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SCHOOL OF MANAGEMENT SCIENCES

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COURSE TITLE: PRINCIPLES OF TAXATION

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Course Team Mr. Yohanna Gyang Jugu (Developer/Writer) - UNIJOS
 Dr. Rauta Bitrus Jat (Editor)
 Dr. Dimis I. Mai-Lafia (Programme Leader) - NOUN
 Mrs. Caroline Aturu–Aghedo (Coordinator) - NOUN



NATIONAL OPEN UNIVERSITY OF NIGERIA

National Open University of Nigeria
Headquarters
14/16 Ahmadu Bello Way
Victoria Island
Lagos

Abuja Office
No. 5 Dar es Salaam Street
Off Aminu Kano Crescent
Wuse II, Abuja
Nigeria

e-mail: centralinfo@nou.edu.ng
URL: www.nou.edu.ng

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MODULE 1

Unit 1	Historical and Legal Background of Taxation in Nigeria
Unit 2	Tax Administration in Nigeria
Unit 3	The Difference between Taxation of Income and the Taxation of Capital
Unit 4	Basis of Assessment of Profits of Businesses (Basis Period)
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UNIT 1 HISTORICAL AND LEGAL BACKGROUND OF TAXATION IN NIGERIA**CONTENTS**

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1.0 INTRODUCTION

Most economies of the world are based on one form of taxation or the other. Taxation has always been with man and it will continue to be with him. Countries of the world have different fiscal policies that enable them to explore various types of taxation and impose them on their citizens for the purpose of enhancing revenue and for regulation and governance of the economy. The government of Nigeria, as one of these countries, has legislative powers to impose on its citizens, any form of tax and at whatever rate it deems appropriate.

In this unit, therefore, the objectives of taxation and the basic characteristics of taxation, among other things, shall be made known to you.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- state clearly, the objectives of taxation in Nigeria
- explain the structure of the Nigerian tax system
- discuss the evolution of taxation in Nigeria
- illustrate the sources of Nigerian tax laws
- distinguish between a tax and taxation, and between taxes and levies.

3.0 MAIN CONTENT

3.1 Definition of Tax and Taxation

Tax is a compulsory extraction of money by a public authority for public purposes and taxation is a system of raising money for the purpose of governance by means of contributions from individuals or corporate bodies (Sayode & Kajola, 2006:3).

According to the Oxford Advanced Learner's Dictionary (1995:224), tax is money that has to be paid to the government. People pay tax according to their incomes and it is often paid on goods and services. Black's Law Dictionary (1997:1469) defines tax as "monetary charge imposed by the government on persons, entities or property, levied to yield public revenue".

In Ola (1985:1), taxation is defined as the demand made by the government of a country for a compulsory payment of money by the citizens of the country. For Thomas Cooley in ICAN study pack (2006:3), taxes are "enforced proportional contribution from persons and property, levied by the state, by virtue of its sovereignty, for the support of government and for all public needs".

Nightingale (1997) describes tax as a compulsory contribution imposed by the government and concludes that even though tax payers may receive nothing identifiable in return for their contributions, they nevertheless have the benefit of living in a relatively educated, healthy and safe society. According to Soyode & Kajola (2006:4), taxation is defined as "the process of levying and collection of tax from taxable persons".

SELF-ASSESSMENT EXERCISE 1

Define taxation in your own way.

3.2 Objectives of Taxation

In both developed and developing economies, the primary purpose of taxation is mainly to generate revenue for settling government expenditure and for the provision of social amenities and the welfare of the populace. Again, taxation is used as an instrument of economic regulation for the purpose of discouraging or encouraging certain forms of social behaviour.

Hence, you should note the following major objectives for designing a tax policy.

- (a) To raise money for the provision of services such as defence, health services, education, etc;
- (b) To re-distribute income and wealth. That is, the rich pay more tax than the poor. This is achieved by the graduation or “progressiveness” of the rates at which the taxes are levied;
- (c) To discourage the consumption of harmful goods such as alcohol and cigarettes;
- (d) To harmonise diverse trade or economic objectives of different countries so as to provide for the free movement of goods/services, capital and people between member states;
- (e) For the management of the economy. Taxation is important in the planning of savings and investments. It can be harmonised with a development strategy. Also, in changing an economic structure, the government can use taxation as a powerful fiscal weapon to plan and develop a country.

Additionally, taxation can be used to achieve specific economic objectives of nations. In Nigeria, governments- oftentimes, introduce tax incentives and attractive tax exemptions as an instrument to attract and retain local and foreign investors. It is also a device to improve gross domestic product, induce economic development and influence favourable balance of payments with other countries.

SELF-ASSESSMENT EXERCISE 2

1. Why do you think the achievement of tax objectives is necessary?
2. What are the other specific economic objectives that can be achieved using taxation?

3.3 Structure of the Nigerian Tax System

The structure of the tax system in Nigeria can be classified into two forms; under the first form of classification, Nigerian taxes are classified as follows.

(I) Proportional Tax System

This form of tax assesses taxpayers on a fixed percentage. As a result, the amount of tax payable is proportional to every taxpayer's income. For example, if the tax rate is fixed at 10%, every taxpayer will have to pay income tax at this rate, as his/her income increases or decreases.

Illustration 1

Taxpayer's Income	Tax Rate	Tax Payable
N	%	N
15, 000	10	1, 500
30, 000	10	3, 000
45, 000	10	4, 500

A taxpayer, whose income doubles, pays double the amount of tax. That is, when the income was ₦15, 000, the tax payable was ₦1,500, but when the income increased to ₦30, 000, the tax payable went up to ₦3,000.00

Advantages

1. It is simple to understand;
2. It is easy to calculate;
3. It does not affect the pattern of income distribution in the country because every person pays the same rate of tax;
4. It is a neutral tax; it has neutralising effects on savings and incentives.

Disadvantages

1. It increases inequalities of income and wealth. Both high-income and low-income groups are taxed at the same rate thereby making the low-income earner to sacrifice more than those in the high income group.
2. It does not encourage maximisation of government revenue because of the constant tax rate.
3. It is against the principle of taxable capacity. This is because the lower income group is required to sacrifice more than the higher income group.

(II) Progressive Tax System

This form of tax is graduated as it applies higher rates of tax as income increases. For instance, the progressive tax concept can be explained with the following illustration:

Table 1.1: Personal Income Tax Table

<i>Taxable Income</i>	₦	<i>Tax Rate (%)</i>
First	30,000	5
Next	30,000	10
Next	50,000	15
Next	50,000	20
Over	160,000	25

From the illustration above, it shows that progressive tax system has a main objective of redistributing the income of the rich to that of the poor in some ways. For instance, the rich are taxed heavily to finance projects of common interest.

Advantages

1. It is based on the ability of the tax payer to pay;
2. It maximises the revenue for the government;
3. It is flexible as government can use it to get more revenue or to grant tax relief to low income earners;
4. It is equitable – this tax system is equitable because it requires proportional sacrifice on the part of taxpayers. The higher income group bears the heaviest tax burden;
5. It promotes economic stability – by reducing the tax rates during recession or depression periods, the government provides relief to the taxpayer so that they may increase their demand for goods and as a result investment is encouraged. On the other hand, tax rates can be raised during economic boom thereby reducing the purchasing power of the taxpayers and as a result, inflation is fought. Thus, this tax system helps in bringing economic stability in the economy;
6. It encourages better use of resources – the high income groups mostly indulge in conspicuous consumption and thereby waste their incomes. By taxing luxury goods and incomes of the rich heavily, the government can prevent them from wasteful expenditures and therefore, be in the position to make better use of the country's resources.

Disadvantages

- i. It has faulty basis – it is based on diminishing marginal utility of income, which is faulty. Utility is subjective and cannot be measured in terms of money, it is not therefore right to base a tax system on subjective utility that is arbitrary;
- ii. It is arbitrary – there is no scientific or standard method of fixing the rate of progression. It is usually fixed by the revenue board; but where there are checks and balances, arbitrariness can be curtailed;
- iii. It discourages capital formation – this tax system adversely affects savings, investment and capital formation as taxpayers that have the ability to save and subsequently invest are taxed heavily;
- iv. It is unjustifiable – some people earn high as a result of working hard, while some remain poor because of laziness; it becomes unjustified to tax high-income groups at high rates thus punishing them for their resourcefulness;
- v. It may lead to tax evasion or tax avoidance – people who are taxed heavily try to evade payment of taxes by maintaining false accounts and submitting false statements to tax authorities or avoid taxes by finding and taking advantage of loopholes in the tax laws.

(III) Regressive Tax

Under this type of tax, the tax payable decreases as the taxpayer's income increases. A high income person pays less tax than a low income person in a regressive tax system.

Illustration 2

Table 1.2: Regressive Tax Table

<i>Taxpayer Income</i>	<i>Tax Rate</i>	<i>Tax Payable</i>
₦	%	₦
20,000.00	30	6,000.00
40,000.00	20	8,000.00
60,000.00	10	6,000.00
80,000.00	5	4,000.00

This system may not be suitable for developing countries as it yields low revenue and condone political and social reactions. However, it is not commonly applied even in developed economies.

The second form of tax classification is by incidence which is given as follows.

(I) Direct Tax

This form of tax is assessable directly on the taxpayer who is required to pay tax on his property, income or profit, etc. He/she is not only advised by notification (called assessment notice), but he/she is duly receipted. The purpose of these formalities is to bring to the taxpayer's notice the incidence of such tax.

The types of tax that fall under this heading include the following:

- Personal income tax
- Companies income tax
- Capital gains tax
- Education tax, etc.

(II) Indirect Taxes

Indirect taxes are borne by persons other than the ones from whom the tax is collected. These are taxes which are imposed on commodities before reaching consumers and are paid by those upon whom they ultimately fall, not as taxes, but as part of the selling price of the commodities.

The types of tax that fall under this heading include the following:

- Value Added Tax (VAT)
- Stamp duties
- Excise duties
- Customs duties, etc.

Indirect taxes may affect the cost of living, as they constitute taxation on expenditure.

SELF-ASSESSMENT EXERCISE 3

1. —What structure of tax system will you recommend for a developing country like Nigeria?
2. What are the demerits of direct and indirect taxes?

3.4 Canons of Taxation

A good tax system is easy to administer and shares the burden of taxation justly. Adam Smith puts forward the following canons or principles of taxation which a good tax system should display.

- (a) **Equity** – a good tax system should be equitable. That is, every person should be taxed according to his/her ability. This principle recommends progressive tax system;
- (b) **Certainty** – the amount of tax to be paid, the time of payment and the manner of payment should be certain and clear to both taxpayers and tax officials;
- (c) **Convenience** – a good tax system should be convenient in terms of time and mode of payment, to the taxpayer;
- (d) **Administrative efficiency** – the process of levying and collecting taxes must be administratively efficient, transparent and economical without any distortion;
- (e) **Productive** – a tax system should be such that brings in sufficient revenue to the government.

SELF-ASSESSMENT EXERCISE 4

Looking at the Nigerian tax system, which canons of taxation is being adhered to?

3.5 Legal History of Personal Income Tax

Taxation in Nigeria started with personal income tax in 1904, when Lord Lugard introduced income tax in the northern part of Nigeria. Community tax became operative through the Revenue Ordinance of 1904. In 1917, after the amalgamation of the northern and southern protectorates, the 1904 Revenue Ordinance was replaced by the Native Revenue Ordinance of 1917. Furthermore, the provisions of the 1917 ordinance were amended in 1918 and extended to southern Nigeria particularly, the west and the Midwest and subsequently, to eastern Nigeria, in 1928.

However, the Native Revenue Ordinance was later incorporated into the Direct Taxation Ordinance No. 4 of 1940, cap 54. Still in the pre-independence era, personal income tax was administered and collected by the native administrations or local government in the name of direct taxation. Under the Direct Taxation Ordinance of 1940, the assessment and collection of taxes were the primary responsibilities of the native administrations/authorities throughout the country, and taxes so collected were their main sources of revenue.

In 1943, another ordinance known as the “Income Tax Ordinance of 1943” was promulgated to take care of Lagos residents, who had opposed the 1940 ordinance. Unlike the 1940 ordinance, the 1943 ordinance was an admixture of both poll tax and income tax which were received from the native residents in the township of Lagos and non-native residents in Nigeria by the central government for the general revenue of the country.

The Nigerian Income Tax Ordinance of 1943 remained in force in the federal territory of Lagos until 1961 when the Personal Income Tax (Lagos) act of 1961 was enacted by the federal government. The root of the present laws on Personal Income Tax in Nigeria can be traced to the Fiscal Commission set up in 1957, which consisted of Sir Jeremy Rainsman as the chairman and professor R.C. Tress as a member among others. The purpose of establishing the commission was to examine the jurisdiction and fiscal powers of the various tiers of government in Nigeria.

At present, the laws that regulate Personal Income Tax in Nigeria are as follows.

1. The Income Tax Management Act (ITMA) 1961;
2. Personal Income Tax Act (PITA) 1979 as amended in 1993;
3. Tax reforms;
4. Annual pronouncements that have been gazetted.

3.5.1 Legal History of Companies Income Tax

Companies’ Income Tax was introduced in 1939 as a source of revenue for the Federal Government of Nigeria. First, tax on companies was imposed under the Companies’ Income Tax of 1939. This was to cover the aspect of income tax that was not covered by the Native Revenue Ordinance of 1917 with all its subsequent amendments.

In 1940, the Income Tax Ordinance of 1940 was promulgated to consolidate the Companies’ income tax ordinance of 1939. Tax under the 1940 ordinance was imposed upon any “person” and this expression was defined to include a company. By 1943, the income tax ordinance was enacted for Lagos residents and foreigners, including corporate organisations. This took care of some major changes such as the introduction of penalties on falsification of returns, failure to file in a return, or failure to keep the required accounting records; which are offences punishable with fine or imprisonment or both.

