax Treaties with each other. **(5 marks)**
(15 marks)

SOLUTION 5
(a) The table below shows comparisons of three main types of business entity in relation to tax and other issues.

Business Entity	Pros	Cons
Sole Proprietorship	Easy to set up and enjoy start up benefits.	No personal Limited liability protection
	Businesses are not taxed.	Profit of the business are taxed in the hand of owners
	It enjoyed both current and carry forward Loss Relief	
	No double taxation.	Cannot raise fund from the capital market.
	Tax rate is low or since it is assessed on personal income basis with maximum rate of 24%.	Income reported on personal income tax return.
Partnership	No double taxation	No personal limited protection (unless a limited partner in a limited partnership).
	All income is taxed proportionately to each of the partners who report it on their personal tax returns.	
	Tax rate as in sole proprietorship	
Limited Liability Company (Private and Public)	Personal Limited Liability of members	Double taxation since profit is taxed at the company level and dividends to shareholder is subject to WHT at 10%.
	Companies with turnover less than N25 million enjoy 0%	

	Companies Income Tax and Education Tax (Finance Act 2020)	
	Have a better access to fund from money market.	Company Income Tax and Education tax are targeted at the same source, that is, company's profit.
	It enjoys only carry forward loss relief	It does not enjoy current year loss relief
	Can raise capital from the capital market, if it is a public company.	

(b) Tax Treaties with other countries:

This is aimed at:

i. Eliminating double taxation through the granting of credit for tax paid by a Nigerian company in the other country, etc.;
ii. The protection of tax incentives legislations of the government which would otherwise be nullified by the tax measures of the other country;
iii. Stable tax regime; and
iv. Concessions of treaty-rules for investment income which are lower than domestic rates and are available to treaty partners only.

EXAMINER'S REPORT:

This question tests candidates' understanding of the tax implications of the three main business associations – Sole Trader, Partnership and Limited Liability, and in the (b) part requires candidates to state the aims of Tax Treaties between countries.

Candidates, though appeared to understand the question, discussed outside the tax issue which was merely glossed over and about 50% of them discussed the registration requirements of the business associations. Over 60% gave the (b) part a good attempt.

Candidates are advised that they should make use of the Institute's Pathfinders and Study Pack when preparing for future examination.

QUESTION 6

Business operation is always a circular movement that always end in improvement of the organisation's cash resources.

Required

Discuss business operating cycle and how a company can manage its operating cycle to avoid liquidity problem. **(15marks)**

Solution 6

Operating cycle

A company's operating cycle is the time it takes the company to convert its investment in inventory back into cash. It considers the number of days the company ties down cash it invested in inventory before the cash is realised back after collection of receivables. The operating cycle of a company that manufactures and sell goods comprises of five phases as follows:

- Raw materials are purchased, and turned to work in progress;
- Work in progress turned into finished goods and kept in inventory;
- Goods are sold from inventory to generate revenue which may be on credit, in cash or both;
- Extend credits to its customers which leads to account receivables; and
- Accounts receivable are collected to generate cash.

However, for a company that only buys goods to resell, the first two phases above will not apply, its operating cycle will only involve the last three phases. The same thing applies to a company that only renders services to its customers.

Operating cycle is normally measured by number of days in each of the phases listed above. For example:

The number of days fund is tied up in inventory is measured by:

- The total fund invested on inventory; and
- The average days of cost of goods sold.

Usually, the fund tied up in inventory is represented by the closing inventory shown on the company's financial position at the end of the financial year, however, some people felt that the average fund invested in both the cost of inventory at the beginning and at the end of the financial year is more representative of funds tied up in inventory during the year. Both methods of calculating the number of days funds are tied up in inventory is, however, acceptable. The average days cost of goods sold is the cost of goods sold on average, daily in the year which is measured by dividing the cost of goods sold by the number of days in the year. The number of days in the year is normally taken to be 365 days unless otherwise stated.

A company can manage its operating cycle to ease liquidity by implementing the following:

- Introduce just in time production system, where raw materials inventory is not in existence, as they are supplied as at when needed in production and there are no work in progress;
- Reduce the level of finished goods inventory by manufacturing to customers' orders; and
- Reduce the credit days given to its customers by offering discount for timely payments.

EXAMINER'S REPORT:

The question tests candidates' understanding of business operating cycle and how its' proper operation can aid in alleviating firm's liquidity problems.

Over 70% of the candidates who attempted the question had a good understanding of the question but could not relate how the cycle aids in alleviating or reducing a firm's liquidity problems. While about 20% of candidates were completely at loss on business operating cycle and discussed business gearing and cashflow statements.

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

QUESTION 7

Argob Nigeria Limited is a company manufacturing household items that are distributed throughout the six geopolitical zones in Nigeria. The company has its sales branches in each of the 36 states of Nigeria, its manufacturing plant in Agbara, Ogun State with its corporate head office in the Capital Territory.

Lately, the company has been having problem with the tax authorities in many states and also with the Federal Inland Revenue Service. The CFO of Argob has complained of receiving Administrative Demand Notice from these revenue authorities for what they termed tax evasion tendencies of the company, whereas the CFO is of the opinion that these are tax avoidance strategies of the company, to optimise its overall tax exposure. He has contacted you as a tax professional to advise the company on these tax issues.

Required

a. Differentiate between tax evasion and tax avoidance, giving relevant examples**.** **(10marks)**
b. List 10 ways tax may be evaded by companies. **(5marks)**

Solution 7

a. Distinction between tax avoidance and tax evasion

Tax avoidance is defined as the arrangement of a taxpayer's financial affairs in a form that would make him pay the least possible amount of tax. It involves using the tax shelters in the tax laws, and avoiding tax traps in the tax laws, so as to pay less tax than he or she would otherwise pay.

The principle behind tax avoidance strategies by companies and individuals is not an issue of morality. Although it has been established that individuals have a moral obligation to contribute to the society of which they are a part and from which they derive benefits, but it is also a fact that the obligation to pay tax is imposed by law and that there is no obligation on any taxpayer to pay more tax than the law requires.

A major tax avoidance strategy is to carry out a critical review of the tax laws, take note of the loopholes in the law and then implement schemes to exploit the loopholes discovered in the tax laws to minimise tax liability.

Tax avoidance is permissible in law as it does not always involve the contravention of any law – it is done within the limits of the law.

Tax evasion is a deliberate and willful practice whereby a person uses an illegal means to reduce his tax liability or avoid paying tax entirely. It is an intentional behaviour designed to reduce a person's tax liability through non – disclosure or misrepresentation. Tax evasion is a serious criminal offence that may result in prosecution and substantial penalties. The Canadian Department of National Revenue defines tax evasion as, "the commission or omission of an act knowingly with intent to deceive so that tax reported by the taxpayer is less than the tax payable under the law, or a conspiracy to commit such an offence. This may be accomplished by deliberate omission of revenue, the fraudulent claiming of expenses or allowances, and the deliberate misrepresentation, concealment or withholding of material facts".

Therefore, the essence for tax evasion is an intentional deceit, misrepresentation or non – disclosure.

Both tax avoidance and tax evasion aim at reducing the taxpayers tax liability. However, one is lawful while the other is unlawful. The tax authority frowns at tax evasion, as it is seen as a criminal way of reducing tax liability while they mostly allow tax avoidance practices that are within the ambit of the law.

The distinction between tax avoidance and tax evasion, therefore, is that tax avoidance involves lawful actions or transactions effected by taxpayers that, if effective for tax purposes, reduce the taxpayer's tax liability. While tax evasion involves using an unlawful means to reduce one's tax liability. The key factor in making the distinction between tax avoidance and tax evasion is that tax evasion involves fraud, deceit, misrepresentation or non- disclosure, whereas tax avoidance does not. If a taxpayer fully discloses all of the material facts, it is inconceivable that the taxpayer could be convicted of tax evasion.

b. Tax may be evaded through different methods such as:

- Refusing to register with the relevant tax authority;
- Failure to render a return, statement and information or keep records required;
- Making incorrect returns by omitting or understating any income liable to tax;
- Overstating expenses so as to reduce taxable profit or income;
- Entering into artificial transactions;
- Outright Refusal or neglect to pay tax;
- Omission to state income received from landed properties;
- Omission to state income received in or brought into Nigeria from source outside Nigeria;
- False claim of contributions to a pension scheme;
- Reduction of quantum of tax liabilities through fraudulent tax returns;
- Under declaration or dishonest declaration of income, earnings or assets; and
- Giving any incorrect information in relation to any matter or thing affecting the liability to tax of any taxable person.

EXAMINER'S REPORT:

This question is on tax avoidance and evasion and it provided a soft landing for the candidates. Over 80% of them understood both the (a) and (b) parts very well and their performance was very good. However, about 20% of them confused avoidance with evasion.

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

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

OCTOBER 2024: PROFESSIONAL EXAMINATION

PTE II: INTERNATIONAL TAXATION

TUESDAY 15TH OCTOBER, 2024 **EXAM NO………**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

TIME: 3 HOURS.

SHOW ALL WORKINGS

QUESTION 1

On July 10, 2000, the CEO of Erinjinyan Limited, attended a seminar on management of foreign currency. One of the papers presented dwelt richly on earnings and how best to go about it for corporate entities. According to the presenter, "if you are able to do what you are doing to make huge turnover and profit in your country in another country, you will be making super contribution margin. Such organisation will also be regarded as important for bringing needed foreign currency into the country of origin." Mr Olorunjo, nursed the thoughts from this seminar to maturity in year 2005 when he was able to convince other shareholders to have a branch in Ghana.

Since its establishment, the branch has been doing well. For ease of consolidation of financial statements of the group, the foreign branch also prepares accounts to December 31, annually.

Extracts from the financial statements of the group for year ended December 31, 2020, are as stated below:

DETAILS	₦'000
Income from operations in Nigeria	125,000
Income from operations in Ghana	75,000
Group overheads	110,000
Other information:	₦
i) The overheads include:	
Depreciation (Nigeria):	120,000
Depreciation - Ghana operations	49,000

Allowance for doubtful debts - Nigeria	267,000
Sales tax (Nigeria)	220,000
Preliminary expenses written off (Nigeria)	200,000
VAT paid on property, plant and equipment (Nigeria)	220,000

ii) Tax paid in Ghana was ₦2,600,000.

iii) The bad debts control account revealed the following entries:

	₦		₦
Bad debt w/o	140,000	General Prov. b/f	30,000
Loans to customer w/o	145,000	Specific Prov. b/f	36,000
General prov. c/f	70,000	Bad debt recovered	118,000
Specific prov. c/f	96,000	Charged to O/H	267,000
	451,000		451,000
		General prov. b/f	70,000
		Specific prov. b/f	96,000

iv) The net profit from Ghana business was ₦15,050,000.

v) Capital allowance paid in Ghana certified by the Nigerian Tax Authority was ₦4,750,000

vi) Qualifying capital expenditure (Nigeria):
Tax written down values as at January 1, 2020:
Machinery: ₦880,000
Furniture: ₦990,000

The furniture was disposed on 31/08/2020 for ₦600,000. A new set of furniture was acquired on the same date for ₦1,000,000 only
The machinery has two (2) more years for the claim of capital allowance.

vii) Note: This company is a Nigerian company.

Required:

(a) Explain the three main objectives underlying a country's incorporation of international tax rules into its tax legislations.
[6 Marks]

(b) Ascertain the taxes payable by the company for the relevant assessment year. [24 marks]

(c) Advise the management of Erinjiyan Limited on the double taxation relief available to the company.
[10 marks]

[Total 40 marks]

SOLUTION TO QUESTION 1

a] The three main objectives underlying a country's incorporation of international tax rules into its tax legislation include:

i) National wealth maximisation

- National wealth maximisation means that a country tries to ensure that it gets its fair share of revenue from cross-border transactions to enhance the well-being of its citizens, and in doing so, maintains its domestic tax base.
- The way international transactions are taxed ultimately determines the allocation of the tax imposed between the two or more states involved in the international transaction(s).
- National wealth maximisation requires that a country maximises its share of tax imposition. National wealth maximisation encompasses both the private return that is obtained by an investor that invests abroad and the tax revenue that the investor's government collects from that investor in respect of the foreign investment.

ii) Tax equity or fairness

- Tax equity or fairness refers to imposing equal taxes on taxpayers with equal income or equal ability to pay without reference to the source or type of income and the legal structures through which the income is derived.