Chick Fiscal Commission preceded the 1954 constitution, which was the first federal constitution in Nigeria, recommended that the two taxes imposed under the Income tax ordinance of 1943 be within the exclusive jurisdiction of the federal government. The present tax system in Nigeria has its roots in the Rainsman Fiscal Commission recommendation that jurisdiction over companies income tax be exclusive to the federal government and that the States, except for certain uniform principles, should have jurisdiction over personal income tax.

It was in the light of this that the 1960 constitution conferred an exclusive fiscal power upon the federal government to impose taxes on the incomes and profits of companies. Consequently, the Companies Income Tax Act (CITA) 1961, was enacted to repeal the Income Tax Ordinance, Cap 85 which itself repealed the Income Tax Ordinance of 1943. CITA, 1961 has undergone several amendments.

SELF-ASSESSMENT EXERCISE 6

Tax practice in Nigeria predates colonialism, discuss.

3.6 Sources of Nigerian Tax Laws

The general sources of Nigerian tax laws are as shown below.

1. Legislations such as Personal Income Tax Act (1979), Companies Income Tax Act (1961), Petroleum Profit Tax Act (1959), Income Tax Management Act (1961), etc;
2. 1999 Federal constitution;
3. Court judgements;
4. Circulars and practices of inland revenue officials;
5. Opinions of income tax experts;
6. Budget and pronouncements of relevant ministries.

The main legislative sources of tax laws are as follows.

1. **Taxation of personal income** – the 1979 constitution invalidated all the various state laws on personal income tax and promulgated a uniform law known as Personal Income Tax Act of 1993. It was also aimed at replacing the Income Tax Management Act of 1961, Income tax (Armed forces and other persons' special provision) act, 1972 and the Income Tax Management (Uniform taxation provisions) act, 1975 (Soyode & Kajola, 2006).
2. **Company taxation** – the legislation governing this has undergone several amendments. It was first enacted in 1939, but repealed and replaced with the Income Tax Ordinance of 1943.

By 1961, another legislation known as Company Income Tax Act was enacted. This was replaced by Company income tax decree of 1979. Other amendments that follow include Decree 4 of 1985, Decree 12 of 1987, Decree 31 of 1989, Decree 55 of 1989, Decree 21 of 1991, Decree 63 of 1991, Decree 3 of 1993, and Decree 30, 31 & 32 of 1996.

3. **Capital taxation** – this has two legislations that govern its administration and assessment. The Capital Gains Tax Act (CGTA) of 1967 and Capital Transfer Tax Act (CITA) of 1979, which have witnessed various amendments over the years. For example, the rate of Capital Gains Tax was reduced from 20% to 10% as a result of one of these amendments. Some objectives for these amendments were to stimulate the activities in the capital market, encourage capital formation through investment and prompt efficient management arising from merger, acquisition and take over. For the *CITA*, however, it was abrogated through the 1996 budget in the interest of the country.
4. **Petroleum profit taxation** – the upstream sector of the petroleum industry in Nigeria started in 1957 and made its first export of oil in 1958. This brought the need to have a separate and exclusive legislation for the industry. The Petroleum Profit Tax Act (PPTA), 1959 was enacted, and between 1966 and 1979, it underwent series of amendments which were consolidated into the Petroleum Profits Tax Act, Cap 354, Laws of the Federation of Nigeria (LFN) 1990. Various amendments have also been effected on the *PPTA* (1990) through various decrees, as shown below.
 - (a) Petroleum Profit Tax (amendment) decree No. 104 of 1993;
 - (b) Petroleum Profits Tax (amendment) decree No. 31, 1996;
 - (c) Petroleum Profits Tax (amendment) decree No. 18, 1998;
 - (d) Petroleum Profit Tax (amendment) decree No. 30, 1999.
5. **Consumption taxation** – this was formerly legislated by Sales Tax Decree No. 7 of 1986, which has now been replaced by Value Added Tax (VAT) decree No. 102 of 1993. The legislation takes care of indirect taxes that pass the burden of tax to the final consumer.
6. **Sectoral tax** –the education sector has a form of tax known as Education Tax, which is legislated by the Education Tax Decree No. 7 of 1993. The primary objective of having a sectoral tax for education is to raise funds for the upgrading of the nation's educational infrastructure.

SELF-ASSESSMENT EXERCISE 7

Education levy is governed by which of the legislations outlined above?

3.7 Distinction between Taxes and Levies

Tax has been defined as a compulsory levy imposed by government on persons and entities to yield revenue. The term “tax” is unique and specific in the sense that it is imposed by the government of a country or state. Examples of taxes are Companies’ Income Tax, Personal Income Tax, Valued Added Tax, etc. On the other hand, the term ‘levy’ is generic as it could describe the imposition by a legal authority of tax, penalties and fines.

It follows, therefore, that while all forms of taxes can be described as levies as they constitute imposition, not all levies can be properly described as taxes. A tax can be imposed once and the payers continue to pay, as and when due and on regular basis. Levy on the other hand and in most cases, is a one off permanent that may not occur again.

Tax, like levy, is involuntary in the sense that its compliance is compulsory, but is usually not intended to be punitive as a levy. A tax must be charged and exacted, pursuant to a legislative authority that is supported by a particular written legal instrument. If it is backed by a particular valid tax law, it is a tax irrespective of whether it is described as levy or tax.

SELF-ASSESSMENT EXERCISE 8

Highlight the difference between a tax and a levy?

4.0 CONCLUSION

The foregoing discussion is essential to imparting the background knowledge of taxation and its principles in you. This background information has justified the necessity for the imposition of taxes by governments the world over.

5.0 SUMMARY

The unit has highlighted the historical & legal background of taxation in Nigeria. Specifically the following areas have been covered.

- Definition of a tax and a levy;
- The primary purposes of taxation;
- The structure of the Nigerian Tax System;

- The canons of taxation;
- The origin of taxation in Nigeria;
- Sources of Nigerian tax laws.

6.0 TUTOR-MARKED ASSIGNMENT

1. In not more than two hundred words, discuss the history of taxation in Nigeria?
2. What is the essence of taxing the Nigerian citizenry?

7.0 REFERENCES/FURTHER READING

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UNIT 2 TAX ADMINISTRATION IN NIGERIA

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1.0 INTRODUCTION

The administration of taxes in Nigeria rests on various tax authorities depending on the type of tax under consideration.

Broadly speaking, we have three tax authorities, as shown below.

- (a) The Federal Board of Inland Revenue (FBIR)
- (b) The State Internal Revenue Board (SIRB)
- (c) The Local Government Revenue Committee

The principles of fiscal federalism give the three tiers of government the right to collect taxes within their areas of jurisdiction. The enabling law in respect of each type of tax contains a provision as to the body charged with the administration of such a tax. Each body with its composition had been discussed in details.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- discuss the different organs charged with the responsibility of tax administration in Nigeria
- enumerate the various tax laws in Nigeria
- explain the functions and composition of the Joint Tax Board
- outline the procedures for registering taxpayers.

3.0 MAIN CONTENT

3.1 Tax Laws

Taxation in Nigeria is governed by the following laws.

- (a) Personal Income Tax Act (PITA) *Cap. P8, LFN 2004* – this enables the imposition of tax on incomes of individuals, sole traders and partnerships. For example, Pay – As – You – Earn (PAYE) by employees is covered by the provisions of this act.
- (b) Companies Income Tax Act, (CITA) *Cap. C21, LFN 2004* – this imposes tax on the incomes of companies other than sole proprietorships, partnerships, and companies engaged in downstream petroleum operations. An example is corporation tax- with rate fluctuating between 30% - 45%, depending on yearly fiscal policies of the federal government.
- (c) Petroleum Profits Tax Act, (PPTA) *Cap. P13, LFN 2004* – this imposes tax on the profits of companies engaged in upstream petroleum operations.
- (d) Value Added Tax Act, (VAT) *Cap. VI, LFN 2004* – which replaced sales tax in 1994. It imposes tax on the supply of goods and services by businesses that are not specifically exempted from the payment of such a tax
- (e) Stamp Duties Act, (SDA) *Cap. 58 LFN 2004* – these are charges on all contract documents listed in the Act.
- (f) Education Tax Act, (ETA) *Cap. E4, LFN 2004* – this imposes education levy/tax on the assessable profits of all registered companies in Nigeria.
- (g) Capital Gain Tax Act, (CGTA) *Cap. C1, LFN 2004* – this imposes tax on capital gains arising from the disposal of chargeable assets listed in the act.

SELF-ASSESSMENT EXERCISE 1

Identify other tax legislations not captured above.

3.2 Organs of Tax Administration: Federal Board of Inland Revenue (FBIR)

The administration of taxes on the profits of all incorporated companies, and income tax of the Armed Forces and residents of the Federal Capital Territory is vested in the FBIR whose operational arm is known as the Federal Inland Revenue Service (FIRS).

This is covered by section 1(1) of CITA.

3.2.1 Composition of the Board

The board consists of the following officers.

- (a) Executive chairman –to be appointed by the president.
- (b) All FIRS directors and heads of department.
- (c) The director of planning, research and statistics in the Federal ministry of finance.
- (d) A member of the board of the National revenue mobilisation allocation and fiscal commission.
- (e) An officer from *NNPC* not below the rank of an executive director.
- (f) A director from the National planning commission
- (g) A director from the Nigerian customs services
- (h) Registrar–general of the Corporate affairs commission; and
- (i) The legal adviser to the *FIRS*
- (j) A secretary (an ex-officio member) who shall be an employee of the *FIRS*.

Any seven (7) members of the board shall constitute a quorum provided there is in attendance the chairman or a director of a department of *FIRS*.

Functions of *FBIR*

The functions of the board are listed below.

- (a) Administration of *CITA* and other tax acts as may be vested in *FBIR*;
- (b) Assessment and collection of companies' income tax;
- (c) Accounting for all amounts collected in a manner to be prescribed by the minister of finance;
- (d) Advising the federal government of Nigeria through the minister of finance on tax matters including amendments to tax laws; and
- (e) Issuing directives or guidelines on the interpretation of the provisions of the *CITA* and other tax laws.

- (f) Setting up a technical committee to assist the board in the performance of its duties. This committee shall comprise of the executive chairman of *FBIR* as the chairman and all directors and heads of department of the *FBIR*, the legal adviser to *FIRS* and the secretary to *FBIR* as members.

The technical committee shall consider and make recommendations to the board on all tax matters that require professional and technical expertise. Also, to advise the board on its powers and duties which it may not delegate except to the Joint Tax Board (JTB) with the consent of the minister.

3.2.2 State Board of Internal Revenue (SBIR)

Section 87 of *PITA* provides for the setting up of a board of internal revenue for each state whose operational arm is to be known as the State Internal Revenue Service (*SIRS*).

Composition – the board of internal revenue for each state and the *FCT*, Abuja consists of:

- (a) the chief executive of the state internal revenue service as chairman;
- (b) directors and heads of department within *SIRS*;
- (c) a director from the state ministry of finance;
- (d) the legal adviser to the *SIRS*
- (e) three other persons nominated by the commissioner for finance on their personal merit; and
- (f) a secretary (an ex-officio member) who shall be an employee of the *SIRS*.

Any five members of the state board of internal revenue, of whom one shall be the chairman or a director, shall constitute a quorum.

Functions of the *SBIR*

The state board of internal revenue has the following responsibilities.

- (a) Ensure the effectiveness and optimum collection of all taxes and levies due to the government, under the relevant laws;
- (b) Undertake such things as may be deemed necessary and expedient for the assessment and collection of taxes and shall account for all monies so collected in a manner to be prescribed by the commissioner of finance;

- (c) Make recommendations, where appropriate, to the Joint Tax Board on tax policy, tax reforms, tax registration, tax treaties and exemptions as may be required from time to time;
- (d) Control the management of the *SIRS* on matters of policy, subject to the provisions of the law setting up the *SIRS*.
- (e) Appoint, promote, transfer and impose discipline on employees of the *SIRS*.

Delegation of Functions

The *SBIR* may, by notice in the gazette or in writing, authorise any person to:

- (a) perform or exercise on behalf of the board, any function, duty or power conferred on the board; and
- (b) receive any notice or other documents to be given or delivered to it or in consequence to this act or any subsidiary legislation made under it. However, the *SBIR* shall not delegate any power conferred on it under some specific sections of *PITA* (example- section 2, 6, 7, etc.) to any person. This is sequel to the abuse of tax administration experienced in some states during the military era in Nigeria.

In order to assist the *SBIR* in the performance of its duties, section 89 of *PITA* also provides for the establishment of a sub-committee of the board, known as “the technical committee”.

The technical committee is to comprise the following officials.

- (a) The chairman of the *SBIR* as chairman;
- (b) The directors within *SIRS*;
- (c) The legal adviser to the *SIRS*; and
- (d) The secretary of the *SBIR*.

The committee is expected to carry out the following functions.

- (a) Exercise the powers of co-opting additional staff from within the *SIRS* in the discharge of its duties;
- (b) Treat all matters that require professional and technical expertise and make recommendations to the *SBIR*;
- (c) Advise the *SBIR* on all its powers and duties; and
- (d) Attend to such other matters as may, from time to time, be referred to it by the board.

3.2.3 Local Government Revenue Committee

This committee was established by the provisions of section 90 of *PITA*. It states that each local government in Nigeria should have Local Government Revenue Committees (LGRCs).

Composition of *LGRCs*

The Committee shall consist of:

- (a) the supervisory councillor for finance as chairman
- (b) three local government councillors as members; and
- (c) two other persons experienced in revenue matters to be nominated by the chairman of the local government- on their personal merits.

Functions of *LGRCs*

The Committee shall be responsible for the assessment and collection of all taxes, fines and rates under its jurisdiction and shall account for all monies so collected in a manner to be prescribed by the chairman of the local government.

The revenue committee shall be autonomous of the local government treasury department and shall be responsible for the day – to – day administration of the department which forms its operational arm.

3.2.4 Joint Tax Board (JTB)

Section 86 of *PITA* provides for the establishment of the *JTB* which shall comprise the following.

- (a) The chairman of the *FBIR* , who should also serve as the chairman;
- (b) One member from each *SBIR*, being a person experienced in income tax matters nominated either by name or office, from time to time, by the commission charged with the responsibility of matters relating to income tax in the state in question;
- (c) The secretary, who is not a member of the board, and is appointed by the Federal Civil Service Commission (FCSC)
- (d) The legal adviser of *FIRS* acts as the legal adviser to the *JTB*.

Any seven members or their representatives shall constitute a quorum.

Functions of *JTB*

The board shall:

- (a) exercise the powers or duties conferred on it by the *PITA* and other acts;
- (b) advise the federal government, on request, in respect of double taxation arrangement with any other country;
- (c) advise the federal government on request, in respect of rates of capital allowances and other taxation matters having effect throughout Nigeria in respect of any proposed amendment to *PITA*;
- (d) promote uniformity both in the application of *PITA* and in the incidence of tax on individuals throughout Nigeria; and
- (e) impose its decisions on matters of procedure and interpretation of *PITA* on any state for purposes of conforming to agreed procedures or interpretations.

3.2.5 Joint State Revenue Committee (JSRC)

Section 92 of *PITA* establishes the *JSRC* for each state of the federation.

Composition

The *JSRC* comprises the following.

- (a) the chairman of the *SIRS* as the chairman;
- (b) the chairman of each of the *LGRC*;
- (c) a representative of the Bureau for Local Government Affairs, not below the rank of a director;
- (d) a representative of the Revenue Mobilisation Allocation and Fiscal Commission (RMAFC), as an observer.
- (e) The state sector commander of the Federal Road Safety Commission (FRSC), as an observer;
- (f) The legal adviser of the *SIRS*;
- (g) The secretary of the committee who shall be a staff of the *SIRS*.

Functions of *JSRC*

The functions of the committee are as listed below.

- (a) Implementing the decisions of the *JTB*
- (b) Advising the *JTB*, and the state and local governments on revenue matters;
- (c) Harmonising tax administration in the state;

- (d) Enlightening members of the public generally on state and local government revenue matters; and
- (e) Carry out such other functions as may be assigned to it by the *JTB*.

3.2.6 Body of Appeal Commissioners

The minister or a state commissioner of finance may, by notice in the gazette, establish a body of appeal commissioners. An appeal commissioner:

- (a) shall be appointed from among persons appearing to the state commissioner to have had experience and shown capacity in the management of a substantial trade or business or the exercise of a profession of law, accountancy or taxation in Nigeria;
- (b) shall hold office for a period of three years from the date of his appointment;
- (c) may at any time resign as an appeal commissioner by notice in writing addressed to the minister or state commissioner; except that on the request of the minister or state commissioner, he may continue to act as an appeal commissioner after the date of his resignation and sit at any further hearing in a case in which he has already sat before that date to hear an appeal, until a final decision has been given with respect to that appeal;
- (d) shall cease to hold office if the state commissioner determines that his office is vacant and on notice of the determination being published in the state gazettes or on his acceptance of a political appointment.

3.2.7 Tax Jurisdictions: Taxes to be collected by the Federal Government

The FBIR is constituted under section one of CITA to assess and collect the following taxes on behalf of the federal government.

- (a) Companies income tax of limited liability companies (incorporated companies);
- (b) Withholding tax on companies and residents of the FCT,-Abuja, and non-residents;
- (c) Petroleum profits tax, VAT and education tax
- (d) Capital gains tax and stamp duties on corporate bodies, residents of the FCT and non-residents;
- (e) Pay – As – You – Earn (PAYE) of members of the armed forces, police force, residents of the FCT and the staff of the ministry of foreign affairs and non-residents.

3.2.7.1 Taxes and Levies to be collected by the State Government

The SBIR shall have the power to assess and collect the following categories of taxes and levies.

- (a) Pay – As – You –Earn (PAYE), direct taxation (self-assessment and withholding and capital gains taxes of individuals.
- (b) Stamp duties on instruments executed by individuals
- (c) Pools, betting and lotteries, gaming and casino taxes
- (d) Road taxes and naming of street registration fees in the state capital
- (e) Business premises registration fees
- (f) Development levy, right of occupancy fees and market taxes and levies

3.2.7.2 Taxes and Levies to be collected by the Local Governments

The following taxes and levies are collectable at the local government level.

- (a) Shops, kiosks rates and tenant rates
- (b) On and off liquor license fees
- (c) Marriage, birth and death registration fees
- (d) Naming of street, right of occupancy fees for towns and lands in the rural areas
- (e) Market and motor park levies
- (f) Domestic animal license fees and cattle tax
- (g) Merriment and road closure levy
- (h) Radio and television license fees
- (i) Wrong parking charges
- (j) Customary burial grounds permit fees
- (k) Religious places establishment permit fees
- (l) Signboard and advertisement permit fees.

3.2.8 Registration of Taxpayers

An incorporated company is expected to register with the FBIR, while unincorporated entities and individuals are expected to register with the SBIR of the state where they are resident.

Incorporated companies

Within 18 months of incorporation or six months after the end of its first accounting period, whichever is earlier, a newly incorporated company is required to register with the FBIR, through a written application giving the following details.

- (a) Nature of the company's business;
- (b) The company's adopted year end;
- (c) The names of directors;
- (d) The appointed auditor and tax consultants, if already appointed;
- (e) The appointed bankers, if any;
- (f) Certified true copies of the certificate of incorporation;
- (g) Certified true copies of the memorandum and articles of association.

The company will be registered if the FBIR is satisfied with the application, otherwise, it will call for further information and /or documents.

Other businesses/persons

A taxable person is expected to register with the relevant tax authority within 3 months of the year by completing the prescribed forms and forwarding them to the relevant tax authority. For employees, the employer is expected to register itself as an agent of the State tax authority for the purposes of deduction of taxes from the emoluments of its employees and remitting the tax so deducted to the tax authority under the PAYE scheme.

SELF-ASSESSMENT EXERCISE 2

Enumerate the functions of the various organs charged with the responsibility of tax administration in Nigeria.

4.0 CONCLUSION

The discussion of tax administration in Nigeria is very vital to you as a future accountant. Therefore, it is very essential for you to keep what you have learned to heart and apply it to your studies in taxation and even beyond.

5.0 SUMMARY

The unit has exposed you to the various organs charged with the responsibility of tax administration in Nigeria. Specifically, it has:

- discussed the existing and relevant tax laws in Nigeria
- itemised the main organs of tax administration, for each tier of government in Nigeria
- detailed the composition of each organ including the composition of *JTB*, *JSRC*, and body of appeal commissioners
- outlined the functions of all the organs and the number of attendants necessary to form a quorum for each meeting
- analysed taxes collected by the three tiers of government.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the fiscal powers, in relation to tax, that are bestowed on the three tiers of government in Nigeria?
2. What process would you adopt in registering taxpayers, such as companies, in Nigeria?

7.0 REFERENCES/FURTHER READING

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UNIT 3 TAXATION OF INCOME VERSUS TAXATION OF CAPITAL

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1.0 INTRODUCTION

In every country, taxes are levied on profits arising from a regular business operation or from a one – off action which may not necessary involved a business activity. In Nigeria, taxes are levied on income from employment business operations and the disposal of capital goods. Legislations such as PITA, CITA and PPTA regulate taxation of income, while CGTA regulates taxation of capital. This unit explains to you, extensively, capital gains tax and draws a clear difference between it and other forms of taxes.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- state the differences between the taxation of income and taxation of capital
- illustrate the composition of the taxation of income and taxation of capital
- discuss the similarities between the two forms of taxation
- define capital gains tax, clearly
- explain roll over relief, vividly.

3.0 MAIN CONTENT

3.1 Taxation of Income

Income accruing in Nigeria (income producing assets), derived from Nigeria (income producing activities), brought into Nigeria (remittances) and received in Nigeria (emoluments) are all subject to income tax. Income tax is payable on income from a source inside or outside Nigeria and in particular, but not restricted to the following:

- (a) profit or gains from a trade, business, profession or vocation;
- (b) remunerations from and employment which may be salary, wage, fees, allowances or gains from employment; including compensations, commissions, bonuses, premiums or benefits in kind.

Individuals and companies alike are assessed on any taxable incomes they received or earned. For individuals, graduated tax rates are used in assessing them, while companies/corporate organisations are assessed using fixed and uniform rates as determined by the relevant legislation or the tax policy prevailing in that period. Taxation of income has been discussed in subsequent units.

SELF-ASSESSMENT EXERCISE 1

What are the legislations that govern the taxation of income in Nigeria?

3.2 Taxation of Capital

Basically, taxation of capital gains arises from the disposal of assets by both private and business entities. It was introduced in Nigeria through the capital gains tax act, Cap 42, LFN, 1990. Capital gains tax is charged on the proceeds of assets disposed of by a taxpayer. It is remarkable that while taxation of income had been a permanent feature of the English tax system

since 1799, capital gains were not introduced until 1962. Even then, the tax was introduced solely for the limited purpose of levying speculative gains. A comprehensive version of capital gains tax was instituted in the United Kingdom only in 1965. One would have suggested that the decision to tax capital gains could have been implemented by integrating such gains into the mainstream of taxable income.

3.2.1 The Structure of Capital Gains Tax (CGT)

The tax aims at all gains accruing to any person upon the disposal of assets in the year of assessment. Such gains are determined by deducting from the proceeds of the disposal, certain specified sums. That is, the amount or value of the consideration laid out to acquire the asset, incidental costs of the acquisition, cost of improvements to the property, any amount incurred in establishing, preserving or defending the disposer's title to or right over the asset and incidental costs of the disposal. However, any sum which is ordinarily allowable as a deduction in computing the profits of a trade or business, profession or vocation for the purpose of income tax, may not be deducted in the computation of capital gains.

3.2.2 Assets Subject to Capital Gains Tax (CGT)

As has been obvious by the foregoing discussions, the subject matter of the tax is assets. Under the act, all forms of property, except those expressly excluded, are deemed to be assessable. Specific examples of assets given by the act include options, debts and incorporeal property (assets) generally; any currency other than Nigerian currency; any form of property created by the person disposing off it, or otherwise, coming to be owned without being acquired; and stocks and shares of every description. Until recently, it did not matter whether the assets were situated in Nigeria or not (*CGTA*, Section 3). Gains on foreign assets are chargeable in Nigeria if any part of such gains are brought into or received in Nigeria.

3.2.3 Capital Taxation Versus Income Taxation

From the description of assets, one may wonder where to draw the dividing line between incomes which are taxable under the PITA and CITA on the one hand, and capital gains intended to be taxed under CGTA on the other hand. Under the CGT act, a possible guide is the reference to the receipt of a capital sum as a condition precedent to capital gains tax liability. However, there is no helpful definition of a capital sum in the act. Section 6(2) defines it vividly as any money's worth which is not excluded from the consideration taken into account in the computation of chargeable gains.

Unfortunately, one cannot take the general view that only the disposal of capital assets gives rise to the receipt of a capital sum. Apart from the customary dilemma of distinguishing capital from other assets, the act itself clearly contemplates the possibility of capital gains arising from the disposal of all forms of property, including tangible moveable properties. To be on a safe side, one can only summarise, albeit vaguely, that no recurrent gains, especially those that result from the disposal (not exploitation) of capital assets will be regarded as capital gains.

What amounts to a disposal? Disposal is itself a term capable of very wide definition. Under section 6 of the act, it includes a sale, lease, transfer, assignment and compulsory acquisition, but it does not include a gift. Also, a disposal occurs where any capital sum is received in return for feature or surrender of rights, or for refraining from exercising rights; and where any capital sum is received as consideration for use or exploitation of any asset. Hence, a disposal may be said to have taken place even where the person paying the capital sum thereby acquires no asset.

Disposal of assets also includes a part disposal. However, a conveyance or transfer by way of security of an asset and the subsequent retransfer on redemption of the security are, specifically, exempted. Similarly disregarded are cases where the disposal is from a deceased person to his personal representative or from the personal representative to a legatee. Gains made upon a compulsory acquisition of land by the government are also exempted.

3.2.4 Definition of Capital Gains

Capital Gains is defined as gains resulting from increases in the market value of assets to a person who does not regularly offer them for sale and in whose hands they do not constitute stock – in trade. These gains may be “paper” or realised gains. The gains are “paper gains” where the asset appreciate in the hands of the owner, and are “realised gains” when the assets are sold or disposed of.

Example of assets that usually give rise to capital gains are; stocks, shares, securities, land and buildings, plant and machinery and other business assets such as goodwill. Conditions for assessing capital gains to tax, according to Ayua (1999), include the following.

- (a) There must be a person chargeable to tax;
- (b) There must be a chargeable asset which gives rise to a chargeable gain upon disposal; and
- (c) There must be a disposal of the asset by the person chargeable to tax.

3.2.5 Capital Gains Tax

CGTA provides for the taxation of capital gains accruing on disposal of assets. The rate of capital gains tax, which was formerly 20%, has been amended to 10% through decree No 18 of 1998. The tax is administered by the FBIR in respect of individuals resident in the FCT and corporate bodies; while the tax is administered by the SBIR in respect of individuals, based on their residential status.