- A country has the option of imposing its notion of fairness on its residents (by taxing all of their worldwide income), but it cannot impose the same standard of fairness on non-residents because it does not have the ability to tax income of non-residents that arises outside the country.

iii) Economic efficiency

- Economic efficiency is concerned with developing the competitiveness of a country's domestic economy, ideally by ensuring that taxation does not drive a wedge into optimal investment decision-making.

- Investors will make investment decisions that generate the maximum return to them. Therefore, the tax imposed on the pre-tax return from an investment should not, largely, distort the after-tax return on the investment and thereby create a bias in the investor's decision-making process.

- For an unbiased outcome to be achieved, the imposition of tax should be neutral as between the array of different domestic and foreign investment options, which faces an investor.

- A country seeks to avoid tax measures that undermine its competitive position in the world economy, i.e., it will want to avoid adopting international tax rules that draw capital and skills out of the country or discourage the importation of capital and skills.

- A government that wishes to adopt sound international tax policies will try to ensure that taxpayers compliance and the tax authority's administrative costs are minimised when the policy becomes operational.

b] Computation of taxes payable

Details	Nigeria	Ghana	Total
	₦	₦	₦
Net profit **(Wi)**	74,950,000	15,050,000	90,000,000
Add:			
Depreciation	120,000	49,000	169,000
Bad debt adj. **(Wiv)**	185,000	-	185,000
Sales tax	220.000	-	220,000
Preliminary expenses	200,000	-	200,000
VAT on PPE	220,000	-	220,000
Adj. profit	75,895,000	15,099,000	90,994,000
Less C/A **(Wii)**	840,000	4,750,000	5,590,000
Less B/A**(Wiii)**	390,000	-	390,000
Total profit	74,665,000	10,349,000	85,014,000
Tax @ 30%			25,504,200
Less double tax relief			1,552,350

Companies income tax payable	23,951,850
Education tax payable at 2% of ₦90,994,000	1,819,880

WORKINGS

i] **Determination of adjusted profit for each unit**

	₦
Income from Nigeria	125,000,000
Income from Ghana	75,000,000
Gross income	200,000,000
Deduct group overheads	110,000,000
Group net profit	90,000,000
Net profit attributable to Ghana	15,050,000
Net profit attributable to Nigeria	74,950,000

ii] **Computation of capital allowance – Nigeria**

Assets	Machinery	Furniture	Cap. Allow.
	₦	₦	₦
TWDV	880,000	990,000	
Addition	-	1,000,000	
	880,000	1,990,000	
Disposal	-	(990,000)	
	880,000	1,000,000	
I A	-	(250,000)	250,000
A A	(440,000)	(150,000)	590,000
Capital Allow.			
TWDV	440.000	600,000	840,000

iii] **Balancing allowance**

	₦
TWDV of asset disposed	990,000
Sales proceeds	600,000
Balancing allowance	390,000

iv] **Bad debt reconstruction/adjustment account – Nigeria**

	₦
Specific provision b/f	36,000
Bad debt recovered	118,000
Bad debt written off	(140,000)
Specific provision c/f	(96,000)
Amount to be written off	(82,000)

Necessary adjustment:	₦
Amount charged to overhead	267,000
Amount to be written off	(82,000)
Excess amount written off	185,000

The excess amount written off as part of overhead shall be added back to arrive at the adjusted profit for Nigeria business.

c] Letter of Advice

ABCD & Co.
[Firm of Tax Consultants]
Olowojeunjeje Street, Kano, Nigeria

Date: 15 October, 2024
The Managing Director
Erinjinyan Limited
Orodu street, Ajegunle
Lagos State

Dear Sir,

RE: ADVICE ON DOUBLE TAXATION RELIEF

We refer to our discussion in respect of the above subject matter. We wish to comment as follows:

i) <u>Computation of the applicable relief rate</u>

The relief available to a Nigerian company from tax on its foreign income shall be:

- If the commonwealth rate of tax does not exceed one-half of the Nigerian rate of tax, the commonwealth rate of tax applies, and
- In any other case, half of the Nigerian rate applies.

Based on the above, the applicable relief rate is computed thus:

$$\text{Commonwealth rate of tax} = \frac{\text{Tax paid in Ghana}}{\text{Total profit in Ghana}} \times 100\%$$

$$= \frac{₦2,600,000}{₦10,349,000} \times 100\%$$

$$= \underline{\underline{25\%}}$$

½ Nigerian rate of tax (NRT)

Is computed thus 30/2 % = 15%.

The relief is granted at the lower of CNRT and ½ NRT. Therefore, the applicable rate of tax is 15%.

ii) Computation of double taxation on relief available to the company

The double taxation relief available to the company is the total profit in Ghana multiplied by the applicable relief rate, that is, 15%.

Relief is computed at 15% of total profit of the foreign branch.

$\frac{15}{100}$ of ₦10,349,000 = ₦1,552,350

It is pertinent to state that the maximum relief must not exceed the foreign tax paid, that is, ₦2,600,000.

Arising from the above, the double taxation relief is ₦1,552,350, as computed above.

iii) Appreciation

We thank you for the confidence reposed in us. Please do not hesitate to contact us if you need further explanation on any aspect of the report.

Yours faithfully,
For: ABCD & Co.

A. James
Partner

EXAMINER'S REPORT:

The question tests candidates' knowledge of international tax rules, double taxation relief, and taxation of a company with a foreign branch.

This being a compulsory question, almost all the candidates attempted it but the performance was very poor.

Many of the candidates could not explain the main objectives underlying a country's incorporation of international tax rules into its legislations. In the ascertainment of the taxes payable, they were unable to compute the double taxation relief and amount to be written off in respect of bad debts. It is surprising that some candidates are yet to understand how the tax liabilities of a company with a foreign branch are computed.

Candidates are advised to ensure that this important topic in the syllabus is fully understood before sitting for any subsequent examination.

Question 2

Regional integration is a process in which neighbouring States enter into an agreement in order to upgrade cooperation through common institutions and rules.

A trade bloc is basically a free-trade zone, or near-free-trade zone, formed by one or more tax, tariff, and trade agreements between two or more countries.

Required:
Explain the following:

a. Objectives of regional integration (4 marks)
b. The four main types of regional economic integration (4 marks)
c. Benefits of regional economic integration and trade blocs (3 marks)
d. Disadvantages of regional economic integration and trade blocs agreements (4 marks)

(Total 15 marks)

Suggested solution to Question 2

a) The objectives of regional integration include the following:

i. Strengthening of trade integration in the region;
ii. Creation of an appropriate enabling environment for private sector development;
iii. Development of infrastructure programmes in support of economic growth and regional integration;
iv. Development of strong public sector institutions and good governance;
v. Reduction of social exclusion and the development of an inclusive civil society;
vi. Contribution to peace and security in the region;
vii. Building of environment programmes at the regional level; and
viii. Strengthening of the region’s interaction with other regions of the world.

b) The four main types of regional economic integration

i. **Free trade area**
This is the most basic form of economic cooperation. Member countries remove all barriers to trade between themselves but are free to independently determine trade policies with non - member nations.

ii. **Customs union**
This type provides for economic cooperation as in a free-trade zone. Barriers to trade are removed between member countries. The primary difference from the free trade area is that members agree to treat trade with non - member countries in a similar manner. The Economic Community of West African States (ECOWAS) is an example of this.

iii. **Common market**
This type allows for the creation of economically integrated markets between member countries. Trade barriers are removed, as any restrictions on the movement of labour and capital between member countries. Like customs unions, there is a common trade policy for trade with non - member nations. The primary advantage to workers is that they no longer need a visa or work permit to work in another member country of a common market.

iv. **Economic union**
This type is created when countries enter into an economic agreement to remove barriers to trade and adopt common economic policies. An example is the European Union (EU).

c) The benefits derivable from regional economic integration and trade blocs agreements include the following:

i. **Trade creation:** These agreements create more opportunities for countries to trade with one another by removing the barriers to trade and investment. Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries;

ii. **Employment opportunities:** By removing restrictions on labour movement, economic integration can help expand job opportunities;

iii. **Consensus and cooperation**: Member nations may find it easier to agree with smaller numbers of countries. Regional understanding and similarities may also facilitate closer political cooperation; and

iv. **Impetus for private sector planning and investment**: Regional economic integration can serve a useful economic purpose beyond the direct gains from trade liberalisation, by reducing uncertainties and improving credibility and thus making it easier for the private sector to plan and invest.

Indeed, reducing uncertainty may be vital for realising gains from liberalisation.

d) Disadvantages of regional economic integration and trade bloc agreements include:

i. **Trade diversion**: The flip side to trade creation is trade diversion. Member countries may trade more with each other than with non-member nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country;

ii. **Employment shifts and reductions**: Countries may move production to cheaper labour markets in member countries. Similarly, workers may move to gain access to better jobs and wages. Sudden shifts in employment can distort the resources of member countries; and

iii. **Loss of national sovereignty**: With each new round of discussions and agreements within a regional bloc, nations may find that they have to give up more of their political and economic rights.

EXAMINER'S REPORT:

The question tests candidates' knowledge of regional economic integration and trade blocks.

About 95% of the candidates' attempted the question and the performance was good.

Despite the good performance of the candidates, some of them could not explain the disadvantages of regional economic integration and trade bloc agreements.

Candidates are advised to read widely on how African countries are ensuring stronger regional integration to reap the benefits of larger markets and take advantage of economies of scale.

Question 3

There is a general notion that the line between tax evasion and tax avoidance is very thin. Besides, both tax evasion and tax avoidance have negative impact on the government's tax yield. Therefore, tax avoidance scheme instituted by taxpayers are usually scrutinised by the tax authorities in Nigeria.

Required:

a) Differentiate between tax evasion and tax avoidance. (9 marks)
b) Discuss the possible reasons for tax evasion and avoidance in Nigeria. (6 marks)

(Total 15 marks)

Solution to Question 3

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

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

Tax avoidance and tax evasion can be compared as follows:

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

(b) The following are the possible reasons for tax evasion and tax avoidance in Nigeria:

i. **Equity**: A tax system must not only be seen to be fair and equal; the principle of fairness and equity must be entrenched. In the same way that equity before the law is deemed to be right and proper, so must this be under a tax system that intends to get the best out of the citizens. The Nigerian tax system can hardly be said to satisfy the equity criteria;
ii. **Allowances and reliefs:** Another contributory to tax evasion and avoidance is the structure of allowances and reliefs available to individuals. The allowances and relieves are far from being reasonable and will only push the taxpayer to file returns that will limit his tax exposure;
iii. **Tax Authorities:** The Revenue officials are not well motivated and equipped to aggressively fight tax evasion and avoidance. Most of the Revenue offices are not computerised to the extent that records of taxpayers are still manually maintained;
iv. **Multiple taxes:** This discourages honest taxpayers and the implication is that it encourages taxpayer to put in place all sorts of schemes to limit their tax exposure;
v. **Accelerated Revenue Generation Programme:** The use of tax consultants for collection and enforcement of taxes in some states also encourage both tax evasion and avoidance in varying degrees. This is due to the fact that no matter how hard a taxpayer tries to comply with the provisions of the relevant tax law, the Consultants will always come up with one form of underpayment or the other and this affect the level of information being disclosed to them by the taxpayers;
vi. **Poor governance:** Due to poor governance over the years, the citizens were unable to appreciate why they should continue to pay tax to the government with no benefit derived from the tax paid; and
vii. **Provisions of the tax laws:** There exist several loopholes in the Nigerian tax provisions. The poor drafting of some of these laws allows several manipulations of the statutory provisions in favour of the taxpayer.