3.2.6 Chargeable Assets

The following forms of property shall be assets which the proceeds from their disposal are subject to capital gains tax under the act. These assets may or may not be situated in Nigeria.

- (a) Options, debts and incorporeal property. Incorporeal properties are assets that have values but are not tangible e.g. goodwill, copyrights and patents. Where the assets of a debtor are acquired in exchange for a debt owed and such assets are subsequently disposed, capital gains are deemed to have arisen;
- (b) Any currency other than Nigerian currency;
- (c) All qualifying capital expenditure under CITA, PITA, PPTA, or any form of property created by the person disposing it of, or otherwise coming to be owned without being acquired;
- (d) Stocks and shares of every description. This was, however, repealed by decree No 19 of 1998 in order to accelerate the development of capital market.

3.2.7 Allowable & Disallowable Expenditure

Allowable deductions (section 14)

These cover the following

- (a) Cost of acquisition or purchase price, including all costs incidental to the purchase and necessary costs incidental to the disposal;
- (b) Improvement costs wholly, exclusively and necessarily incurred;
- (c) Costs wholly, exclusively and necessarily incurred in establishing, preserving or defending the owner's title to or a right over the asset.

Disallowable deductions (section 15)

Sums allowable as a deduction in computing the profit or gains or losses of a trade for income purposes are not allowable deductions under section 14 above. Insurance premiums on the asset are also not allowable (section 16).

3.2.8 Determination of Consideration

Normally, the amount indicated as capital gain in the tax returns of the taxpayer will be accepted as the basis of assessment, but the act envisages various situations in which the taxpayer might not be able to state the consideration accurately, or in which his statement would be held suspect. For instance, where a single bargain comprises two or more transactions whereby assets are disposed of, those transactions are to be treated as a single disposal for the purposes of computing capital gains. Also, disposals would, in certain circumstances, be deemed to be for a consideration equal to the market value of the asset.

Examples include cases in which the disposal is not by way of a bargain made at arm's length and those in which the disposal is wholly or partly for a consideration that cannot be valued. The first part of the foregoing provision suggests that a disposal of property free of charge is deemed to be a disposal at market value and, therefore, that a donor of property may be made liable to capital gains tax.

3.2.9 Exemptions and Relieves

As is usual with other tax statutes, gains of ecclesiastical, charitable or educational institutions and statutory and diplomatic bodies are exempted. Where trustees or nominees transfer assets to beneficiaries, they are not considered to be disposing of the assets; hence, the transaction does not attract capital gains tax. For gains which are also liable to be taxed abroad, the double taxation relief provision of the income tax management act applies.

Other exemptions include gains made upon a disposal of business assets where the proceed are spent in acquiring new business assets; gains made upon the disposal of an interest in, the rights under any policy of assurance or contract for deferred annuity on the life of any person; sums obtained by way of compensation or damages for any wrong or injury suffered by an individual; and gains made upon the disposal of a house. Another important relief is one granted to businessmen or trade under section 32(1), where old business assets are sold and the proceeds are used to procure new and similar business assets. In that case, no gain will be considered to have occurred.

3.2.10 Part Disposal of Assets

Where a part of a whole asset is disposed of within the purview of section 6(2)(b), the sums representing the amount or value of the consideration for the acquisition of the asset referred to as cost of acquiring the assets, together with any amount of expenditure wholly, exclusively and necessarily incurred on the asset for the purpose of enhancing the value of the asset as are attributable to the asset shall—both for the purposes of computation under the act and in relation to the property which are not disposed of, be apportioned.

This may be represented as follows-

$$\text{Cost of Partial Disposal} = \frac{A}{(A+B)} \times C$$

Where A = Sales proceeds of the part disposed of;
 B = Market value of the part not disposed of;
 C = Cost of acquisition of the whole asset.

Illustration 1

Sele Ltd. purchased a set of generating plants at a cost of ₦24, 000 on 1st April, 2006. Part of the plants was sold on 31st December 2009 for ₦7, 500. The company incurred ₦1, 500 as expenses incidental to the sale. The market value of remaining plants was ₦25, 000 on 31st December, 2009.

What is: (i) the chargeable gain, if any, on the asset sold;
 (ii) the new cost of the remaining asset.

Suggested solution to illustration 1

(i) Chargeable Gain

	₦
Sales proceeds	7,500
Less cost of sale	<u>1,500</u>
	6,000
Less cost of partial disposal	<u>5,538</u>
$\frac{(7,500 \times 24,000)}{7500 + 25000} \times 1$	
Chargeable gain =	<u>462</u>

(ii) Cost of the remaining asset

$$24,000 - 5,538 = 18,462$$

3.2.11 Computation of Capital Gains

In the computation of any chargeable gain, such as may be chargeable to tax shall be the difference between the consideration accruing to any person on the disposal of the asset and any sum to be excluded from that consideration; and there shall be added to that sum the amount of the value of expenditure allowable to such person on such disposal. This can be represented as shown below.

	N	N
Consideration (sales proceeds)		xx
Less: Cost of acquisition	xx	
Allowable expenditure	<u>xx</u>	<u>xx</u>
Chargeable gains		<u>xx</u>

Therefore, chargeable tax will be 10% of chargeable gains

Exclusion of losses

In the computation of chargeable gains, the amount of any loss, which accrues to a person on a disposal of any asset, shall not be deductible from gains accruing to such person on the disposal of such an asset.

3.2.12 Connected Persons

If the disposal of a property is to a connected person, sections 23 and 24 will apply. A connected person to:

- (a) an individual – his/her spouse or relative or spouse of a relative
- (b) a trustee – his/her relative or a settler
- (c) partnership – any spouse or relative of all or one of the partners
- (d) a company – any subsidiary company or an associated company or any person who has some significant degree of control over the company.

3.2.13 Roll over Relief

Where a company, carrying on a trade or business, obtains a consideration on the disposal of eligible assets used in the business and applies such consideration in acquiring new assets of the same class as the old ones which are to be used solely for the business, a roll over relief is granted. The company will be entitled to deduct the gains arising on disposal from the cost of the new assets.

Full relief is obtained only when total consideration for the sale of the old asset is applied in the acquisition of the new asset or assets of the same class. It further states that where the amount re-invested in an asset

of the same class as that sold is less than the full sales proceeds, the chargeable gain that should be rolled over (that is, allowed as a deduction from the cost of the new asset) will be limited to so much of the chargeable gain so re-invested.

The effect of this roll over relief is to reduce the cost of acquisition of a new asset with the resulting increase in the capital gains arising on eventual disposal of the second asset. There will be a partial roll over relief where the amount re-invested on the new asset is more than the cost of the old asset, but not up to the sales proceeds of the old asset. More importantly, there will be no roll over relief when the amount re-invested in the new asset is not up to the cost of the old asset.

This roll over relief is by way of deferral of tax liability to some future dates when the asset newly acquired is eventually disposed. It is however, available only for the following classes of assets.

- (a) Any land & building of a permanent or semi-permanent nature occupied and used for trading purposes;
- (b) Any plant & machinery, ships, aircraft or goodwill.

The consideration arising on disposal must be re-invested within twelve months before or after disposal before the roll over relief can be granted.

SELF-ASSESSMENT EXERCISE 2

1. Define capital gains tax in your own words.
2. What is the structure of capital gains tax in Nigeria?
3. Jat Ltd. purchased a set of plants at a cost of ₦120, 000 on 1st April, 2006. Part of the plants was sold on 31st December, 2009 for ₦35, 000. The company incurred ₦7, 500 as expenses incidental to the sale. The market value of remaining plants was ₦125, 000 on 31st December, 2009.

What is:

- (i) the chargeable gain (if any) on the asset sold?
- (ii) the new cost of the remaining asset?

4.0 CONCLUSION

This unit has focused more on taxation of capital. It is pertinent for you to acquaint yourself with the basic principles for computing capital gains, noting all the variables necessary for computing chargeable incomes from a trade, business, profession or vocation.

5.0 SUMMARY

The unit has exposed you to the following:

- the difference between taxation of income and taxation of capital
- capital gains tax, which is a cardinal attribute of capital taxation
- the structure of *CGT*
- part disposal, chargeable assets including all qualifying capital expenditure (fixed assets), options, debts and incorporeal properties
- allowable expenses
- roll over relief and the conditions for granting it.

6.0 TUTOR-MARKED ASSIGNMENT

1. Mailafia Ltd. sold a building acquired in 2006 at a cost of ₦500,000 on 1st July, 2008. On December 31st, 2008, the company re-invested part of the proceeds of disposal in the acquisition of another building. This building, acquired on 31/12/2008 was sold on 30th June, 2009 for ₦1,500,000.

Required: compute the capital gains tax payable as a result of each of the above transactions.

2. Mr. Jat Jack who has a successful business decided to sell it to a limited liability company, Nasuwa located in Bauchi, on 1st January 2007. In exchange for this, he was offered ₦500,000 cash.

The assets of Jat Jack's business are as detailed below.

	Cost (₦)	Market value (₦)
Plant & machinery	250,000	470,000
Equipment	113,400	245,370
Freehold premises	1,692,000	9,000,000
Stocks of goods	330,000	210,000
Other sundry items	408,000	396,000
Debtors	294,000	-

Also Mr. Jat Jack spent extra ₦170,000 on machinery; while only ₦93,800 was recovered from debtors after spending ₦56,000 on debt recovery. In respect of Freehold premises, the part he disposed of at ₦2,500,000 was a duplex within the whole property. He spent about ₦828,000 to refurbish the whole property before the disposal of the duplex. He valued goodwill at ₦240,100.

You are required to compute:

- i. the chargeable gains
- ii. the chargeable tax.

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UNIT 4 BASIS OF ASSESSMENT OF PROFITS OF BUSINESSES (BASIS PERIOD)

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1.0 INTRODUCTION

As you are going to see in this unit, the basis period of assessment is very important, as it is a determinant of the assessable income or profits, and hence, the amount of tax payable by any taxpayer. Therefore, this unit shall focus on the rules for determining the assessable profits of businesses that are just commencing, those that changed their accounting dates and also those that have ceased from business operations.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define assessable profits
- determine the basis of assessment for a subsisting business, new business and so on
- compute the total profits necessary for tax purposes.

3.0 MAIN CONTENT

3.1 Determination of Basis of Assessment

It is of significance that the tax authority determines the correct basis period for a business that is liable to tax. The reasons are:

- (a) tax authority will neither tax a taxpayer twice nor leave a portion of the profit unassessed.
- (b) it helps the tax authority to grant capital allowances to tax-payers, as well as, carry forward any excess of such.
- (c) it helps in the set off of loss reliefs as well as lapsing of any losses without relief.

SELF-ASSESSMENT EXERCISE 1

Justify the necessity for determination of basis period by a tax authority.

3.2 Basis of Assessing a Subsisting Business

The basic principle underlying the concept of “basis of assessment” is that the assessable profits for a year of assessment shall be the business profits that are adjusted profit for its accounting year, ended in the preceding year of assessment. For instance, the profits that will be assessed to taxation in the year 2009 will be the profits of the year 2008. This is what is popularly referred to as the “Preceding Year Basis” (PYB) of assessment and the applicable rule is known as the “*normal rule*”.

Illustration 1

Nerat Ltd. is a Company which commenced business on 1st January, 1995. Its profit and loss account for the year ended December 31st 2008 showed a profit of ₦20million. After applying the rules of allowable expenses and taxable income, the company had an adjusted profit of ₦30million for the year ended December 31st 2008. The company’s adjusted profits for the two previous years are as follows:

Year ended December 31, 2006	-	₦15million
Year ended December 31, 2007	-	₦22million

You are required to determine the basis of assessment and assessable profit for all relevant years of assessment.

Suggested Solution

NERAT LTD

The assessable profits on Preceding Year Basis (PYB), for all relevant years are as follows:

Assessment year	Basis Period	Assessable Profits N=million
2006	1/1/05 – 31/12/05	15
2007	1/1/06 – 31/12/06	22
2008	1/1/07 – 31/12/07	30

Note: The above principle only applies in a situation where a company has been in business for some years and there is no change of accounting date.

SELF-ASSESSMENT EXERCISE 2

Kim Ltd. is a company which commenced business on 1st January, 1991. Its profit and loss account for the year ended December 31st 2004 showed a profit of ₦10,000,000. After applying the rules of allowable expenses and taxable income, the company had an adjusted profit of ₦15million for the year ended December 31st 2004.

The company's adjusted profits for the three previous years are as follows:

Year ended December 31, 2001	-- ₦ 7.5million
Year ended December 31, 2002	-- ₦ 6million
Year ended December 31, 2003	-- ₦ 5million

You are required to determine the basis of assessment and assessable profit for all relevant years of assessment.

3.3 Basis of Assessing a New Business

There are commencement rules guiding assessment of a company that is starting business newly. The normal basis period cannot apply because there will be no profit of the preceding accounting period from which assessment can be derived. In ascertaining the assessable profit for any person commencing trade or business newly, three years' accounts must be submitted. When these accounts are submitted, the business will be assessed as follows:

- (1) **First year of assessment (tax year)** – the basis period of assessment is from actual date of commencing business to December 31, of the year in which the business commenced (Actual year). For example, if year of assessment is 2008, the basis period will fall within 2008 too; and the assessable profit will be the profit of same year, 2008;
- (2) **Second year of assessment** – the basis period for the second year is the first twelve months of business operations;

- (3) **Third year of assessment** – the *PYB* of assessment starts from the third year. However, where this cannot be derived, the second tax year basis period, and indeed the profit are repeated for the third year. *PITA* 1993, Section 24 (d) makes provisions for taxpayer’s right of election (election rule) where he feels it will be beneficial to do so. The “actual” profits for the second and third tax years are computed having given notice in writing to the relevant tax authority. The notice should be given within two years after the end of the second tax year, to request that the assessable profits both for the second and third years shall be the profits of the respective years of assessment.

Illustration 2

Mr. Goodness is a dealer in motor spare parts in Jos. He started this business on 1st February, 2003. The following results relate to his business activities.

	31 March	Profits
		₦
13 months ended	2004	390,000
Year ended	2005	420,000
Year ended	2006	600,000
Year ended	2007	950,000

Mr. Goodness had exercised the election rule available under *PITA* 1993 Section 24(d).

Required - determine the assessable profits that will be made based on the above information.

Suggested solution

Mr. Goodness

Computation of Assessment Profits

Normal Basis-

<i>Year of Assessment</i> (<i>Tax Year</i>)	<i>Basis Period</i>	<i>Assessable Profit</i>
		₦
2003 (Date of commencement to 31 st Dec.)	1/2/03-31/12/03 (390,000 x 11/13)	330,000
2004 (The 1 st twelve months)	1/2/03-31/1/04 (390,000 x 12/13)	360,000
2005 (<i>PYB</i>)	1/4/03-31/3/04 (390000x11/13+420,000x1/12)	365,000

Election Basis-

2003 (Date of commencement to 31 st Dec.)	1/2/03-31/12/03	330,000
2004 (Actual)	1/1/04-31/12/04 (390000x3/13+420,000x9/12)	405,000
2005 (Actual)	1/1/05-31/12/05 (420000x3/12+600,000x9/12)	555,000

Preceding Year Basis (PYB)-

2006	1/4/04-31/3/05	420,000
2007	1/4/05-31/3/06	600,000
2008	1/4/06-31/3/07	950,000

The tax payer can now decide on the assessment basis he will like to be assessed. Thus, the two years involved in decision-making are 2004 and 2005 years of assessment.

Normal Rule Election Rule

	₦	₦
2004	360,000	405,000
2005	<u>365,000</u>	<u>555,000</u>
	<u>725,000</u> (A)	<u>960,000</u> (B)

Since election basis is not advantageous for the taxpayer, the final assessment will be based on normal basis as follows-

Year of Assessment	Assessment Profit
	₦
2003	330,000
2004	360,000
2005	365,000
2006	420,000
2007	600,000
2008	950,000

Note- If (B) had been lower than (A), the taxpayer would have elected the second assessment instead of the first.

SELF-ASSESSMENT EXERCISE 3

Izundu is a dealer in tractor spare parts in Bauchi. He started this business on 1st February, 2000.

The following results relate to his business activities-

	30 April	Profits
	₦	₦
14 months ended	2001	360,000
Year ended	2002	520,000
Year ended	2003	680,000
Year ended	2004	750,000

Required- you are to determine the assessable profits of Mr. Izondu that would minimise his tax liability.

3.4 Basis for Assessing a Ceasing Business

When a business ceases operation, the cessation of business rules will apply. The following steps should be followed:

1. Determine the year in which the business stopped its trading activities. This final year of cessation is called "ultimate year". The basis of assessment is the profit from 1st January, preceding cessation to the actual date of cessation. In other words, the basis is *actual*;
2. Identify the period. That is, assessment year before the cessation took place. This preceding tax year is called "*penultimate year*". The basis of assessment is the usual Preceding Year Basis (*PYB*). However, the revenue authority has the right to elect the profits of this assessment year on actual basis.

Illustration 3

Jabest Business Ventures ceased operations on 31st October, 2008. Its adjusted profit/losses for tax purposes were as follows:

	₦
Year ended 30th September, 2005	12,000
Year ended 30th September, 2006	(18,000)
Year ended 30th September, 2007	48,000
Period to 31 st October, 2008	39,000

Required- compute the assessable profits for all the relevant years of assessment, bearing in mind the available option on cessation of business.

Suggested Solution**Jabest Business Ventures**

Assessable Profits on cessation of business.

Year of Assessment	Basis Period	Assessable Profit ₦
2006 (PYB)	1/10/04-30/9/05	12,000
2007 (PYB)	1/10/05-30/9/06	Nil
2008 (Actual)	1/1/08 -31/10/08 (10/13 x 39000)	30,000

Option/Election

2007 Actual	1/1/07-31/12/07 (9/12x48, 000 + 3/13x39, 000)	45,000
2008 Actual	1/1/08 – 31/10/08 (10/13 x 39,000)	30,000

Decision by the tax authority-

	Normal ₦	Election ₦
2007	Nil	45,000
2008	<u>30,000</u>	<u>30,000</u>
	<u>30,000(A)</u>	<u>75,000(B)</u>

The tax authority will elect option “B” because it gives a higher total of assessable profits.

Therefore, the final assessment will give the following figures-

	₦
2006	12,000
2007	45,000
2008	30,000

SELF-ASSESSMENT EXERCISE 4

Bommcos Global Ventures ceased operations on 30th June, 2008. Its adjusted profit/losses for tax purposes were as follows:

	₦
Year ended 30th September, 2005	24,000
Year ended 30th September, 2006	(36,000)
Year ended 30th September, 2007	92,000
Period to 30 th June, 2008	50,000

Required- compute the assessable profits for all the relevant years of assessment, and advise the tax authority on the best option.

3.5 Basis for Assessing Business that Changed Accounting Date

PITA Section 23(3) makes provision for a business that wishes to change its accounting year end. Again, the relevant tax authority must be adequately informed of the change of accounting date. To carry out tax computation under change of accounting date, the following steps are necessary.

- (1) Identify the year of assessment in which the business fails to make up its accounts to the previous date;
- (2) Identify also the two years of assessment that follow the one stated in step one;
- (3) Compute the assessable profits for the first year of assessment as a result of the change in the accounting date using old accounting date as basis period;
- (4) Calculating the two years of assessment that follows step 3 above also using the old accounting date as basis period;
- (5) Using the new accounting date as the basis period, compute the assessments for the three years of assessment in steps 3 and 4 above;
- (6) Aggregate the results in steps 3 and 4 above and compare with the total of the three years in step 5 above;
- (7) The relevant tax authority would adopt the higher amount obtained in step 6 above as the assessments for the period.

Illustration 4

Chenji Bakeries (Nig.) Ltd. had (for several years) been making up its accounts to 31st December of each year. However, as a re-organisation strategy, the business decided to change its accounting year-end to 31st, March. These are the operating results as adjusted for tax purposes.

	₦
Year to 31 December, 2003	360,000
Year to 31 December, 2004	450,000
15 months to 31 March, 2006	540,000
Year to 31 March, 2007	- 620,000
Year to 31 March, 2008	- 650,000
Year to 31 March, 2009	- 710,000

Required- calculate the assessable profits for all the years involved bearing in mind the Revenue's practice when there is a change of accounting date.

Suggested Solution**Chenji Bakeries (Nig) Ltd**

Computation of Assessable Profits for three years based on Old Accounting Date-

Year of Assessment	Basis Period	Assessable Profit ₦
2004	1/1/03-31/12/03	360,000
2005	1/1/04-31/12/04	450,000
2006	1/1/05-31/12/05 (12/15 X 540,000)	432,000
2007	1/1/06-31/12/06 (3/15 X 540,000 + 9/12 X 650,000)	<u>373,000</u>
		<u>1,455,000 'A'</u>

The Computation of assessable profits for three years based on New Accounting Date-

2005	1/4/03 – 31/3/04 (9/12 x 360,000 + 3/12 x 450,000)	₦ 382,500
2006	1/4/04 – 31/03/05 (9/12 x 450,000 + 3/12 x 540,000)	₦ 445,000
2007	1/4/05 – 31/3/06 (12/15 x 540,000)	₦ 432,000
		<u>₦ 1,260,000 'B'</u>

The tax authority will exercise its right and opt for old accounting date which gives higher profits. Subsequent computations using new accounting date for assessable profits after decision has been made.

		₦
2008	1/4/06 – 31/03/07	620,000
2009	1/4/07 – 31/03/08	650,000
2010	1/4/08 – 31/03/09	710,000

Therefore, the tax liability shall be based on the following assessable profits;

	₦
2004	360,000 (old accounting date)
2005	450,000 (old accounting date)
2006	432,000 (old accounting date)
2007	573,000 (old accounting date)
2008	620,000 (new accounting date)
2009	650,000 (new accounting date)
2010	710,000 (new accounting date)

SELF-ASSESSMENT EXERCISE 5

Seige (Nig.) Ltd. had (for several years) been making up its accounts to 31st, March of each year. However, as a re-organisation strategy, the business decided to change its accounting year-end to 31st December. These are the operating results as adjusted for tax purposes.

	N
Year to 31 March, 2004	360,000
Year to 31 March, 2005	450,000
9 months to 31 December, 2006	340,000
Year to 31 December, 2007	- 620,000
Year to 31 December, 2008	- 650,000
Year to 31 December, 2009	- 710,000

Required- calculate the assessable profits for all the years involved bearing in mind the revenue's practice when there is a change of accounting date.

4.0 CONCLUSION

The above discourse and computations show to you the assessment of profits for tax purposes under a subsisting, new and a ceased business, and where there is a change of accounting date by a business.

5.0 SUMMARY

In this unit, you have learnt the following:

- rules governing tax assessment for new, old and ceased businesses
- the computations of assessable profits under new and old accounting dates and the implications thereof
- normal rule/basis for commencement of business has first year as actual, 2nd year as the 1st twelve months and all other years on *PYB*: while election rule/basis has, the first three years, as actual
- in commencement rule, the taxpayer has the right to choose either normal basis or election basis for computations of assessable profits, while in cessation rule, the tax authority reserves the right to make this choice
- when a business changes its accounting date for whatever reason, the tax authority reserves the right to choose three years assessable profits computed either under the old accounting date or the new accounting date.

6.0 TUTOR-MARKED ASSIGNMENT

1. Antele (Nig.) Ltd. had (for several years) been making up its accounts to 31st January of each year. However, as a re-organisation strategy, the business decided to change its accounting year-end to 30th April. These are the operating results as adjusted for tax purposes-

	N
Year to 31 January, 2003	180,000
Year to 31 January, 2004	225,000
15 months to 31 April, 2006	270,000
Year to 31 April, 2007	- 310,000
Year to 31 April, 2008	- 325,000
Year to 31 April, 2009	- 355,000

Required- calculate the assessable profits for all the years and states who has the power to opt for higher total profits.

- 2 Rocklinks Integrated Ventures ceased operations on 30th November, 2008. Its adjusted profit/losses for tax purposes were as follows-

	N
Year ended 31 st October, 2005	24,000
Year ended 31 st October, 2006	36,000
Year ended 31 st October, 2007	96,000
Period to 30th November, 2008	78,000

Required- compute the assessable profits for all the relevant years of assessment, bearing in mind the available option on cessation of business.

7.0 REFERENCES/FURTHER READING

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UNIT 5 LOSS RELIEF

CONTENTS

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
 - 3.1 Rules on Loss Relief
 - 3.2 Methods of Obtaining Loss Relief
 - 3.3 Losses used in Aggregation
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
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1.0 INTRODUCTION

As you are going to see in this unit, tax is based on profits which accrue to businesses; but where losses occur instead, the assessment of tax interest of the business or organisation is nil. Hence, a business that makes a loss from its operations is to relieve such a loss by carrying it forward for set-off against the assessable profits of the following four assessment years commencing from the year following that in which the loss was incurred. This unit exposes you to the rules, principles and treatment of loss relief.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- discuss the rules governing loss relief in Nigeria
- explain clearly the principle involved
- explain the methods and treatment of loss relief.

3.0 MAIN CONTENT

3.1 Rules on Loss Relief

The following are the rules or principles for applying loss relief to businesses, except those in agro-allied businesses.

- (a) Business loss to be deducted from assessable profit of a year of assessment shall not exceed the actual loss incurred by the business in the previous year of assessment;
- (b) According to section 31 (1) of CITA, losses are not aggregated with assessable profits in the computation of total profits that

accrue from different lines of business operations. Consequently, a business cannot aggregate any loss from one of its businesses. Sources of profits cannot be set-off against profits from another source; a loss incurred from a particular line of business can only be relieved in future years from assessable profits derived from the same source or line of business;

- (c) When losses incurred in two different assessment years are carried forward against future profits, the first loss incurred will be relieved in priority to the subsequent loss, subject to a maximum of four years loss relief periods after which any unabsorbed losses elapsed;
- (d) When business operation ceases, any terminal loss resulting therefrom, which could not be relieved in the year of cessation- due to non-availability or insufficiency of profit- is deemed lost. This is because the Nigerian tax system has no provision for carry-back of terminal loss;
- (e) No previous loss is deducted from current profits if a claim in writing, made within 12 months after the year of assessment, has not been made.

SELF-ASSESSMENT EXERCISE 1

Stipulate the conditions for granting loss relief.

3.2 Methods of Obtaining Loss Relief

There are two methods of obtaining loss relief in the Nigerian tax system. These include current year loss relief system and carry forward loss relief system. Let us look at this one after another.

(a) Current year loss relief system

This is the process of setting off the loss incurred against the total assessable profit of the taxpayer for the year of assessment in which the loss was incurred. Characteristics of current year loss relief system are listed below:

- (a) It is only applicable to individuals chargeable to tax under *PITA*;
- (b) It is not automatic; a taxpayer who wishes to enjoy this relief must claim it in writing within a period of 12 months after the end of the year of assessment;
- (c) The current year loss relief is not confined to profit from a trade, business, profession or vocation, but may be set off against all sources of income for that year including investment income;
- (d) Under the current-year loss relief system, loss relief is available only in the first year when the loss is incurred, any unrelieved

balance can only be set off against profit from the source from which the loss was incurred;

- (e) It is useful when profit from trade is declining but rising on other sources of income.