EXAMINER'S REPORT:

The question tests candidates' knowledge of differences between tax evasion and tax avoidance, and the possible reasons for evading and avoiding tax in Nigeria.

About 90% of the candidates attempted the question but surprisingly, their performance was poor.

Despite the fact that the question was simple, many candidates could not differentiate between tax evasion and tax avoidance, let alone discuss the possible reasons for tax evasion and avoidance in Nigeria.

Candidates are advised to read the Institutes' Study Pack, Pathfinders and relevant texts when preparing for subsequent examinations.

Question 4

Your firm of Tax Practitioners has instituted in-house bi-weekly technical session to enhance the technical competence of tax professionals in your firm. The presentations to be made during the technical session are usually drafted by the facilitator for the senior officers' review to guarantee the qualities of the presentation. As a manager in your firm, you have been selected to make presentation during the upcoming technical session.

Required:

Draft a memo to your Senior Manager on the following issues, to be presented by you during the upcoming technical session:

(a) Dutchee Inc is a corporate entity based in The Netherlands. The company has a representative office in Nigeria strictly for the display of its products. Due to change in management of Dutchee Inc, the new Group Chief Executive Officer was of the view that considering the high population of Nigeria, he sees no reason why sales should not be conducted in Nigeria office and he immediately directed that all facilities and personnel should be put in place to actualise his directives. Subsequently, sales were regularly conducted from the inventories of products held for the display.

Discuss the implications of this decision. (5 marks)

(b) Implications of Finance Act, 2019 on Thin Capitalisation (5 marks)

(c) FIVE fundamental principles of ethics required from every professional. (5 marks)

(Total 15 marks)

Solutions to Question 4

Tax Practitioners Consulting
Internal Memo

Date: 15 October, 2024
To: Senior Manager – International Tax Unit
From: Tax Manager – International Tax Unit
Subject: Presentation of Upcoming Technical Session

In view of the upcoming technical session to be presented by me, please find below the draft of my presentation for your review in line with the existing procedures.

(a) Tax implication of Dutchee Inc products display office that was later turned to sales office

In line with the provisions of the Nigerian tax laws, a branch of a non-resident company in Nigeria will not be liable to tax in Nigeria if :

i. the branch is used solely for storage or display of goods or merchandise; and
ii. the branch is used solely for the collection of information.

With the activity of the representative office of Dutchee Inc restricted solely to the display of the company's products in Nigeria, the branch office will retain the status of a representative office and will not be held liable to Nigerian tax.

However, with the sales activity of the branch office as directed by the new Group Chief Executive Officer, the status of the branch has changed to a sales' outlet and this will turn it into Dutchee Inc fixed base in Nigeria. Therefore, the Nigeria branch office becomes taxable on profits arising from the sales.

(b) Implications of Finance Act, 2019 on Thin Capitalisation

A company is said to be thinly capitalised when its capital is made up of a much greater proportion of debt than equity, that is, its gearing, or leverage, is too high.

Thin capitalisation can feature as transfer pricing or as tax avoidance depending on the intention of the investing entity. In Nigeria, the problems of thin capitalisation usually arise between the Nigerian subsidiary and the head office or between a multinational enterprise group and an associated recipient in Nigeria.

Prior to the Finance Act, 2019 there were no thin capitalisation rules in Nigeria.

However, in practice, Federal Inland Revenue Service (FIRS) sometimes seeks to disallow interest deductions considered excessive and in most cases the excess are arbitrarily determined. The Finance Act, 2019 introduced a specific benchmark of thirty percent (30%) of earnings before interest, taxes, depreciation and amortisation (EBITDA) as the limit for interest deduction on loans by a foreign 'connected person'. Any excess interest expense can only be carried forward for 5 subsequent years. The Finance Act, 2019 exempts Nigerian subsidiaries of foreign companies engaged in banking and insurance from this rule.

The benchmark introduced by the Finance Act, 2019, is consistent with the recommendation of the Organisation for Economic Cooperation and Development (OECD) through its Article 4 on base erosion and profit shifting (BEPS) project.

(c) Fundamental principles of ethics required from every professional are;

The five fundamental principles of ethics as specified by the International Ethics for Professionals are:

(i) Integrity

A professional shall comply with the principle of integrity, which requires a professional to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness. A professional shall not knowingly be associated with reports, returns, communications or other information where the professional believes that the information contains materially false or misleading statement.

(ii) Objectivity

A professional shall comply with the principle of objectivity, which requires a professional not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others. A professional shall not undertake a professional activity if a circumstance or relationship unduly influences the professional's judgment regarding that activity.

(iii) Professional competence and due care

A professional shall comply with the principle of professional competence and due care, which requires a professional to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation and act diligently and in accordance with applicable technical and professional standards.

(iv) Confidentiality

A professional shall comply with the principle of confidentiality, which requires a professional to respect the confidentiality of information acquired as a result of professional and business relationships.

The principle of confidentiality imposes an obligation on all professional to refrain from:

- Disclosing outside the firm or employing organisation's confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
- Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.

(v) Professional behaviour

A professional shall comply with the principle of professional behaviour, which requires a professional to comply with relevant laws and regulations and avoid any conduct that the professional knows or should know might discredit the profession. A professional shall not knowingly engage in any business, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

I await further directives and guidance from you on the subject.

Kind regards.

Pascal Omoreige

EXAMINER'S REPORT:

The question tests candidates' knowledge of the tax implications of a fixed base, implications of the Finance Act 2019 on Thin Capitalisation, and the five fundamental principles of ethics required from every professional.

About 50% of the candidates attempted the question and their performance was poor.

Many candidates could not explain the tax implications of a fixed base and the benchmark introduced by the Finance Act, 2019, in relation to Thin Capitalisation.

Candidates are advised to read the relevant texts, Institute's Study Pack and Pathfinders in their preparations for future examination.

Question 5

For a non-resident company of a country to be liable to tax in respect of the income from trade operations or profits generated from another country, it must have sufficient presence in that other country. It is not every income that a non-resident company generates from another country that is liable to tax in that other country. Also, the interpretation of tax treaties bears certain similarities to that of domestic tax legislation.

Required:

a. Discuss the taxation of dividend and interest as investment income as they relate to cross border transactions.
[10 marks]

b. Differentiate between tax treaties and domestic tax legislations.
[5marks]

(Total 15 marks)

SUGGESTED SOLUTION TO QUESTION 5

a] The following shall be applicable to taxation of investment income as they relate to cross border transactions.

(i) **Dividends**

- Dividends derived from a company which is a resident of a contracting state by a resident of the other contracting state may be taxed in that other State.
- Such dividends may also be taxed in the contracting state of which the company paying the dividend is a resident according to the law of that State.
- The term "dividends" means income from shares, where the beneficial owner of the dividends, is a resident of one of the contracting state, has in the other contracting state a permanent establishment, or performs in that other state independent personal services from a fixed base situated therein.
- Where a company which is a resident of a contracting state derives profits or income from the other contracting state, that other state may not impose any tax on the dividends paid by the company.

(ii) **Interest**

- Interest arising in a contracting state and paid to a resident of the other contracting state may be taxed in that other state.

- However, such interest may also be taxed in the contracting state in which it arises, and according to the law of that state.
- Interest arising in a contracting state shall be exempt from tax in that state if it is derived and beneficially owned by the Government of the other contracting state or a local authority.
- Interest shall be deemed to arise in a contracting state when the payer is that state itself a political sub-division, a local authority or a resident of that state.
- Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest paid exceeds, for whatever reason the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the excess part of the payments shall remain taxable.
- The term "interest" means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits.

b] Important differences between tax treaties and domestic tax legislations:

i. Tax treaties are addressed to a broader audience than domestic legislation, namely, to both the governments and taxpayers of each country.
ii. Tax treaties are often not drafted using the same terms as domestic legislation. For example, the United Nations Model Convention uses the term "enterprise," which is not used in the domestic legislation of many countries.
iii. Tax treaties are primarily relieving in nature, as discussed and they do not impose tax.
iv. The United Nations and OECD Model Conventions and Commentaries thereon have no counterparts in the context of domestic tax legislation.

EXAMINER'S REPORT:

The question tests candidates' knowledge of the taxation of dividend and interest as investment income in relation to cross border transactions. Additionally, they are required to differentiate between tax treaties and domestic tax legislations.

About 80% of the candidates attempted the question but their performance was poor.

Many of the candidates defined dividend and interest instead of discussing taxation of same. In addition, they could not differentiate between tax treaties and domestic tax regulations.

Candidates are advised to adequately cover the syllabus when preparing for subsequent examination.

Question 6

The relevance and importance of transfer pricing cannot be overemphasised. It is a very important tool to deal with international tax avoidance and evasion techniques of multinational corporations.

Required:

a) Explain the features of a transfer pricing policy. [3 marks]

b) Explain the contents of Transfer Pricing Declaration form to be submitted to the Federal Inland Revenue Service (FIRS). [6 marks]

c) State the contents of Transfer Pricing Disclosure form to be submitted to FIRS. [6 marks]

(Total 15 marks)

SUGGESTED SOLUTION TO QUESTION 6

(a) Features of a Transfer Pricing Policy include:

i. Prospective in nature;
ii. Typically, not updated unless there are significant changes in business;
iii. Provides a future view of likely intercompany transactions; and
iv. Provides guidance on pricing of the transactions and methodology.

b] Contents of Transfer Pricing Declaration form to be submitted to FIRS

The Federal Inland Revenue Service expect all taxpayers to develop appropriate transfer pricing policy and provide relevant information to be stated in transfer pricing declaration form that contain the following:

i. Particulars of reporting company or entity;
ii. Particulars of immediate parent company;
iii. Particulars of directors of reporting company;
iv. Particulars of major shareholders of reporting company and related parties;
v. Ownership, structure of reporting entity and related parties;
vi. Particulars of subsidiaries and other connected persons;
vii. Particulars of external auditors of reporting entity;
viii. Particulars of tax consultant of the reporting entity;
ix. Particulars of company secretary of the reporting entity
x. Particulars of the person making the declaration; and
xi. Contents of declaration

c] Contents of Transfer Pricing Disclosure form to be submitted to FIRS

The Federal Inland Revenue Service expect all taxpayers to develop appropriate transfer pricing policy and provide relevant information to be stated in transfer pricing disclosure form that contain the following:

i. Particulars of reporting company or entity;
ii. Income from controlled transactions;
iii. Costs of controlled transactions;
iv. Summary of controlled transactions with connected persons;
v. Transfer pricing method and documentation;
vi. Basic financial information for reporting entity and the group;
vii. Particulars of the person making the disclosure; and
viii. Declaration.

EXAMINER'S REPORT:

The question tests candidates' knowledge of the features of a transfer pricing policy, and the contents of Transfer Pricing Declaration and Transfer Pricing Disclosure forms which relevant companies should submit to the Federal Inland Revenue Service (FIRS).

About 85% of the candidates attempted the question and their performance was above average.

The common pitfalls of the candidates were their inability to explain the features of a transfer pricing policy and identify the contents of the forms to be submitted to the Federal Inland Revenue Service (FIRS).

Candidates are advised to be abreast of developments and concepts in international tax matters to improve their performance in future examination.

Question 7

The International Tax Department of the Federal Inland Revenue Service recently organised taxpayers' sensitisation programme to update multinational enterprises in Nigeria on the ongoing efforts of the Organization for Economic Co-operation and Development (OECD) on global anti-base erosion model rules popularly referred to as Pillar Two rules.

As part of the programme, an Assistant Director of the service also made presentation on observed base erosion and profit shifting activities of some multinational companies in Nigeria and the proposed compliance requirements going forward.

Many Chief Finance Officers of big multinational enterprises in Nigeria attended this programme. Mr. Chunchin, the Chief Finance Officer of Senith Products Nigeria Limited, having its parent company in China struggled throughout the programme to understand the issues being discussed. Your firm is the Tax Consultants of Senith Products Nigeria Limited. When he got to the office, he narrated his ordeal to your Senior Partner for assistance on proper explanation of the matters discussed at the programme.