(b) Carry forward loss relief system

Under this system, the taxpayer is given the right to carry forward losses and to set them off against future assessable profits from the particular trade in which the losses were incurred.

Characteristics of carry forward loss relief system include the following:

- (a) Unlike the current year loss relief system which is available only to individuals, carry forward loss relief system is available to both individuals and companies;
- (b) The carry-forward relief is confined to the amount of loss suffered in respect of trade business, profession or vocation;
- (c) Under no circumstances shall the aggregate deduction from assessable profit in respect of any loss exceed the amount of such loss;
- (d) Losses are only available to be set off against income from which the loss was incurred, it cannot be set off against any other source of income;
- (e) Loss relief under this system is automatically granted. That is, the tax authority will use carry forward relief if the taxpayer has not applied for current year relief;
- (f) Losses incurred by a property letting business will be treated as if it were a loss incurred by the individual in a trade or business carried on by him, and therefore, can only be set off only under the carrying forward system;
- (g) Carry-forward relief is available only to the taxpayer that has incurred the loss, and the taxpayer must be carrying on the same trade or business as that in which the loss arose. Where he ceased to carry on trade, any unused losses cannot be made use of by the new purchaser of the trade or firm;
- (h) Carry-forward relief is useful where profits or income from business are increasing or where there is the likelihood of an increase in tax rates, as this will put money into the hands of the taxpayer.

SELF-ASSESSMENT EXERCISE 2

Briefly distinguish between carry forward loss relief and current year loss relief.

3.3 Losses used in Aggregation

Under the commencement regime, it is possible for the losses incurred in a particular period to be used in determining the assessable profits or losses in more than one tax year. The implication of the above is that when such losses are eventually aggregated, the total losses available for relief may be in excess of the actual loss incurred. The provision of the act in this respect is that losses to be relieved must be restricted to the actual losses incurred.

Illustration

Gwopak (Nigeria) Ltd. had sustained losses for years. In 2004, it made a good recovery. The returns for some years showed the following adjusted results.

	₦
Year ended 31 st December, 1999 (loss)	35, 000
Year ended 31 st December, 2000 (loss)	25, 000
Year ended 31 st December, 2001 (loss)	45, 700
Year ended 31 st December, 2002 (loss)	7, 500
Year ended 31 st December, 2003 (profit)	7, 900
Year ended 31 st December, 2004 (profit)	45, 000

Required- show the relief of losses against assessable profits allowed.

Suggested Solution

Gwopak (Nig.) Ltd

2000 Year of assessment (basis period- 1/1/99-31/12/99)

	₦
Loss for the year carried forward	(35,000)

2001 Year of assessment (basis period- 1/1/2000 – 31/12/2000)

	₦
Loss for the year	(25, 000)
Add unrelieved loss brought forward	<u>(35, 000)</u>
Total loss carried forward	<u>(60, 000)</u>

2002 Year of assessment (basis period- 1/1/01 -31/12/01)

	₦
Loss for the year	(45, 700)
Add unrelieved losses brought forward	<u>(60, 000)</u>
Total losses carried forward	<u>(105, 700)</u>

2003 Year of assessment (basis period- 1/1/02-31/12/02)

		₦	
Loss for the year			(7, 500)
Add unrelieved losses brought forward			<u>(105, 700)</u>
Total losses carried forward			<u>(113, 200)</u>
2004 Year of assessment (basis period- 1/1/04 – 31/12/03)			
	₦	₦	
Assessable profits for the year			7, 900
Unrelieved losses brought forward	(113, 200)		
Less relief	<u>7, 900</u>		<u>(7, 900)</u>
	(105, 300)		-
2000 loss lapsed	<u>27, 100</u>	(35, 000 – 7, 900)	
Unrelieved loss carried forward	<u>(78, 200)</u>		
2005 Year of assessment (basis period- 1/1/04-31/12/04)			
	₦	₦	
Assessable profits for the year			45, 000
Unrelieved losses brought forward	(78, 200)		
Less Relief: 2001 loss	25, 000		
2002 loss	<u>20, 000</u>		<u>(45, 000)</u>
Unrelieved loss carried forward	<u>(33, 200)</u>		-

SELF-ASSESSMENT EXERCISE 3

Enumerate at least five features of carrying over loss relief.

4.0 CONCLUSION

In this unit, you learnt that losses accumulated from business operations can be relieved from current and future profits. However, the relief is restricted to a maximum of four years, counting from the year of loss. Therefore, businesses can take this tax incentive and be encouraged in spite of any negative results.

5.0 SUMMARY

In this unit, you have learnt the following.

- Loss relief is granted to tax payers who have any unrelieved losses
- The rules on loss relief spell out some basic principles that a taxpayer must adhere to for him to enjoy this relief
- The methods for obtaining loss relief are current year and carry forward loss relief systems
- Loss relief is deducted from assessable profit before capital allowances are deducted.

6.0 TUTOR-MARKED ASSIGNMENT

1. Blessedson Lee commenced a merchandising business on the 1st may, 2003 and had always prepared his accounts to 30th April of each year. The assessable profits of his business from commencement period to 30th April 2007 are stated below.

	₦
12 month- up to 30 th April, 2004	(400, 000) loss
12 month- up to 30 th April, 2005	(20, 000) loss
12 month- up to 30 th April, 2006	500, 000 profit
12 month- up to 30 th April, 2007	600, 000 profit

You are required to:

- (a) compute his assessable profits for the relevant years of assessment- up to and including 2008 assessment year;
- (b) show how the losses will be relieved against the assessable profits of the succeeding years of assessment.
2. Ton (Nigeria) Ltd. had sustained losses for years. In 2004, it made a good recovery. The returns for some years showed the following adjusted results.

	₦
Year ended 31 st December, 1999 (loss)	350, 000
Year ended 31 st December, 2000 (loss)	250, 000
Year ended 31 st December, 2001 (loss)	457,000
Year ended 31 st December, 2002 (loss)	75,000
Year ended 31 st December, 2003 (Profit)	79,000
Year ended 31 st December, 2004 (Profit)	450, 000

Required- show the relief of losses against assessable profits.

7.0 REFERENCES/FURTHER READING

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MODULE 2

Unit 1	Capital Allowances
Unit 2	Taxation of Employees and Sole Traders
Unit 3	Partnership Taxation
Unit 4	Companies Taxation
Unit 5	Taxation of Settlement Trust and Estate

UNIT 1 CAPITAL ALLOWANCES

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1.0 INTRODUCTION

For an item of expenditure to be treated as an allowable deduction, it must be in form of revenue, rather than being in form of capital. However, relief from taxation may be given in respect of capital expenditure by means of the system of capital allowances; the appropriate allowance being set off against taxable profits in a manner similar to that of relieving losses.

This unit exposes you to the various types of qualifying capital expenditure, types of capital allowances- with their respective rates. It focuses on the provisions of PITA and CITA only. The provisions of PPTA on this same issue are beyond the scope of this course.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the term capital allowance
- discuss the essence of capital allowance in tax assessment
- illustrate the types of capital allowances in the Nigerian tax system
- state the rates of capital allowances- as applicable to every qualifying capital expenditure
- compute capital allowances for tax purposes.

3.0 MAIN CONTENT

3.1 Definition of Capital Allowances

Capital allowance may be defined as a form of standardised depreciation given under income tax laws on certain specified qualifying capital expenditures. They are granted in place of depreciation charges, which are disallowed by the government to the trader/businessman, over a considerable period of time, in order to encourage automation in the industry (Ologhodo, 2007:125).

According to Soyode & Kajola (2006:143), capital allowances are allowances granted at approved specified rates on qualifying capital expenditures and rates on assets in use for the purpose of business at the end of the relevant basis period. Accordingly, the qualifying capital expenditure must have been incurred in a basis period that is preceding the basis period ending in the preceding tax year. The allowance is allowed not as a deduction in computing assessable profit but as a deduction from assessable profits in arriving at chargeable profits.

3.2 Types of Capital Allowances

The system of capital allowances in Nigeria comprises, at least, five types- as shown below.

- (a) Initial or First Year Allowance (IA)** - which is claimed when the qualifying capital expenditure is first put into use;
- (b) Annual Allowance (AA) or written down Allowances** - which is claimed on the straight line basis over the estimated tax (useful) life of the Qualifying Capital Expenditure (QCE). This type of allowance will not apply if there is 100% initial allowance.

To get estimated tax life, the following formula is applied-

$$\frac{100}{\text{Annual Allowance Rate}}$$

For example, if the annual allowance granted on motor vehicles is 25%, the estimated tax life is $\frac{100}{25} = 4$ years.

The formula for computing the annual allowance on a straight-line basis is given as follows- $\frac{\text{Cost of QCE} - \text{Initial Allowance}}{\text{Tax Life}}$

Any result from this formula shall be the amount of annual allowance applicable for the entire tax life of the *QCE*.

- (c) **Balancing adjustment** - this type of allowance arises where a qualifying capital expenditure is disposed off. The overall idea is to bring the allowance into line with actual expenditure. Where sales proceed is less than the tax written down value at the time of disposal, a balancing allowance is deducted from assessable profit in a similar manner, as both initial and annual allowances.

Where on the other hand, the sales proceeds is more than the tax written down value at the time of disposal, a balancing charge is obtained. The tax treatment of balancing charge is to regard it as an additional taxable income. However, in subjecting balancing charge to tax, it is limited to the maximum capital allowance previously claimed on the asset prior to the disposal.

The maximum capital allowance claimed is the difference between the original cost of acquisition and the tax written down value at the time of disposal, excess balancing charge is available for capital gains tax.

- (d) **Investment allowance** – this is an incentive granted where a company has incurred expenditure on plant and equipment (Section 32 (1)- CITA or on plant and machinery (second schedule (paragraph 18 (3))- CITA. The investment allowance is granted at the rate of 10% of qualifying expenditure and such allowances shall not be taken into account in ascertaining the tax written down value of qualifying expenditure.
- (e) **Rural Investment Allowance (RIA)** – this allowance is granted to companies sited at least 20km away from the provision of electricity, water, tarred road or telephone for the purpose of its trade and which has provided the facilities that the government

failed to provide can claim rural investment allowance which is an addition to the initial allowance on such capital expenditure as follows.

- (a) No telephone – 5% of capital expenditure on asset in use;
- (b) No tarred road – 15% of capital expenditure on asset in use;
- (c) No water – 30% of capital expenditure on asset in use;
- (d) No electricity – 50% of capital expenditure on asset in use;
- (e) No telephone, tarred road, water and electricity (that is, no facility at all, 100% of capital allowance on asset use)

Investment allowance cannot be claimed on the same asset on which rural investment allowance has been claimed. Rural investment allowance can only be claimed in the year the capital expenditure is incurred and cannot be carried forward.

SELF-ASSESSMENT EXERCISE 1

First year allowance is on pro rata basis. Discuss?

3.3 Categories of Qualifying Capital Expenditure

Categories of capital expenditure that qualify for the grant of capital allowances are as follows:

- (a) Qualifying building expenditure – that is expenditure on buildings or work of a permanent nature;
- (b) Qualifying industrial building expenditure- that is expenditure on buildings or structure in regular use, such as a mill/factory, mechanical workshops, dock, port and wharf;
- (c) Qualifying mining expenditure (expenditure on a mine, oil well, etc).
- (d) Qualifying plant expenditure – that is, expenditure incurred on plant, machinery and fixtures;
- (e) Qualifying plantation expenditure (expenditure incurred on clearing of land for planting, etc)
- (f) Qualifying research and development expenditure, that is , expenditure incurred on equipment, facilities, patent licences, etc;
- (g) Qualifying agricultural expenditure (expenditure incurred on plant in use for agricultural trade or business);
- (h) Qualifying public transportation, new mass transit coach expenditure.

SELF-ASSESSMENT EXERCISE 2

Why are fixed assets referred to as qualifying expenditure?

3.4 Condition for Granting Capital Allowances

Capital allowances are granted if the following conditions are satisfied.

- (a) The business must have incurred qualifying capital expenditure;
- (b) The claimant/business must remain the beneficial owner of the asset at the end of the basis period of the company;
- (c) The asset must be in use wholly, exclusively, and reasonably for the purpose of a trade or business carried on by the firm at the end of its basis period.

SELF-ASSESSMENT EXERCISE 3

Can a car which is used by a sole trader for both business and private purposes be granted capital allowance?

3.5 Rates of Capital Allowances

The following rates are applicable under CITA

	IA	AA
	%	%
<i>Qualifying Expenditure in respect of-</i>		
Building expenditure	15	10
Industrial building expenditure	15	10
Manufacturing industrial plant expenditure	50	25
Mining expenditure	95	nil
Furniture & fittings (F&F) expenditure	25	20
Plant expenditure (excluding F&F)	50	25
Construction plant expenditure (excluding furniture & fittings)	50	25
Motor vehicle expenditure	50	25
Public transportation motor vehicle	95	Nil
Plantation equipment expenditure	95	Nil
Agricultural plant expenditure	95	Nil
Housing estate expenditure	50	25
Ranching & plantation expenditure	30	50
Research & development expenditure	95	Nil

SELF-ASSESSMENT EXERCISE 4

Justify the nil annual allowances indicated against some qualifying capital expenditure?

3.6 Basis Period for Capital Allowances

Qualifying capital expenditure bought for the purpose of a trade or business in a basis period gives rise to the right to capital allowances. Capital allowances are calculated by reference to the basis period; and the essence of determining the basis period for capital allowances is to know which tax year will benefit from initial and annual allowances resulting from the acquisition of capital assets.

3.6.1 Basis Period

The basis period for capital allowances is the same as that for the assessment of the profits of a business. This means that capital allowances are given in an assessment year in respect of assets acquired or qualifying expenditure incurred in the preceding year of assessment.

Illustration 1

Wazobia (Nig.) Ltd. normally makes up its annual accounts on acquired assets as follows:

Date	Assets purchased	₦'Million
31/12/2004	Building	5
15/5/2005	Motor vehicle	3
30/7/2006	Machinery	2
13/3/2007	Furniture and Fittings (F&F)	1.5

Here, you are required to determine the basis period and compute the capital allowances for all the relevant years.

Suggested Solution

(i) Determination of basis period-

Year of Assessment (YOA)	Basis Period for Assessable Profits	Basis Period for Capital Allowances
2006	1/7/04 – 30/6/05	1/7/04 – 30/6/05
2007	1/7/05 – 30/6/06	1/7/05 – 30/6/06
2008	1/7/06 – 30/6/07	1/7/06 – 30/6/07

(ii) Computation of capital allowances-

Building	Motor Vehicle	Machinery	Furniture	Total Allowance
1A (%)	15	50	50	25
AA (%)	10	25	25	20

2006	YOA	₦'000	₦'000	₦'000	₦'000	₦'000
	Cost	5,000	3,000			
	IA (Wk1)	(750)	(1,500)	-	-	2250
	AA (Wk 2)	<u>(425)</u>	<u>(375)</u>			<u>800</u>
	TWD	3,825	1,125			<u>3,050</u>
2007	YOA					
	Cost	-	-	2,000	-	
	Investment Allowance (On Machinery)	-	-	-	-	200
	IA	-	-	(1,000)	-	1000
	AA	<u>(425)</u>	<u>(375)</u>	<u>(250)</u>	-	<u>1,050</u>
	TWD	3,400	750	750		2,250
2008	YOA					
	Cost	-	-	-	1,500	
	1A	-	-	-	(375)	375
	AA	<u>(425)</u>	<u>(345)</u>	<u>(250)</u>	<u>(225)</u>	<u>1,275</u>
	TWD	<u>2,975</u>	<u>375</u>	<u>500</u>	<u>900</u>	<u>1,650</u>

Calculation-

(1) Initial Allowance (1A): Building = $5,000,000 \times 15\% = 750,000$
 Motor vehicle = $3,000,000 \times 50\% = \text{₦}1,500,000$
 Machinery = $2,000,000 \times 50\% = \text{₦}1,000,000$
 Furniture = $1,500,000 \times 25\% = \text{₦}375,000$

(2) Investment Allowance – Machinery = $2,000,000 \times 10\% = \text{₦}200,000$

(3) Annual Allowance (AA)- Building = $\frac{5,000,000 - 750,000}{(100/10)} = \text{₦}425,000$
 Motor vehicle = $\frac{3,000,000 - 1,500,000}{(100/25)} = \text{₦}375,000$
 Machinery = $\frac{(2,000,000 - 1,000,000)}{(100/25)} = \text{₦}250,000$
 Furniture = $\frac{1,500,000 - 375,000}{(100/20)} = \text{₦}225,000$

Note- the preceding year basis of assessment is applicable only in a situation where a normal (12 – months) accounting period ended in the preceding year of assessment is used. However, this is usually not the case on commencement, cessation of business or change of accounting dates; as these will bring about overlapping/ coincidence and gaps in the basis periods.

3.6.2 Overlapping Basis Period

Overlapping basis period occurs when a basis period is common to more than one year of assessment.

Illustration 2

Noro Mercy Ltd. is a company engaged in the entertainment business. It commenced business on 1st September, 2005 and made up accounts as follows-

10 Months ended 30/6/2006;
Year ended 30/6/2007

Required- determine the basis period for assessing the company, assuming normal rule is used.

Suggested Solution

(i) Determination of basis period for assessment

YOA	BP	
OVERLAPPING PERIOD		
2005(Actual)	1/9/05-31/12/05	-
2006(1 st 12 month)	1/9/05-31/8/06	1/9/05-31/12/05
2007(PYB)	1/9/05-31/8/06	1/9/05-31/8/06

Since basis period for capital allowances derives from that for assessment of profits, the question that arises is- when will the initial allowance be giving in respect of assets purchased during the overlapping basis period?

Suppose that the company purchased a motor vehicle on 15th December, 2005, in which of the assessment years will the initial allowance be given since the period 1/9/05 to 31/12/05 is common to 2 years of assessment (that is- 2006 & 2007)?

The rule when there is an overlapping basis period - when there is an overlapping basis period between two years of assessment, the period common to both is deemed to form part of the earlier year of assessment, for the purpose of determining the assessment year to which the initial allowances is allocated.

Illustration 3

Applying the rule on overlapping basis period to Noro Mercy Ltd., the basis period for assessment and for capital allowance, using the normal rule, is as follows.

Suggested Solution

Determination of Basis Period (BP) for Assessment Years and Capital Allowances-

YOA	BP for Assessment	BP for Capital Allowances
2005	1/9/05-31/12/05	1/9/05-31/12/05
2006	1/9/05-31/8/06	1/1/06-31/8/06
2007	1/9/05-31/8/06	-
2008	01/7/06-30/6/07	1/9/06-30/6/07

SELF-ASSESSMENT EXERCISE 5

Why the need for the determination of separate basis periods for capital allowances and assessable profits.

4.0 CONCLUSION

In this unit, you have seen that an understanding of the treatment of capital allowances is very vital in assessing businesses to tax. Therefore, it is very essential for tax inspectors and tax consultants to be acquainted with these principles. Determining basis periods for both assessable profits and capital allowances is also crucial.

5.0 SUMMARY

In this unit, you have been exposed to the following.

- The meaning and scope of capital allowances
- The concept of basis period for capital allowances, as well as the rules for overlapping and gaps in basis periods
- Capital allowances are computed on a straight line basis after initial allowances have been deducted from the cost of assets
- Investment allowance is granted to businesses that procure machinery in addition to initial allowance and annual allowance, but has no effect on the computations of either IA or AA.

6.0 TUTOR-MARKED ASSIGNMENT

1. Rejoice Ltd. is a company engaged in the fashion business. It commenced business on 1st September, 2006 and made up accounts as follows:

9 Months ended 30/6/2005
Year ended 30/6/2006

Required- determine any overlapping /gap in basis period for assessing a company, assuming election rule is used.

2. Maigari (Nig.) Ltd. normally makes up its annual accounts on acquired assets as follows:

Date	Assets Purchased	₦'Million
31/12/2005	Freehold Premises	15
15/5/2006	Delivery Van	9
30/7/2007	Plant & Machinery (P & M)	6
13/3/2007	Furniture and Fixtures (F&F)	4.5

Required- determine the basis period and compute the capital allowances for all the relevant years.

7.0 REFERENCES/FURTHER READING

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UNIT 2 TAXATION OF EMPLOYEES AND SOLE TRADERS

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1.0 INTRODUCTION

The taxation of employees and sole traders is covered by ITMA and *PITA*. It falls under the personal income tax system of Nigeria. The collection of personal income tax is vested in the State Board of Internal Revenue (SBIR) of the principal place of residence of self – employed individual and principal place of business of employed individuals. Each *SBIR* is assisted by its operational arm- the State Internal Revenue Service (IRS), in carrying out its primary duties which include assessment and collection of taxes from individuals resident or working in a state.

This unit, therefore, exposes you to the Pay-As-You-Earn (*PAYE*) system, earned and unearned incomes of a sole proprietorship business

with all associated deductions and non-deductible expenses. Reliefs and allowances will also be considered.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- itemise personal incomes chargeable to tax in Nigeria
- explain the meaning of earned and unearned incomes
- outline allowable and non-allowable deductions
- illustrate adjusted profits of a sole trader
- enumerate all available reliefs and allowances due to an individual
- discuss the Pay-As-You-Earn system.

3.0 MAIN CONTENT

3.1 Personal Income Chargeable to Tax

PITA section 2(1) contains some relevant provisions on personal income tax in Nigeria.

1. Self-employed individuals – the appropriate/relevant *SBIR* is determined by the principal place of residence of the individual on the 1st day of the year of assessment; and it remains unchanged till the end of the assessment year
2. The taxpayer's total global income derived within or outside Nigeria is liable to tax in Nigeria, irrespective of the source and whether or not it is brought into Nigeria. The assessment of the income is usually done on the preceding year basis.

Income tax is payable on any income that has accrued in Nigeria from productive assets; derived from Nigeria from productive activities, brought into Nigeria in form of emoluments. Income tax is payable on income from sources within and outside Nigeria, in particular, but not restricted to the following.

1. Profits or gains from a trade, business, profession or vocation;
2. Remuneration from an employment from both the public and private sectors. Remuneration covers salaries, wages, fees, allowances including compensations, commissions, bonuses, premiums, benefits or other perquisites allowed, given or granted by any person to an employee.

However, remuneration does not include refund of out-of-pocket expenses, medical expenses, and cost of passages to and from Nigeria, sums received for up keep of a child which are all exempted from tax. Benefits, in kind, include the following.

- i. The use of a motor vehicle provided by an employer;
- ii. Furniture and accommodation provided by an employer;
- iii. Services of domestic servants paid for by an employer;
- iv. Free food provided by an employer;
- v. Cost of water and electricity consumption borne by employer.

Benefits in kind are assessed to tax under the following rules.

- (a) Where an asset belonging to an employer is made available for an employee's use, the employee will be treated as receiving a taxable benefit equal to:
 - i. 5% of the cost of the asset to the employer; or
 - ii. where the cost cannot be ascertained, 5% of the market value of the asset at the date it was acquired by the employer;
 - iii. where the employer rents or hires an asset, which is thereafter made available for employee's use, the taxable benefit received by the employee is the annual cost of the rent or hire;
 - iv. where living accommodation is provided for an employee or the employee's spouse, he will be assessed to taxable benefit equal to the annual value for local rating purposes, less any rent refunded or otherwise suffered by the employee or his spouse. If the living accommodation is not assessed to local rates, then the tax authority of the territory in which the individual resides will determine the annual value to use;
 - v. where an employee receives a benefit in kind in respect of free accommodation, which is considered as necessary for him to do his job properly or which his position demands, for example, hotel managers, housekeepers, night watchmen etc., the benefit in kind shall not be assessed to tax. The accommodation is regarded as a **representative accommodation**.
3. Gains or profits including any premiums arising from a right granted to any person for the use or occupation of any property;
4. Dividends, interests or discounts received;

5. Any charge or annuity received;
6. Any balancing charge arising where a business person disposed off an asset used for the purpose of trade or business carried on by it at a profit;
7. Any profit, gain or other payments not falling within items 1-6 above.
8. The summation of items 1-7 above will amount to statutory total income.

3.1.1 Earned and Unearned Incomes

In relation to an individual, earned income means income derived from a trade, business, profession, vocation or employment carried on by him and a pension derived by him in respect of any previous employment. Unearned income, on the other hand, represents rent, dividends, royalty, discounts, which may be received net of withholding tax. These are also known as investment incomes. Where they are received net of withholding tax, they are referred to as “**Franked investment income**”.

3.1.2 Determination of Profits or Gains

This is in relation to profits or gains arising from a trade, business, profession or vocation. There are different kinds of businesses- ranging from sole proprietorship, partnership to incorporated companies. In this section, we are concerned with the profits or gains made by an individual business person who engages in a trade, business, profession or vocation. PITA (1993) defines an “individual” to include a corporation, sole and a body of individuals; but does not include partnership, community, family, trustee or an executor. A “person” on the other hand is defined to include an executor, trustee, company, partnership, community, family and individual.

To determine the profits or gains arising from a sole proprietorship business, a computation of adjusted profit in respect of a defined period is carried out, by considering statutory total incomes and deducting all allowable deductions. For an individual who is engaged in an activity to be referred to as a sole proprietor or trader, he must be operating a legal and registered business which is not in contravention of the law in any way. Again, for a sole trader to be assessed to tax, he must have been in business for, at least, three years from the date of commencement. The formats for computing adjusted profit are given in (a) & (b) below.

(a) Method one – adjusting the accounting profit

<u>ABC Enterprises</u>		
<i>Adjusted Profit for the 2008 Tax Year (TY)</i>		
	₹	₹
Net profit as per account of the firm	XX	
Add disallowable expenses	<u>XX</u>	
		XX
Less: allowable items not treated	XX	
Income exempted	<u>XX</u>	(XX)
Adjusted Profit		<u>XX</u>

(b) Method two – re-computing the accounts

	₹	₹
Sales/Turnover		XX
Less purchases/Direct expenses		<u>XX</u>
Gross profit/income		XX
Less operating expenses:		
Selling & administrative	XX	
Salaries & wages	XX	
Discount allowed	XX	
Bad debts	XX	
Transport and travelling	XX	
Telephone & postage	XX	
Rent & Rates	XX	
Other allowable expenses	<u>XX</u>	<u>XX</u>
Profit subject to tax assessment		<u>XX</u>

*Figure 2.1: Formats for Computing Adjusted Profit***SELF-ASSESSMENT EXERCISE 1**

Identify two types of taxable income.

3.2 Allowable and Non-allowable Deductions

To arrive at the profit for tax purposes, there are expenses to be allowed as deductions and there are others that should not be allowed. These are called allowable and non-allowable deductions.

3.2.1 Allowable Deductions

PITA provides that all outgoings and expenses wholly, exclusively, necessarily and reasonably incurred during that period and ultimately

borne by a business in the production of the income are deductible in the process of determining the assessable income or profit to be used for tax purposes.

These deductions include the following.