Required:

Write a letter to the company's Chief Finance Officer on the following areas:

a. Distinction between base erosion and profit shifting (3 Marks)

b. Techniques of base erosion and profit shifting (4 Marks)

c. Five action initiatives of the Organisation for Economic Cooperation and Development (OECD)against base erosion and profit shifting. (6 Marks)

d. The implications of engaging in base erosion and profit shifting (2 Marks)

(Total 15 Marks)

Solutions to Question 7

Bay and Bay & Co (Tax Consultants)
94, Martins Street, Ikeja, Lagos

15 October, 2024

The Chief Finance Officer
Zenith Products Nigeria Limited
25, Shehu Yaradua Street
Odogunya, Ikorodu, Lagos

Attention: Mr. Chunchin

Dear sir,

Re: Base Erosion and Profit Shifting (BEPS)

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

a. **Distinction between base erosion and profit shifting**

Base erosion has the following features:

i. It is the use of financial measures and tax planning to reduce the size of the company's taxable profits in a country;
ii. It is often achieved by structuring income to have more favourable tax treatment or by finding ways to write off certain expenditure against taxable income; and
iii. It has the effect of reducing a company's tax liabilities below what would otherwise have been.

Profit shifting has the following features:

i. This involves making payments to other group companies in order to move profits from high-tax jurisdictions to lower-tax regimes;
ii. This serves to increase the overall profits available to the group shareholders;
iii. Often, these intra-group payments (known as transfer pricing) take the form of royalties and interest payments, as these expenses can be deducted from pre-tax profits; and
iv. Another issue with these types of payment is that some jurisdictions have lower tax rates on them when received as income by other persons.

b. **Techniques of base erosion and profit shifting**

Base erosion and profit shifting could be achieved using any of the following techniques:

i. **Trademark and technology licensing/transfer pricing:** Managing the group's trademark, design and patent through an entity that applies a lower tax rate to intellectual property, and then charging group companies royalties on the use of the brand;

ii. Thin capitalisation: By setting up subsidiaries with minimal share capital, group can use a financing arm to fund the new company's operation with debt. This large debt attracts interest, which has different treatment in some jurisdiction and can therefore reduce the group tax payment if structured correctly;

iii. **Hybrid mismatch arrangements:** Different tax rules amongst countries can sometimes give rise to unintended effects like double non taxation which can be exploited by businesses to reduce their tax burden. This primarily applies to national treatment of certain instruments in such a way that they are treated in the paying country as tax deductible debt, but seen in the receiving country as tax exempt income;

iv. **Putting assets into entity without substance:** Some countries introduce preferential tax regimes as a way to compete for business. However, this is only useful if the business with substance begin to locate them in the country. Otherwise, this form of tax competition simply erodes the tax base of the country where the activity takes place; and

v. **Tax havens:** A multi-national enterprise may locate its head office in a jurisdiction with tax preference on tax haven and its operations with its subsidiaries and permanent establishments located in another jurisdiction may be such that is eroding the tax base of the countries where the subsidiaries are located.

c. The Organisation for Economic Cooperation and Development (OECD)'s action initiatives against base erosion and profit shifting are to:

i. Address the tax challenges of the digital economy;
ii. Neutralise the effects of hybrid mismatch arrangements;
iii. Strengthen controlled foreign company rules;
iv. Limit base erosion via interest deductions and other financial payments;

v. Counter harmful tax practices more effectively, taking into account transparency and substance;
vi. Prevent treaty abuse;
vii. Prevent the artificial avoidance of permanent establishment status;
viii. Assure that transfer pricing outcomes are in line with value-creation intangibles;
ix. Assure that transfer pricing outcomes are in line with value-creation risk and capital;
x. Assure that transfer pricing outcomes are in line with value-creation of other high-risk transactions;
xi. Establish methodologies to collect and analyse data on BEPS and the action to address it;
xii. Require taxpayers to disclose their aggressive tax planning arrangement;
xiii. Re-examine transfer pricing documentation and country-by-country Reporting;
xiv. Make dispute resolution mechanisms more effective; and
xv. Develop a multilateral instrument to modify bilateral tax treaties.

d. Implications on the company if it engages in base erosion and profit shifting

i. Base erosion and profit shifting are basically tax avoidance strategies used to exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.

ii. It reduces the total profit upon which tax is payable

iii. It reduces the tax revenue in the country where it is being practiced

iv. This act is totally condemned by more than 100 countries in the world as being an unfair practice

v. The initiatives put in place by OECD in combating this activity are legendary. It is, therefore advisable for a company (in collaboration with its parent company) not to involve in this act.

We hope our comments will meet your requirements, nevertheless, please do not hesitate to contact us if you require further clarification on any aspect of the report.

Yours faithfully,
For: Bay and Bay & Co (Tax Consultants)

Gbolagade Dawodu
Senior Partner

EXAMINER'S REPORT:

The question tests candidates' knowledge of base erosion and profit shifting (BEPS) with emphases on the differences between both, the techniques, implications, and the five action initiatives of the Organisation for Economic Cooperation Development (OECD) against these corporate tax planning strategies.

About 40% of the candidates attempted the question and their performance was poor.

The common pitfalls of the candidates were their inability to differentiate between base erosion and profit shifting. Additionally, they could not state the initiatives of OECD against these corporate tax planning strategies.

Candidates are advised to be conversant with base erosion and profit shifting as these are topical issues in international taxation.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

OCTOBER 2024: PROFESSIONAL EXAMINATION

PTE II: INCOME TAX FOR SPECIALIZED BUSINESS

WEDNESDAY 16TH OCTOBER, 2024 **EXAM NO..................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

TIME: 3 HOURS.

SHOW ALL WORKINGS

QUESTION 1

National Eagle Bank, a commercial bank, offers diverse cutting-edge financial solutions tailored to meet individual, business, and corporate banking requirements.

Recently acclaimed as the nation's best and most innovative bank, the executive directors of National Eagle Bank are committed to upholding exemplary practices and fostering a reputation of a responsible corporate citizen. In response to the Federal Inland Revenue Service's (FIRS) intensified efforts to combat tax evasion and bolster tax revenues, numerous banks nationwide are implementing additional measures to ensure full compliance with tax laws in their operations.

In light of these developments, the Bank's financial controller has engaged your firm of Tax Consultants to assist the bank in preparing the tax returns based on the financial statements for the year ending December 31, 2023.
You are to note that Stages 1 and 2 impairment provisions relate to recoverable losses, while stage 3 relates to credit-impaired losses.

The financial information of the Bank for the year ended December 31, 2023 is as follows:

	₦	₦
Interest income	542,000,000	
Interest expense	(207,450,000)	
Net interest income		334,550,000
Fee and commission income	90,505,000	
Fee and commission expense	(60,000,000)	
Net fee and commission income		30,505,000
Impairment charge for credit losses		(90,000,000)

Other operating income		170,000,000
Other operating expense		(120,000,000)
Profit before tax		**325,055,000**

Notes:

1. Included in the interest income are:
   Interest income on loans and advances to customers – ₦365,000,000
   Interest income on federal government bonds – ₦100,000,000
   Interest income on treasury bills – ₦77,000,000

2. Included in the other operating income are:
   - Profit from the disposal of shares in an associate – ₦100,000,000.
     Note: The shares sold had an original purchase price of ₦50,000,000. The Bank invested ₦120,000,000 in the purchase of shares of another company immediately after the disposal of the shares in its associate. The sales proceeds from the earlier share disposal were used in making the new acquisition.
   - Exchange gain of ₦10,000,000 consists:
     - Gain from revaluation of balances – ₦6,000,000
     - Realised foreign exchange gain – ₦4,000,000
   - Dividend income on equity investment – ₦35,000,000
   - Profit from the disposal of equipment – ₦12,000,000 (The estimated balancing charge from this disposal is ₦8,500,000)

3. The impairment for credit charge is made up of:
   Stage 1 credit loss: ₦20,000,000
   Stage 2 credit loss: ₦35,000,000
   Stage 3 credit loss: ₦35,000,000
4. Other operating expense is made up of:
   - Expenses attributable to generating the tax-exempt income – ₦48,000,000
   - Depreciation – ₦49,000,000
   - Cheque book cost – ₦1,500,000
   - Recruitment expenses – ₦1,000,000
   - Management Fraud – ₦2,000,000
   - CBN penalties – ₦1,000,000
   - Tax consultancy fees – ₦3,500,000
   - Auditor's fees – ₦6,000,000
   - Additional tax assessment from a recently concluded tax audit – ₦7,000,000
   - Professional fees paid for the disposal of shares in associate – ₦1,000,000

5. The Bank has an unrelieved loss brought forward of ₦95,000,000 and unutilised capital allowance b/f of ₦20,000,000

6. The capital allowance for the year is estimated at ₦36,000,000

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

Required:

a) Estimate the bank's tax liabilities for the relevant year of assessment. All workings should be shown. (35Marks)

b. Discuss the requirement that banks should obtain Tax Identification Numbers (TINs) of new and existing business customers. (5Marks)

Solution to Question 1

a. Computation of tax payable

National Eagle Bank
Tax Computation for 2024 Year of Assessment
Basis Period (January to December 2023)

	₦	₦
Profit before tax		**325,055,000**
Add back:		
Stage 1 credit loss	20,000,000	
Stage 2 credit loss	35,000,000	
Expenses attributable to generating the tax-exempt income	48,000,000.00	
Depreciation	49,000,000	
Fraud & robberies	2,000,000	
CBN penalties	1,000,000	
Additional tax assessment from a recently concluded tax audit	7,000,000	
Professional fees paid for the disposal of shares in associate	1,000,000	
Total add-backs		163,000,000
Less:		
Interest income on federal government bonds	100,000,000	
Dividend income on equity investment	35,000,000	
Unrealised foreign exchange gain from revaluation of balances	6,000,000	
Profit from the disposal of equipment	12,000,000	

Profit from the disposal of shares in an associate	100,000,000.00	
Total deductions		(253,000,000)
Assessable profit		**235,055,000**
Add: Balancing charge		8,500,000
		243,555,000
Loss available for relief	(95,000,000)	
Loss relieved	95,000,000	(95,000,000)
Profit/Loss balance	**-**	148,555,000
Capital allowance b/f	20,000,000	
Capital allowance for the year	36,000,000	
Capital allowance available for relief	56,000,000	
Capital allowance relieved	(56,000,000)	(56,000,000)
Capital allowance c/f	**-**	
Total profits		92,555,000
Tax on normal basis at 30%		**27,766,500**
Minimum tax		
Gross turnover		
Interest income	542,000,000	
Fee and commission income	90,505,000	
Other operating income	170,000,000	
Total	**802,505,000**	
Less: Dividend income (Frank Investment Income)	**(35,000,000)**	
	767,505,000	
Minimum tax @ 0.5% of 767,505,000.00		**3,837,525**
Tax payable is higher of		
Tax on normal basis		27,766,500
Minimum tax		3,837,525
Company Income Tax payable		**27,766,500**
Tertiary Education Tax payable (3% of the assessable profit of 235,055,000.00)		**7,051,650**
Information Technology Levy payable (1% of PBT)		**3,250,550**
Capital gains tax (CGT) payable (W.K 1)		**-**
Total tax payable		**38,068,700**

Working

1. **CGT**

Purchase price for the shares	₦50,000,000
Profit =	₦100,000,000
Sales proceeds	₦150,000,000

Capital gain = Sales proceeds – original purchase cost – incidental cost to sell

Capital gain = ₦150,000,000 – ₦50,000,000 – ₦1,000,000= ₦99,000,000.

Capital gain subject to CGT = Capital gain – amount reinvested on the same asset type within the same year of assessment

Capital gains subject to CGT = ₦99,000,000 - ₦120,000,000= (₦30,000,000). Based on this, there is no capital gain subject to CGT; therefore, there is no CGT applicable to the disposal of shares in the associate.

b. The requirement that banks should obtain Tax Identification Number (TIN) of new and existing business customers

Section 10 (2) of CITA provides that every person engaged in banking or other financial services in Nigeria shall require all companies to provide their TIN as a precondition for opening a bank account or, in the case of an account already opened within three months of the passage of the Act, the Bank shall require such TIN to be provided by all companies as a precondition for the continued operation of their accounts.

The above provision implies that banks cannot open accounts for a company without a TIN. They are also prevented from allowing the operation of an existing account of companies until such companies provide their TIN within three months of the provision's effect.

EXAMINER'S REPORT:

Question 1 is on a bank's tax liabilities for the relevant year of assessment. It further tests the requirement by banks on Tax Identification Numbers (TINs) for new and existing business customers.

Being a compulsory question, about 90% of the candidates attempted the question and performance was fair.

Candidates’ understanding appears inadequate as many of them added what was to be removed and vice-versa.

The Institute’s Pathfinder is hereby recommended to candidates to aid their understanding and performance in future examination.

QUESTION 2

Nigeria's landmark Petroleum Industry Act (PIA), enacted in August 2021, revolutionises the oil sector, driving efficiency and transparency to attract vital investments. By streamlining regulations and establishing dedicated oversight bodies like the Upstream and Midstream/Downstream Regulatory Authorities, the PIA paves the way for a more competitive and resource-rich future for Nigeria.

The PIA provides for the establishment of the Nigerian Upstream Petroleum Regulatory Commission. (“the Commission” or “NUPRC”) to be responsible for the technical and commercial regulation of upstream petroleum operations.

Explain any five objectives/roles of the Commission in line with the provisions of the PIA?

(15Marks)

Solution 2

Established under the PIA, the Commission has specific objectives aligned with the PIA's overarching goals of enhancing efficiency, transparency, and accountability in the upstream sector. Here are some of the key objectives of the Commission:

a. **Regulatory Oversight**
The NUPRC is tasked with providing effective regulatory oversight of upstream petroleum operations. This includes exploration, production, and development activities to ensure compliance with industry regulations and standards.

b. **Licensing and Permitting**

The Commission is responsible for issuing licenses, permits, and leases for upstream petroleum activities. This involves evaluating applications, conducting due diligence, and granting approvals in accordance with the provisions of the PIA.

c. **Resource Management**

NUPRC plays a pivotal role in the management of Nigeria's upstream petroleum resources. This includes formulating policies to optimise resource utilisation, promoting sustainable development, and maximising the economic benefits derived from these resources.

d. Promotion of Investments

A key objective is to attract local and international investments in the upstream sector. The NUPRC aims to create an environment that encourages investment by clarifying regulations and fiscal terms and ensuring a fair and competitive playing field.

e. Data Management and Transparency

The Commission is tasked with maintaining a comprehensive database of upstream petroleum activities. This promotes transparency by providing stakeholders with access to accurate and up-to-date information on licenses, production, and other relevant data.

f. Health, Safety, and Environmental Compliance

NUPRC focuses on ensuring that upstream operations adhere to the highest health, safety, and environmental standards. This includes monitoring and enforcing compliance with regulations to mitigate potential risks and protect the environment.

g. Conflict Resolution

The Commission is equipped with mechanisms for resolving disputes and conflicts that may arise among stakeholders in the upstream petroleum sector. This contributes to a stable and harmonious operating environment.

h. Capacity Building

NUPRC is involved in capacity-building initiatives, fostering skill development and knowledge transfer within the industry. This contributes to the growth and sustainability of the upstream sector by ensuring a skilled workforce.

EXAMINER'S REPORT:

The question requires candidates to explain any five objectives/roles of Nigerian Upstream Petroleum Regulatory Commission in line with the provision of the Petroleum Industry Act.

About 70% of the candidates attempted the question with above average performance.

However, candidates' understanding of the question's requirement was inadequate and most candidates that did not perform well misinterpreted the question's requirement.

Candidates are advised to make use of the Institute's Study Pack and Pathfinders when preparing for future examination.

QUESTION 3

A unit trust scheme is any arrangement made for the purpose of providing facilities where the public are beneficiaries under a trust, in profits or income arising from the acquisition, holding, management or disposal of securities or any property whatsoever. The legal basis for the administration of unit trust scheme in Nigeria is the Companies Income Tax Act Cap. C21, LFN 2004 (as amended).

Required:

(a) State TWO objectives of a unit trust scheme. (3 Marks)

(b) In line with relevant provisions of CITA 2004 (as amended), discuss the:

(i) Treatment of income arising to the trustees of an authorised unit trust (3 Marks)

(ii) Treatment of dividend payment on profit accruing to trustees of unit trusts (6 Marks)

(iii) Contemporary tax mechanisms put in place to guaranty transparency of the unit trust scheme in Nigeria (3 Marks)

(15 Marks)

SOLUTION 3

(a) The objectives of a unit trust scheme include:

- To encourage and pool the savings of the low and middle income group for investment purposes; and
- To enable the low and middle income group to share in the benefits and prosperity of the industrial development in the country.

(b)(i) Treatment of income arising to the trustees of an authorised unit trust

It will have effect as if:

- The trustees were a company whose business consists mainly in the making of investments and the principal part of whose income is derived therefrom;
- The rights of the unit holders were shares in the company; and
- So much of the income accruing to the trustees as is available for payment to the unit holders were dividends on such shares and reference to in the Act to a company shall be constructed in accordance with the foregoing provision.

(b)(ii) Treatment of dividend payment on profit accruing to trustees of unit trusts

- Section 4 of CITA provides that the provisions of Section 53 of the Act shall apply to dividends accruing to the trustees of a unit trust. This involves filing of assessment returns in respect of dividends that accrues to the unit trust.
- Section 5 provides that so much of the profit accruing to the trustees of a unit trust as is available for payment to unit holders or for investment shall be deemed to be dividends paid or payable by the trustees to the unit holders in proportion to their rights.
- The provisions of Section 21 of the Personal Income Tax Act 2004 (as amended) shall apply to the dividend paid or payable to any member of an authorised unit trust.
- The profits earned by the unit trust is subject to tax in the hand of the trustee.
- Also, any income distributed to the unit holders are treated as dividends since the right of such unit holders are deemed to be shares in the unit trust scheme.
- While the dividends paid to a corporate unit holder (an incorporated company) is exempted from withholding tax, but dividends paid or payable to individual unit holders is liable to withholding tax at 10% under the Personal Income Tax Act

(b)(iii) Contemporary tax mechanisms put in place to guaranty transparency of the unit trust scheme in Nigeria

- The CITA treats the trustees of the unit trust as a company and the unit holders as shareholders. Therefore, the profits earned by the unit trust are subject to tax in the hand of the trustees.
- Any income distributed to the unit holders are treated as dividends since the rights of such unit holders are deemed to be shares in the unit trust scheme;
- The trustees are under obligation to file self-assessment returns with the FIRS as stipulated by the provisions of Section 17(4) of CITA 2004 (as amended).
- The trustees are under obligation to deduct a withholding tax from dividends paid to individual unit holders and remit same to the various tax authorities of the unit holders' States of residence.

EXAMINER'S REPORT:

The question tests candidates' understanding of the unit trust scheme. It requires candidates to state 2 objectives of a unit trust scheme and candidates to discuss the followings in line with relevant provisions of CITA 2004 (as amended):

i. Treatment of income arising to the trustees of an authorised unit trust;
ii. Treatment of dividend payment on profit accruing to trustees of unit trusts; and
iii. Contemporary tax mechanisms put in place to guaranty transparency of the unit trust scheme in Nigeria.

About 80% of the candidates attempted the question with more than half scoring above average. However, some candidates did not understand the question.

Candidates are hereby advised to attend credible tuition house as well as obtaining the Institute's Study Pack and Pathfinder for indepth understanding of the subject and better performance in future examination.

QUESTION 4

Phoenix Green Managers, a financial institution headquartered in Monaco with a primary focus on asset management, is actively exploring the prospect of venturing into the Nigerian market. This strategic consideration aligns with the prevalent trend of heightened mergers and acquisitions shaping the economic landscape of Nigeria during its post-pandemic recovery phase. Acknowledging the intricacies and challenges inherent in such a move, the Chief Financial Officer (CFO) of Phoenix Green Managers has proactively engaged your firm, recognising the need for expert guidance to navigate the complexities associated with this potential investment.

The CFO specifically has the following questions bothering his mind concerning the investment in Nigeria:

(a) The meaning of Mergers and Acquisitions. (5 Marks)

(b) The tax implications of a merger between two companies where one of the companies inherits all the assets and operations of the merging companies.(5 Marks)

(c) The tax implications of selling or transferring a company to another company in which both belong to the same holding company in Nigeria. (5Marks)

(Total 15 Marks)

Solution 4

1 (a) Mergers and Acquisitions

A merger is an arrangement in which the assets, liabilities and businesses of two or more companies are vested in and carried on by one company, which may or may not be one of the merging companies and under a situation in which the owner of the merging companies owns the new company.

Acquisition is the act of acquiring effective control over assets or management of a company by another company by acquiring substantial shares or voting rights of the target company.

(b) (i) The surviving company must file returns not more than six months after the end of its accounting year in accordance with Section 55(3)(a)

(ii) Commencement rule will not be applicable.

(iii) No initial allowance on assets transferred.

(iv) Claim of annual allowance is based on tax written down values of the assets transferred.

(v) The Company cannot inherit the unabsorbed losses and unutilised capital allowances of the merger unless there is evidence that the company is reconstituted, the merging companies have been members of the same group for at least 365 days before the date of the reorganisation and the assets transferred will not be sold for at least 365 days after the date of the reorganisation.
(vi) All fees paid will be liable to VAT and WHT.
(vii) Stamp duties will be paid on an increase in share capital.

C. Where a company is sold or transferred to another company either for the purpose of better organisation or transfer of management and provided that the Revenue believes that both companies belong to the same group for at least 365 days prior to the date of reorganisation:
(i) There will be no application of either the commencement or cessation rules;
(ii) All the qualifying capital expenditures transferred are deemed to have been made at their tax written-down values;
(ii) In the computation of capital allowance, no initial allowance may be computed, while the annual allowance would be based on the unexpired tax life of the qualifying capital expenditure;
(iv) Any unutilised capital allowances transferred are deemed to have been transferred prior to sale; and
(v) Any unrelieved losses transferred are also deemed to have been relieved prior to the transfer or sale.

EXAMINER'S REPORT:
The question deals with merger and acquisitions. It tests the candidates' understanding of:

i. The meaning of mergers and acquisitions;
ii. The tax implications of a merger between two companies where one of the companies inherits all the assets and operations of the merging companies; and
iii. The tax implications of selling or transferring a company to another company in which both belong to the same holding company in Nigeria.

More than 80% of the candidates attempted the questions and more than 50% of them scored well above average.

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

QUESTION 5

The International Labour Organisation (ILO) specifies that free trade zones are established with the aim of having a positive effect on the economy.

Required:

(a) Discuss THREE primary objectives of the Federal Government of Nigeria in setting up free trade zone. (6 Marks)

(b) Explain the tax implications of the following in respect of operating in a free trade zone:

(i) Imported goods conveyed through other ports outside the zones but consigned to the zones (2 Marks)

(ii) Submission of tax returns to FIRS by approved enterprises (2 Marks)

(iii) Business activities of head offices or branch offices of approved enterprises located in customs territory with approved enterprises (2 Marks)

(c) Discuss the issues concerning filing of returns by registered companies operating in the free trade zone (3 Marks)

(15 Marks)

SOLUTION 5

(a) The primary objectives of the Federal Government of Nigeria in setting up free trade zone include:

(i) Generation of foreign exchange: By promoting non-traditional exports, greater export earnings may have a positive impact on the exchange rate and the amount of foreign exchange generated by the country;

(ii) Providing jobs and creating income: In many developing countries, such as Nigeria, workers move from the agricultural sector (rural areas) to better paid jobs in the manufacturing sector (urban areas). Shifting workers into industrial production has a low opportunity cost to the economy. The economy does not lose much agricultural output and gains additional output of non-traditional export goods;

(iii) Attracting foreign direct investment (FDI) with a larger capital stock for the host country; and

(iv) Generating technological transfer, knowledge, spillover and demonstration effects.

(b) **The tax implications of the under listed subject matter in respect of operating in a free trade zone**

(i) Imported goods conveyed through other ports outside the zones but consigned to the zones: No value added tax (VAT) and withholding tax (WHT) provided the goods are escorted from the port of entry to the free zone by the Nigeria Customs Service.

(ii) Submission of tax returns to FIRS by approved enterprises: Approved enterprises to submit tax returns through the free zone authority to FIRS.

(iii) Business activities of head offices or branch offices of approved enterprises located in customs territory with approved enterprises: All relevant tax laws applicable except as related to purchases and sales.

(c) Issues concerning filing of returns by registered companies operating in the free trade zone include:

(i) Validity of exemptions from State and Local Government taxes: Section 8 of the Nigerian Export Processing Zone Act provides that approved enterprises operating within the zone are exempt from Federal, State and Local Government taxes, levies and rates.

In practice however, free zone enterprises sometimes run into conflicts with State and Local Government authorities who seek to enforce State and Local Government tax rules.

(ii) Types of taxes covered by the exemptions: Section 18(a) of the Nigerian Export Processing Zone Act states that legislative provisions pertaining to taxes, levies, duties and foreign exchange regulations shall not apply within the zones. This would suggest that even beyond being specifically exempt from paying corporate income tax or value added tax, free zone companies are not obliged to comply with any provisions or laws and not just provisions seeking to charge them to tax.

The vague provisions of the Nigerian Export Processing Zone Act have led to significant confusion in practice with many companies that register as free zone enterprises and operate in free zones not fully understanding their tax obligations and frequently being challenged by the FIRS and State tax authorities.

EXAMINER'S REPORT:

The question tests candidates' knowledge on the objective of setting up of free trade zone, the tax implication of the companies operating in the zone and the filling of returns by the companies.

About 80% of the candidates attempted the question. While a few scored well above average, a larger percentage of the candidates performed below average.

The candidates demonstrated a very good understanding of part (a), but a shallow understanding of parts (b) and (c) that deals with tax implication and filling of returns.

Candidates are advised to prepare adequately for future examination by making use of the Institute's Study Pack and Pathfinders.

QUESTION 6

Sunny Wonder Cable Limited is a foreign company, which provides cable services between the Nigeria and the rest of the world. The operating records of the company for the year ended December 31, 2023 revealed the following:

	₦'000	₦'000
Income from cable operations:		
From Nigeria to Madrid, Spain		120,100
From Chicago, USA to Nigeria		200,600
From Nigeria to Liverpool, UK		250,700
From Johannesburg, South Africa to Nigeria		43,800
From other routes to Nigeria		260,300
		875,500
Deduct:		
Salaries and wages	352,650	
Depreciation	172,900	
Administrative expenses	60,100	
Other operating expenses	8,000	593,650
Net Profit		281,850

The following additional information were provided:

(v) Administrative expenses:

	₦'000
Renovation of office complex	12,200
Repairs and maintenance of equipment	1,400
Rent and other municipal charges	3,800
Allowance for doubtful debts (general provisions)	13,900
Power costs	15,300
Others (allowable)	13,500
	60,100

(vi) Other operating expenses:

	₦'000
Subscription to Nigerian Cable Providers Association	1,000
Donation to the Nigerian Museum	2,750
Others (allowable)	4,250
	8,000

Required:

As the Company's Tax Consultant, you are to compute for the relevant assessment year, the company's:

(a) Total profit (12 Marks)

(b) Income tax payable (3 Marks)

(15 Marks)

SOLUTION 6

Sunny Wonder Cable Limited

Computation of Total Profit

For 2024 Assessment Year

(a) Computation of total profit

	₦	₦
Nigerian adjusted profit (WK. v)		203,643,360
Less: Capital allowances:		
For the year (WK. vi)	73,233,000	
Utilised	(73,233,000)	(73,233,000)
c/f	NIL	
Total profit		**130,410,360**

Workings

(i) Nigerian Income

From Nigeria to Madrid, Spain	=	**₦120,100**
From Nigeria to Liverpool, UK	=	**₦250,700**
		₦370,800

(ii) Global adjusted profit

	₦	₦
Net profit as per accounts		281,850,000
Add back:		
Depreciation	172,900,000	
Renovation of office complex	12,200,000	
General allowance for doubtful debts	13,900,000	199,000,000
Adjusted profit		**480,850,000**

(iii) Adjusted Profit Ratio (APR)

$= \frac{\text{Global adjusted profit}}{\text{Global income}} \times 100$

$= \frac{₦480,850,000}{₦875,500,000} \times 100$

= **54.92%**

(iv) Depreciation Ratio (DR)

$= \frac{\text{Global depreciation}}{\text{Global income}} \times 100$

$= \frac{₦172,900,000}{₦875,500,000} \times 100$

= **19.75%**

(v) Nigerian Adjusted Profit (NAP)

= Nigerian income x APR

= ₦370,800,000 x 54.92%

= **₦203,643,360**

(vi) Capital allowances (CA)

= Depreciation Ratio x Nigerian income

= 19.75% x ₦370,800,000

= **₦73,233,000**

(b) **Sunny Wonder Cable Limited**

Computation of income tax payable

For 2024 Assessment Year

	₦
Total profit (as above)	130,410,360
Companies income tax @ 30% of ₦130,410,360	39,123,108
Tertiary education tax @ 3% of ₦203,643,360	6,109,301
Total tax payable	**45,232,409**

EXAMINER'S REPORT

The question deals with the profit measurement and tax treatment of international companies dealing in specialised business.

More than 80% of the candidates attempted the question. About half of these performed averagely.

The commonest pitfall of the candidates was lack of understanding of the requirement of the question.

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

QUESTION 7

Investment is the acquisition of assets by an individual or firm. It requires the outflow of fund which eventually leads to subsequent benefits in form of returns, dividend, rent etc. With all its benefits, it is only those that have adequate knowledge of investment points that can actually take the advantages.

Required

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

Suggested solution to Q7

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 costs 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.

EXAMINER'S REPORT

The question tests reliefs available to the mining that are capable of attracting both foreign and local investors. It also tests the composition of the National Stakeholders Working Group (NSWG) as it affects the mining business in Nigeria.

The question was largely attempted and well understood. About 80% attempted the question and majority of them performed well above average.

For those that did not perform well, their common pitfalls were answering the question as if it relates to company income tax, and some were also mentioning loss relief, capital gain tax etc.

Candidates are advised to attend approved tuition house and ensure adequate coverage of the syllabus when preparing for future examination.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

OCTOBER 2024: PROFESSIONAL EXAMINATION

PTE II: TAX AUDIT AND INVESTIGATION

TUESDAY, OCTOBER 15, 2024 **EXAM NO...............**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

TIME: 3 HOURS

SHOW ALL WORKINGS.

QUESTION 1

The three-year financial statements of Alimatok Nigeria Limited is as follows:

3-year financial summary

Statement of Profit or Loss for year ended 31 December:

	Notes	**2023 ₦m**	**2022 ₦m**	**2021 ₦m**
Revenue	1	5,564	4,018	3,107
Cost of sales	2	(3,413)	(2,374)	(1,762)
Gross Profit		2,151	1,644	1,345
Overheads/administrative costs	3	(1,881)	(1,367)	(1,046)
Operating profit		270	277	299
Finance expense	4	(42)	(64)	(96)
Profit before taxation		228	213	203
Taxation		(57)	(53)	(51)
Profit for the year after taxation		171	160	152

Statement of financial position

	Notes	**2023 ₦m**	**2022 ₦m**	**2021 ₦m**
Non-current assets				
Property, plant and equipment	4	739	1,067	1,269
		739	1,067	1,269

Current assets:				
Inventories	5	492	328	249
Accounts receivable	6	1436	963	671
Cash and cash equivalents		4	4	36
		1,932	1,295	956
Total assets		2,671	2,362	2,225
Shareholders' equity:				
Ordinary share capital		100	100	100
Retained earnings		867	696	536
Total shareholders' equity		967	796	636
Non-current liabilities:				
Loan	7	-	-	400
		-	-	400
Current liabilities				
Accounts payable	8	1,606	1,085	789
Loan	7	-	400	400
Bank overdraft		98	81	-
Total current liabilities		1,704	1,566	1,189
Total shareholders' equity and liabilities		2,671	2,362	2,225

Required:

a. Carry out a trend analysis of the three years income statements. (20 marks)

b. Calculate Four (4) ratios you think will be of interest to the tax authority for each year and comment on the results. (12 marks)

c. Explain the reasons why a tax auditor should lay emphasis on the audit of non-current assets during a tax audit. (8 marks)

(Total 40 marks)

Solution 1

a. Trend analysis

Income statement	2021 a ₦'m	2022 b ₦'m	CHANGE c = b-a ₦'m	%CHANGE d = c/a ×100 %	2023 e ₦	CHANGE f =(e – b) ₦	%CHANGE g = f/b× 100 ₦
Revenue	3107	4018	**911**	**29.32**	5,564	**1,546**	**38.48**
Cost of sales	-1762	-2374	**-612**	**34.73**	(3,413)	**(1,039)**	**43.77**

Gross Profit	1345	1644	**299**	**22.23**	2,151	**507**	**30.84**
Overheads/administrative costs	-1046	-1,367	**-321**	**30.69**	(1,881)	**(514)**	**37.60**
Operating profit	299	277	**-22**	**(7.36)**	270	**(7)**	**(2.53)**
Finance expense	-96	-64	**32**	**(33.33)**	(42)	**22**	**(34.38)**
Profit before taxation	203	213	**10**	**4.93**	228	**15**	**7.04**
Taxation	-51	-53	**-2**	**3.92**	(57)	**(4)**	**7.55**
Profit for the year after taxation	152	160	**8**	**5.26**	171	**11**	**6.88**

b. Ratio analysis

	2023	2022	2021
i. Gross margin			
Gross profit/Revenue%	2,151/5,564%	1,644/4,018%	1,345/3,107%
	38.66%	40.92%	43.29%
ii. Net profit margin			
Net profit/Revenue%	228/5,564%	213/4,018%	203/3,107%
	4.10%	5.30%	6.53%
iii. Operating expenses to revenue			
Operating exp/Revenue%	1,881/5,564%	1,367/4,018%	1,046/3,107%
	33.81%	34.02%	33.67%
iv. Rate of turnover			
Cost of sales/Inventory	3,413/492	4,018/328	3,107/249
	6.9times	7.2times	7.1times
v. Current ratio			
Current assets/Current liabilities	1,932/1,704	1,295/1,566	956/1,189
	1.13:1.00	0.83:1.00	0.80:1.00
vi. Account receivable days			
Receivables/Revenue X 365	1,436/5,564 X 365	963/4,018 X 365	671/3,107 X 365
	94days	87days	79days
vii. Account payable days			
Payable/Cost of sales X 365	1,606/3,413 X 365	1,085/2,374 X 365	789/1,762 X 365
	172days	167days	163days
viii. Tax/Revenue	57/5,564 × 100 = 1.02%	(53/4,018)×100	51/3,107 = 1.64%

		= 1.32%	
ix. Tax/Net Profit	(57/228) × 100 = 25%	(53/213) × 100 = 26.76%	51/203 = 25.12%

COMMENTS

i. Gross Profit Margin - Gross profit margin decreases year to – year from 43.29% in 2021 to 40.92% and 38.66% in 2022 and 2023 respectively. This must have been caused by increase in cost of sales that increases with the years at a rate higher than the change in revenue over the same years.
ii. Net Profit Margin – There is a decrease in net profit margin from 6.53% in 2021, 5.3% in 2022 and 4.10% in 2023 as a result of increase in operational expenses over the years.
iii. Operating Expenses to Revenue is fairly stable over the years.
iv. Rate of turnover – is fairly stable.
v. Account Receivables days – increases steadily over the years from 2021 to 2023. This implies the ability of the business to recover from debtors/receivable increases.
vi. Account payable days – this increase over the years from 2021 implying the inability of the business to pay creditors.
vii. Tax to Revenue – there is a steady decrease from 1.64% in 2021, 1.32% in 2022 and 1.02% in 2023 implying that as revenue increases, tax paid decreases. This can be due to increase/overloading cost of sales over the years.
viii. Tax to Net Profit – this is fairly stable over the years implies that the costs (cost of sales and overhead) are fairly stable over the years.

c. A tax auditor would emphasise on the audit of non-current assets during a tax audit because:
   i. Non-current assets is possibly the single largest figure on the statement of financial position of companies, especially manufacturing companies;
   ii. The tax auditor needs to verify the total purchases of non-current assets during each year because it is the basis of calculating the initial allowance and to ensure that unallowable costs are not added to the cost of new assets;

iii. The tax auditor must assure himself that, where non-current assets were manufactured by the company, unallowable costs were not added to the cost;
iv. Assets sold during the year need to be determined to assess balancing allowance or balancing charge; and
v. To ensure that the company did not claim capital allowance on assets already sold.
vi. Capital Allowance computation from Non-Current Asset and the effect on tax liability.

EXAMINER'S REPORT:

The question tests candidates' analytical ability especially as it relates to taxation. Being a compulsory question, it was attempted by almost all the candidates but surprisingly, most of the candidates did not perform well.

The commonest pitfall of the candidates was their lack of understanding of the requirement of the question.

Candidates are advised to prepare adequately, and make use of the Institute's Study Pack and Pathfinders, when preparing for future examination.

QUESTION 2

You are part of the audit team sent to carry out a tax audit of Sectove Nigeria Limited, a manufacturer and distributor of consumer products. The team leader has assigned you to carry out the audit of the company's revenue figure for the year.

Required

Discuss the direct and indirect way you will use to generate relevant, appropriate and sufficient evidence to ensure that the company's revenue for the year has not been understated. (15 marks)

Solution 2

A taxpayer's revenue could be audited using direct and direct method. The purpose is to ensure that the taxpayer's revenue has not been understated. So as to ensure that appropriate tax is paid.

Direct method

The following procedures will be adopted:

- Cash sales register shall be fully checked with the carbon copies of the cash sales invoice;
- Summary of daily cash would be computed;
- Salesman's summary, gateman's summary, and cashier summary should be compared;
- Dates of cash sales invoices and the date on which the receipts are recorded in the cash book must be the same. If the dates differ, the same should be inquired into;
- Where cash sales invoices are cancelled, all copies including original copy dully cancelled should be kept in record;
- Where it is a policy of the company to allow a discount, it should be verified, and reconciliation should be made with record of cash received;
- Verify the entries in the cash book and the corresponding effect in sales account in the ledger;
- Compare the amounts of sales disclosed in the Financial Statements with the amounts stated in the Management Accounts, Year End Trial Balances, Sales Ledger, sales day book and sales figures stated in the minutes of the board meetings. Note the difference (if any). Examine daily cash reconciliation and related books entries and bank deposit to see if all receipts are included in the income. Note any undeposited cash receipt or on hand at the end of the year;
- Review the sales ledger and note unusual debit entries for further verifications and explanations. Test entries of the general journal and sales journal;
- Check all credit notes for commissions, discounts, returns etc. and agree them to amounts disclosed in the sales ledger noting any differences;
- Check for sales commissions allowed. Only commissions disclosed in the invoices are allowed;
- Call for invoice files and randomly trace some of the invoices to the sales ledger and or invoice listings; and
- Confirm that invoices are raised for all sales made during the accounting year by checking the seriality of invoice postings in the ledger. Note missing ones and call for explanations on them.

Indirect method

Where no sales ledger and invoice listings are in place or reliance could not be placed on sales records, the tax auditor could fall back to one or more of the following approaches:

- Extraction of all sales invoices: This method requires the tax auditor to extract all the taxpayer's sales invoices during the year and then summarise the total revenue for the year;
- Extraction of credit lodgements in all the company's bank statements excluding loans and overdrafts. Here all credit lodgements into the taxpayer's bank accounts during the year will be summarised while ensuring that items such as loans, introduction of additional capital during the year, etc. are excluded;
- Amounts disclosed in the VAT returns for the accounting year (if higher than figures in the audited accounts). This can be used to determine the taxpayer's sales revenue during the year. However, the tax auditor must ensure that an appropriate VAT rate was charged and that the VAT was accounted for;
- Check journal entries including audit journals for reversals of sales to valid documentary evidence and trace to the sales ledger to ensure correct treatment. Any differences that reduce sales should be added back thereto; and
- If there are large and consistent debit entries to the sales accounts, the Finance Controller may explain that the entries were returns and allowances, but they can be debit entries for customer checks that could not be processed because of insufficient funds.

EXAMINER'S REPORT:

The question tests candidates' understanding of tax audit of revenue of a manufacturer and distributor of consumer products. Most of the candidates did not understand the requirements of the question and this affected their performance. Most of the candidates could not also classify their points into direct and indirect as required by the question.

Candidates are advised to ensure adequate preparation and make use of the Institute's Study Pack and Pathfinders for the future examination.

QUESTION 3

Almost every company has a tax consultant. Tax consultants are normally retained to handle all the company's tax issues, including attending to tax audit, either by the State Internal Revenue Service or Federal Inland Revenue Service.

Required
Discuss the roles and responsibilities of a company's tax consultant before, during and after a tax audit exercise by the Federal Inland Revenue Service. (Total 15marks)

Solution 3

The roles and responsibilities of the tax consultants on tax audit and investigation by the Federal Inland Revenue Service (FIRS)

Tax audit and investigation by FIRS covers the following areas of tax:

- Companies income tax payable by the company;
- Withholding tax payable on contracts and supplies to other companies;
- Withholding tax payable on consultancy and other professional fees payable to other companies;
- Withholding tax on dividends the company paid to its corporate shareholders;
- Stamp duties payable by the company on agreement of sales or rent agreement executed with other companies;
- Withholding tax on rent payable to corporate bodies on properties;
- Capital gains tax on disposal of the company's assets; and
- Value Added tax.

Duties and responsibilities of tax consultant before the audit

When the company receives a letter from FIRS intimating the company of its intention to carry out a tax audit or investigation exercise in the company, the company will send the letter to its tax consultant. On receipt of the letter, the tax consultants will carry out the following activities:

a. The tax consultants will visit the company, discuss with the management and agree on the modalities for the audit, and date of audit;
b. The tax consultants will get in touch immediately with the team coming for the audit, always listed on the letter of audit, for familiarisation and agreement of date to conduct exercise.
c. If need be, the tax consultant will write a letter to FIRS seeking for an extension of time, if the company has a genuine reason why the audit could not take place within the time stipulated on the letter of audit;
d. The tax consultant and his staff will visit the company before the date agreed with the tax auditor to:
    - Ensure the companies accounting records are up to date; and
    - Arrange the documents required for the audit, a list of this is usually attached to the letter of audit.

Duties and responsibilities of the tax consultant during the audit

a. On the first day of the audit, the tax consultants, with his staff, will arrive earlier, before the tax audit team, at the company to:
    - Secure and arrange the place the audit will take place;
    - Arrange all the documents required for the audit;
    - Receive the audit team on arrival;
    - Arrange a pre-audit meeting with the company’s management, himself and the audit team; and
    - Arrange for entertainment of the audit team.

b. The tax consultants or his staff must be on ground throughout the duration of the audit, to answer any question from the audit team and or provide further information the audit team may ask for;
c. On completion of the audit, the tax consultant will hold an exit meeting with the tax audit team and the company's management, where further clarifications could be sought by the audit team from the management regarding their findings, to clear any doubt that may arise;

Duties and responsibilities of the consultant after the audit

a. On receipt of the notice of additional tax liability, based on the audit, from FIRS, the company will send this to the tax consultant for advice;
b. If the liability is within the expectation of the tax consultant, he may advise the company to pay the additional liability, which will bring the audit exercise to a close;
c. However, if the liability is more than the expectation of the tax consultant, he will write a letter of objection to the liability to FIRS, within the stipulated time frame, stating the grounds of objection;
d. The tax consultant will liaise with FIRS to fix a date for a reconciliation meeting;
e. If the disagreement is resolved during the meeting, FIRS will send a revised liability, based on the agreement during the reconciliation meeting, to the company;
f. On receipt of the notice of revised liability, the consultant will advise the company to pay the liability. This will bring the audit exercise to a close and the tax consultant will liaise with the FIRS to obtain a letter of clearance for the company. This letter will indicate that the company has settled its tax liability to FIRS up to the date the audit covered;
g. If an agreement could not be reached during the reconciliation meeting, FIRS will send a letter of refusal to amend the liability to the company or a reduced

liability, based on further evidence produced by the company during the reconciliation meeting;

h. If the company is not satisfied with the position of FIRS, the tax consultant will write a letter of objection to FIRS, attaching further evidence;
i. FIRS may agree or disagree to amend the liability;
j. If the disagreement could not be resolved, either party can refer the dispute to the Tax Appeal Tribunal (TAT) for adjudication;
k. If the company is still not satisfied with the ruling of the Tax Appeal Tribunal, on point of law only, the case will be referred to the High Court for settlement;
l. If the company or revenue service is not satisfied with the ruling of the High Court, the party will appeal to the Court of Appeal; and
m. If either party is still not satisfied with the decision of the Court of Appeal, the party could appeal to the Supreme Court. The decision of the Supreme Court is final on the dispute.

EXAMINER'S REPORT:

The question tests candidates' understanding of the responsibilities of tax consultants on audit of clients records by FIRS. Attempt of the question by the candidates was high while performance too was above average which is an indication that the question was well understood.

QUESTION 4

(a) Write short note on the following:

i. Criminal investigation unit of the Federal Inland Revenue Service. (4 marks)

ii. Civil investigation unit of the Federal Inland Revenue Service. (4 marks)

(b) Explain the roles and responsibilities of the Head of Investigation/ Intelligence unit of the Federal Inland Revenue Service. (7 marks)

(Total 15 marks)

Solution (4)

(a)

i. Criminal Investigation Unit

The criminal investigation unit is responsible to:

- Investigate, penalise and recommend prosecution in case of tax evasion. With tax evasion, you have fraud with "mens rea", the amounts are clearly taxable (suppression of income, fictitious expenses) and does not require an amendment to the tax law. Evasion transactions are done knowing that it was unlawful to do. Normally criminal charges are laid which could result in fines and or jail term in addition to the tax penalties. Examples are:
- arrangement premeditated to reduces tax payable;
- creation of fictitious assets and expenses;
- overstatement of expenses;
- Disproportionate share of expenses and income between offshore and onshore entities;
- Complex management structure and associated entities that would result in tax evasion;
- Non-filing of tax returns or filing of incorrect returns; and
- Denial of Federal Inland Revenue Service access to records/documents.

ii. Investigate and liaise with relevant agencies for prosecution in case of:

- Fraudulent diversion of FIRS taxes such as withholding tax, value added tax etc;
- Fraudulent payment of income tax and other taxes through use of falsified withholding tax receipts;
- Abuses by companies and government agencies in value added tax, withholding tax deduction and remittance; and
- Fraudulent procurement of tax clearance certificate, revenue receipts, withholding tax credit notes.

iii. Carry out search and seizure where such would result in obtaining relevant document for an investigation;

iv. Analyse and evaluate evidences obtained to establish criminal violation, follow up with assessment, penalties and prepare case for prosecution;

v. Identify the areas for amendments to tax laws in order to plug all tax leakages;

vi. Assist in preparing evidence for prosecution of violations; and

vii. Liaise with National Drug Law Enforcement Agency (NDLEA), Economic and Financial Crimes Commission (EFCC), Nigeria Deposit Insurance

Corporation (NDIC) and Central Bank of Nigeria (CBN) to investigate violation of tax law in cases of white-collar crimes such as money laundering.

Civil Investigations Unit

The activities of the unit revolve around the following: -

i. Investigation of tax avoidance schemes, examples are:
   - Artificial transactions – section 18 of CITA as amended, that is, any transaction carried out primarily to obtain tax benefits (reduction or avoidance or deferral of tax or increase in refund of tax etc.); and
   - Creating an offshore company for purposes of reducing tax payable, for example instead of having the Nigeria company buy direct from a foreign supplier, a related offshore company is set up in a tax heaven country to do this and will in turn sell the product at a higher amount to the Nigeria company thereby diverting profits offshore. Another example would be when a profitable division is moved offshore. The key is to determine if in fact it is operating offshore.

ii. Treaty shopping – This involves shopping for the best tax rates offered by treaty countries and then carry out transaction in such a manner to take advantage of those tax rates;

iii. Back to back loans (to avoid withholding tax)

iv. Allege purchase of foreign assets at inflated amounts, which results in excess capital allowances claim;

v. The use of tax heavens and its detrimental impact on the tax system could be significant, both in terms of revenue and compliance;

vi. Income splitting arrangements;

vii. Investigate cases for tax refunds;

viii. Review cases for mergers and acquisitions;

ix. Issue warrants for search and seizure under section 45A, as amended;

x. Refer cases to criminal investigation unit where there are indications of deliberate intention to evade or commit fraud; and

xi. Identify areas for amendments to tax laws in order to plug all areas of tax leakages.

(b) The Investigation/Intelligence Division of FIRS is in charge of all investigations and intelligence activities of FIRS. The roles and responsibilities of the Head of the Division are as follows:

- Articulate and direct policies and programmes aimed at achieving the objectives of the division;
- Define key operating/guiding principles;
- Design strategies for deterring violations of tax laws and hence ensuring tax compliance;
- Set up procedures for case referrals from tax offices;
- Set up proactive processes and define parameters for identifying potential cases of violations;
- Address emerging areas of fraud for example, e-commerce, fraudulent financial reporting;
- Collate and maintain reliable statistics of intelligence work;
- Coordinate the activities of all the units in the division;
- Develop and implement appropriate training program for field officers on how to conduct investigation/intelligence work, preparing cases for court, computer searches for evidence gathering and data recovery etc;
- Partner with other experience tax jurisdiction in the area of information sharing, latest developments in taxation including emerging areas of tax fraud, computer searches and data recovery;
- Liaise with the various regulatory agencies on issues of tax violations;
- Provide law enforcement agencies with information sufficient to prosecute violators;
- Provide management with an update of cases prosecuted;
- Develop and maintain a system of records to track and report on cases, their progress and results;
- Recommend amendments to tax laws in order to plug all areas of tax leakages; and
- Budget and plan for financial, material and human resource requirement of the division.

EXAMINER'S REPORT:

The question tests the candidates' understanding of the Criminal and Civil Investigation Units of FIRS, and the roles and responsibilities of the head of the Investigation/Intelligence Unit of FIRS. Few of them that understood the question performed very well, while majority performed below average. Candidates should be fully prepared for this examination by making use of the Institute's Study Pack and Pathfinders in the future.

QUESTION 5

You have been nominated by your Tax Controller to be part of the team that will carry out a VAT audit exercise of Beautsheen Nigeria Limited, a company dealing with importation and distribution of body creams and beauty products.

You are required to:

Discuss the following in respect of the assignment:

a. Types of VAT audit (8 marks)

b. Documents that you will require to carry out the exercise. (7 marks)

(Total 15 marks)

Solution 5

a. Types of VAT audit

There are three types of VAT audit, these are:

- General Audit;
- Refund Audit; and
- Specific Audit.

General audit: This is an audit carried out to verify how a vatable person is complying with the VAT law. It involves checking the vatable person's financial record to ensure that VAT are deducted from every vatable transaction and they are properly remitted to the Federal Inland Revenue Service promptly, in accordance to the law. The audit also ensures that only qualified input VATs are deducted from the output VAT before remittance. Decision to carry out a general VAT audit on a company is determined by the tax audit division of the FIRS. General Audits form the majority of audits to be completed by the VAT authority
The objective of general audits is to provide broad audit coverage of all vatable persons within five years with additional audits for larger, more complex vatable persons and those with identified under declaration risks.

Refund audit: A refund audit is carried out when a vatable person is asking for a refund of overpaid VAT, where the input tax is more than the output VAT. In such circumstances, FIRS will initiate an audit to ensure that the claim of the vatable person is correct and according to the VAT law. The audit is to check that only qualify VAT input is deducted from the output VAT. It is also to ensure that all outputs VAT have been accounted for and that the claim for VAT refund is appropriate. Any refund will only be paid out once the verification process has been completed

The verification/audit process often requires the vatable person to submit the VAT input and VAT output detailed report, copies of the largest supplier tax invoices and detail of any assets purchased including tax invoices as chosen by the auditor.

Specific VAT audit: Specific VAT audit arises where:

- There is the receipt of urgent references;
- There is a late registration;
- There is cancellation of registration where large amounts of revenue are deemed to be at risk;
- There is credible information regarding suspected major tax evasion from intelligence sources;
- There is receipt of routine references where the taxable person is not registered for VAT;
- Audits resulting from existing audits where the auditor is of the view that there is possibility of tax risk, even if the taxable person is registered
- Audits resulting out of market related information from various sources received by any auditing official.

b. Document required for VAT audit and investigation

The VAT auditor would have to ask for and collect the following documents for a VAT audit and investigation**:**

i. Relevant documents to verify input and output VAT for local purchases and sales to customers:

- The copy of the taxpayer's VAT ledger, both for the input and output VAT;
- The suppliers' ledger (payable ledger) and invoices file;
- The cash book or bank accounts' ledgers;
- The customers' ledger (receivable ledger) and copies of customers' invoices file;
- The suppliers' ledger (payable ledger) and suppliers' invoice files;
- The VAT returns file;
- The sales daybook and sales ledger;
- The purchases daybook;
- Returns inward and outward books or registers; and
- The taxpayer's financial statements and management accounts.

ii. Relevant documents to verify input VAT on imports are:

- The bill of entry;
- The treasury receipt issued by the Nigerian Customs Service; together with the bank payment tellers;
- The approved "Form M" used in importing the goods, this will give the rate of exchange used; and
- The attested invoice issued by the manufacturer or the supplier or exporter of the goods as the case may be the commercial invoice.

EXAMINER'S REPORT:

The (a) part of the question is a very straight forward textbook question.

The 'b' part of the question tests the requirements of an auditor as regards testing determination of VAT of a company dealing in importation and distribution of goods (i.e., body/beauty products). A lot of the candidates failed to relate their points to the specific requirements – importation and distribution. Performance was, however, slightly above average.

Candidates are advised to adequately prepare for future examination by making use of the Institute's Study Pack and Pathfinders.

QUESTION 6
Revenue authorities are allowed to seek law enforcement agents' assistance in trying to recover unpaid taxes by taxpayers.

Required
Discuss the power of tax authorities to seek the assistance of law enforcement agents to recover unpaid taxes as enshrined in the Nigerian tax laws. (15 marks)

Solution 6

Power to co-opt law enforcement officers

The power to enlist the assistance of law enforcement officers for recovery of unpaid taxes are enshrined in Section 36, sub-sections 1 to 3 of the Federal Inland Revenue Service (Establishment) Act, which states as follows:

a. The Service 'may co-opt the assistance and co-operation of any of the law enforcement agencies in the discharge of its duties under this Act.
b. The law enforcement officers shall aid and assist an authorised officer in the execution of any warrant of distraint and the levying of distraint.
c. Any tax officer armed with the warrant issued by a judicial officer and accompanied by a number of law enforcement officers as may be determined by the Executive Chairman shall:
   i. Enter any premises covered by such warrant and search for, seize and take possession of any book, document or other article used or suspected, to have been used in the commission of an offence;
   ii. Inspect, make copies of, or take extracts including digital copies from any book, record, document or computer, regardless of the medium used for their storage or maintenance;
   iii. Search any person who is in or on such premises;
   iv. Open, examine and search any article, container or receptacle;

v. Open any outer or inner door or window of any premises and enter or otherwise forcibly enter the premises and every part thereof; or remove by reasonable force any obstruction, to such entry, search, seizure or removal as he is empowered to effect."

EXAMINER'S REPORT:

The question tests the candidates' understanding of the power of the tax authorities to use the assistance of law enforcement agents. This is not a common question and thus, most of the candidates did not attempt the question and those that attempted got below average mark.

Candidates are advised to ensure complete coverage of the syllabus when preparing for future examination.

QUESTION 7

(a) What is the procedure of investigating the income of an insurance company transacting life business only? (6 marks)

(b) Tax audit is the examination carried out by the tax officials on the accounting books, records, documents and tax returns filed by the taxpayer.

Required:

(i) Identify the key objectives of tax audit (5 marks)

(ii) Explain briefly desk audit and field audit (4 marks)

(Total 15 marks)

Suggested Solutions to Question seven (7)

(a) The verification of the income of an insurance company transacting life business only will include the following procedure:

i. Vouch premium income with the policy books, renewal register and lapsed policies. The auditor can determine gross premium income receivable and deduct there from premium on material policies and lapsed ones;

ii. Check agent's commission payable based on premium received and deduct commission paid. Ensure that adequate provision has been made for commissions payable;
iii. Detailed testing should be carried out on premium received by agents as rendered on their returns as against policy holders' records;
iv. Proper cut off procedures should be adopted to ensure that cash received is properly recorded as income in the appropriate period;
v. Reinsurance and reinsurance recoveries should be checked for corrections and proper accounting i.e., reinsurance should be netted off gross premium while recoveries should be added thereto;
vi. Admitted claims should be tested against cancelled policies: death certificates, discharge notes etc;
vii. Surrendors should be checked against endorsed policies and receipts for cash; payments for amendments should be vouched; and
viii. Premium reserves carried forward should be tested for adequacy.

(b)

(i) The key objectives of tax audit are to ensure that:

- Adequate accounting books and records exist for the purpose of determining the taxable profit or loss of the tax payer and consequently the tax payable;
- The tax computations submitted to the tax authority by the tax payers agree with the underlying records;
- All applicable tax legislations have been compiled with;
- Provide avenue for education of taxpayers on various provisions of tax laws;
- Discourage tax evasion;
- Detect and correct accounting or arithmetical errors in the tax returns;
- Provide feedback to the management on various provisions of the tax law and recommend possible changes;
- Identify cases of tax fraud and recommend for investigation;
- Forestall taxable person failure to file tax returns;
- To encourage voluntary compliance; and
- To forestall taxable person rendering incomplete or inaccurate returns

(ii) Desk audit is the examination carried out in the tax authority office. It is usually carried out on routine basis after the tax returns must have been submitted to the tax authority by the taxpayer. The tax audit official will be looking for apparent errors or mistake in the tax returns submitted. The outcome of desk audit can lead to field audit, if the tax authority is not satisfied with document provided by the tax payer. Desk audit can lead to additional assessment. Desk audit is also called desk review or desk examination.

Field audit is more elaborate and comprehensive than desk audit. It is usually carried out outside the tax authority's office, in the taxpayer premises to enable the tax authority or tax auditors to carry out the examination of applicable documents and also obtain appropriate information directly from the office of the taxpayer.

EXAMINER'S REPORT:

The question tests candidates' knowledge of:

(a) Audit procedures for investigating income of a Life Assurance company;

(b) Objectives of tax audit; and

(c) Desk and field audit.

Performance was above average. Candidates commonest pitfall was that they did not take the requirement of part (a) of the question into consideration while answering question.