- (a) Interest on loan – any interest on money borrowed and employed as capital in acquiring the income;
- (b) Rent & rates - this should be in respect of the land & building occupied for the purpose of the business;
- (c) Repairs and maintenance of any asset employed in the business;
- (d) Provision for doubtful debts of a specific nature;
- (e) Bad debts written off;
- (f) Contribution to a pension scheme approved by the Joint Tax Board(JTB);
- (g) Legal expenses that are limited to:
 - (i) general legal advisory services;
 - (ii) retainership fees;
 - (iii) renewal of a short lease- that is, lease with tenure of not more than 50 years;
 - (iv) any cost of protecting and defending the properties of the business.
- (h) Any other expense proved by the board to have been incurred for the purpose of the business.

3.2.2 Deductions not allowed

The following items shall not be allowed as deductions for the purpose of ascertaining the income of an individual.

- (a) Private/personal expenses;
- (b) Capital expenditure or withdrawal of capital;
- (c) Any loss or expenses recoverable under insurance or contract of indemnity;
- (d) Rent & cost of repairs to any premises or part of premises not incurred for the purpose of producing the income;
- (e) Taxes on income or profits levied in Nigeria or elsewhere except as provided in section 13 of PITA;
- (f) Any unapproved payment to a pension scheme, provident, savings or widows society/orphanages, or any other fund or scheme- except as permitted by paragraphs (f) and (g) of subsection 20 of PITA;
- (g) Depreciation of any asset;

- (h) Any sum reserved out of profits except there is an expression permission of section 20 of the PITA 1993;
- (i) Any provision for doubtful debt of a general nature;
- (j) Any payment of management fees except with the approval of the commission;
- (k) Legal expenses that include:
 - (i) the cost of defending a traffic offence
 - (ii) acquisition of new lease – long or short
- (l) Donations- however, some donations are allowed under CITA;
- (m) Fines and penalties.

3.2.2.1 What is wholly, Reasonably, Exclusively and Necessarily (WREN)?

- (i) **Wholly** – where an individual uses a part of a building privately, as well as for business, the amount paid in any year of assessment will be apportioned on the basis of usage; and the amount attributable to private use will not qualify as an allowable expense in the computation of assessable profit. In effect, the term “wholly” is in reference to the quantum of the money expended. It must be totally for the purpose of business.
- (ii) **Reasonably** – an expense that is reasonable in cost and quantity- incurred for the purpose of generating the income is allowed for tax purposes. Any expense to the contrary should be disallowed.
- (iii) **Exclusively** – the word exclusively is better illustrated with the word “solely”. The expenses must have been incurred solely for the purpose of the business. That is, solely for the aim of promoting the business or its profit earning capacity.
- (iv) **Necessarily** – all expenses that are reasonable will certainly be necessary for the purpose of producing income in a business. The two words, “reasonably and necessarily” connote element of compulsion. That is, it must be shown that incurring the expense played a significant role in the process of acquiring the income.

SELF-ASSESSMENT EXERCISE 2

You have been invited by the Association of Tax Payers to give a lecture on “allowable and non-allowable deductions”. Prepare your presentation.

3.3 Personal Income Tax Payable

To arrive at income tax payable under PITA, statutory total income will have to be determined, followed by assessable income and then chargeable income. Chargeable or taxable income of any individual for any year of assessment shall be arrived at as follows:

<u>Computation of Chargeable Income</u>			
	N	N	N
Adjusted profit b/f			XX
Add balancing charge for the year			<u>XX</u>
			XX
Less:			
Any loss reliefs for the year		XX	
Any capital allowances of the year		XX	
Personal relief & allowances:			
Personal allowance	XX		
Life assurance	XX		
Children allowance	XX		
Dependant relative allowance	<u>XX</u>	<u>XX</u>	<u>XX</u>
Changeable income			<u>XX</u>

Figure 2.2: Computation of Chargeable Income

The net figure, which is called chargeable income, is subject to chargeable tax at the progressive rates in force during the relevant year of assessment.

3.3.1 Personal Income Tax Rates

Personal income tax rate is derived on the principle of progressive tax system. The rates are known as graduated rates which have undergone a lot of changes over the years. The prevailing rates are given as follows.

	1996 – 1997		1998 – 2000		2001 - Date			
	N	%	N	%	N	%		
First	10, 000	5	First	20, 000	5	First	30, 000	5
Next	10, 000	10	Next	20, 000	10	Next	30, 000	10
Next	20, 000	15	Next	40, 000	15	Next	50, 000	15
Next	20, 000	20	Next	40, 000	20	Next	50, 000	20
Over	60, 000	25	Over	120, 000	25	Over	160, 000	25

Figure 2.3: Personal Income Rates

3.3.2 Personal Income Tax Reliefs/Allowances

An individual is entitled to reliefs and allowances on his income as enshrined in PITA. These are usually treated as deductions from assessable profits. These reliefs and allowances are listed below:

- (a) Personal allowance – ₦5, 000 plus 20% of earned income;
- (b) Children allowance – ₦2, 500 per unmarried child who is under 18 years, subject to maximum of 4 children;
- (c) Dependent relatives allowance – ₦2, 000 subject to a maximum of 2. However, where a dependant earns, at least, ₦4, 000, no allowance will be granted to the tax payer;
- (d) Life assurance relief – actual premium
- (e) Rent subsidy/allowance – year 2000 (₦100, 000), year 2001 (₦100, 000), 2002 and thereafter ₦150, 000;
- (f) Transport allowance – year 2000 – 2001 (₦15, 000), year 2002 and thereafter (₦20, 000).

Both tax rates and allowances change from time to time because tax is guided by fiscal policies formulated periodically by government, to achieve desired economic objectives. Reducing tax rates and increasing personal allowances and reliefs will lead to more disposable incomes in the hands of taxpayers.

3.3.3 Other Allowable Deductions

Before arriving at taxable incomes (in furtherance of our discussion on allowable and non-allowable deductions), the following items should be noted.

- (a) Rent or housing allowance – this is not chargeable to tax, provided that the amount received does not exceed the statutory limits given as follows:
 - (i) Up to 1988 tax year – ₦720 per annum maximum
 - (ii) 1989 – 1991 tax year – 20% of basic salary or a maximum of ₦5,064.00
 - (iii) 1992 – 1998:
 - Lagos & Abuja – 28% of annual basic salary or maximum of ₦10, 000 per annum;
 - State Capital - 28% of annual basic salary or maximum of ₦6, 000 per annum;
 - Other places – 28% of annual basic salary or maximum of ₦4, 000
 - (iv) Housing allowance had been reviewed upwards as follows- 2000 and 2001 tax years- ₦100, 000 and ₦150, 000 respectively. In

each case the excess is regarded as benefits -in-kind and it is taxable;

- (b) Transport allowance subject to upper limit of N15, 000 per annum (1999), N20, 000 per annum (2001), any excess is taxable;
- (c) Utility allowance subject to upper limit of N10, 000 per annum, any excess is taxable;
- (d) Leave Grant (LG) subject to upper limit of 10% of annual basic salary. Any excess is taxable;
- (e) Entertainment allowance subject to upper limit of N6, 000 per annum; any excess is taxable;
- (f) Wife allowance – this has been abolished with effect from 1992 except N300 alimony relief which is granted to a man who has divorced his wife at a court of competent jurisdiction.
- (g) Disable Persons Allowance (DPA)- from 1989 year of assessment and beyond, disabled persons additional allowance of N2,000 is granted to an incapacitated employee who uses special equipment. Also considered is the service of an attendant in the course of a paid employment; provided such claim shall not be more than 10% of earned income of the person making the claim.

In other words, DPA shall be limited to:

- (1) N 2,000 or
- (2) 10% of earned income in any one year.

The new changes are:

1997- the higher of N2, 000 or 15% of earned income,
1998 to date –the higher of N3, 000 or 20% of earned income.

- (h) Meal subsidy or allowance -~~N5,000~~ per annum
- (i) Entertainment allowance – ~~N6,000~~ per annum
- (j) Domestic servant allowance- it would not be surprising to note that where the employer engages the services of steward, driver, washman, housemaid etc., to the advantages of an employee (officer), the cost incurred in form of remuneration by the employer to these people (domestic servants) shall be regarded as benefits-in-kind in the hands of the employee (officer), and so, it will be liable to taxation;
- (k) Donations made by a person to research centres not exceeding 10% of his chargeable income during the year of assessment is allowed as a relief against taxable income.

SELF-ASSESSMENT EXERCISE 3

What do you think is the reason for abolishing wife allowance in 1992?

3.4 Methods of Assessing Personal Income-Pay-As-You-Earn (PAYE) System

P.A.Y.E. as an abbreviation relates to how an employee is assessed to taxation. The assessment is on actual year basis, but operates on monthly basis throughout the year. It can simply be defined as a scheme whereby tax on employees' income is deducted at source by the employer and remitted to the relevant tax authority within 14 days after the end of the month.

3.4.1 Residence

A place of residence means somewhere available to an individual for his/her domestic use in Nigeria, on a relevant day (1st January), which excludes a hotel, rest house or other places at which he is temporarily lodging unless there is no other place available for his use on that day. The definition is contained in schedule 1 of PITA, 1993. Further, it may be necessary to determine a principal place of residence- where an individual resides in more than one place. Principal place of residence (not being both within the same territory) means:

- (a) for an individual whose only earned income is pension- the place where he usually resides;
- (b) for an individual with earned income other than pension- the place nearest to his place of work;
- (c) for an individual with unearned income- the place where he usually resides.

3.4.2 Operation of PAYE System

Employers can apply in writing to a tax authority signifying its intention to operate the scheme. On the other hand, local tax officials- in the course of the existence of a business in an area can bring the issue to the notice of the owners of the business. The relevant tax authority will then issue a notice authorising the employer to deduct tax (from source) from the employees' salaries. Information normally demanded from the employer before registering the company as an operator of PAYE scheme includes the following:

- (a) Name of the company/firm and its certificate of incorporation;
- (b) Number of employees and their names including other relevant information about them;

Furthermore, the registration process also involves the following:

- (a) Issuance of Registration number or Tax Identification Number (TIN);
- (b) Issuance of form G – a tax remittance card; form H1 – for giving details of annual returns; and form F3 – a tax deduction card for each employee after each person must have filled in the required income tax forms. This income tax forms can be filed directly by the employee or through his employer.

In filling in the income tax form, employees are expected to be factual and state their basic salaries, all allowances due, marital status, number of children, number of dependant relatives and some other vital information;

- (c) Tax authority computes the monthly tax liability of each employee after setting off reliefs against taxable income. The monthly tax liability is usually captured on form H1.

However, tax tables are always available for the use of the tax authority, taxpayer and employer to ensure that the correct amount of tax is deducted and paid. Where there is any over or under deduction/payment of tax, the excess or shortfall is refunded or recovered.

3.4.3 Direct Assessment of Tax

The other method of collecting personal income tax is through direct assessment by tax officials. By direct assessment, we mean assessment of self employed persons who have one form of income- for example, subsistent farmers, roadside mechanics, vulcanizers, etc.

SELF-ASSESSMENT EXERCISE 4

Enumerate some of the advantages of the PAYE system in Nigeria?

3.5 Minimum Tax and Income

Section 37 and 43 of *PITA* (1993) provides that the computation of minimum tax of an individual should be at the rate 0.5% of ₦3, 000 (1992), ₦5, 000 (1993), ₦7, 500 (1995 & 1996), ₦10, 000 (1997) and ₦30, 000 of income with effect from 1998. The general notion by some individuals that those who earn an income of ₦30, 000 and below are tax exempted is incorrect. Every income earner, as a responsible citizen, is expected to pay tax, no matter how small his/her income is. Therefore,

the minimum tax of 0.5% of the total income, under section 37 of PITA 1993, is still valid and is payable where the:

- (a) taxpayer has no taxable income because of grant of personal reliefs;
- (b) total statutory income produces tax payable lower than minimum tax of 5% of chargeable income. The rule for the 0.5% minimum tax- as given under section 37 is as follows:
 - (i) Where the chargeable income is “nil”, the tax to be deducted is 0.5% of the total income;
 - (ii) Where 5% of the chargeable income is less than 0.5% of the total income, the tax to be deducted shall be 0.5% of the total income;
 - (iii) Where 5% of the chargeable income is higher than 0.5% of the total income, the tax to be deducted is 5% of the chargeable income of the first ₦10, 000- thereafter referred to the graduated tax rates.

SELF-ASSESSMENT EXERCISE 5

What is the relevance of the provision for a minimum tax rate?

3.6 Tax Clearance Certificate (TCC)

This is a certificate that is issued by the tax authority to any taxpayer who had fully paid the assessed tax in the last three (3) consecutive years immediately proceeding the current year of assessment. The relevant tax authority is obliged to issue a TCC within a maximum period of two weeks of its demand or give reasons for the denial in writing. A current year tax can be accepted as a condition for TCC if the person is leaving the country.

TCC shall disclose (in respect of the last three years of assessment):

- (a) chargeable income;
- (b) tax payable;
- (c) tax paid; and
- (d) tax outstanding, or alternatively, a statement to the effect that no tax is due;

TCC is usually required for the following reasons.

- (a) Application for government loan for industry or business;
- (b) Registration of motor vehicles;
- (c) Application for firearms license;

- (d) Application for foreign exchange or exchange control permission to remit funds outside Nigeria;
- (e) Application for Certificate of Occupancy (C of O);
- (f) Application for award of contracts by government, its agencies and registered companies;
- (g) Application for approval of building plans;
- (h) Application for trade/business license;
- (i) Application for import and export license;
- (j) Application for license as agent;
- (k) Application for pool and gaming license;
- (l) Application for registration as a contractor;
- (m) Application for distributorship;
- (n) Confirmation of appointment by government as chairman or member of public board;
- (o) Stamping of guarantor's form for the Nigerian passport;
- (p) Application for registration of a limited liability company;
- (q) Application for allocation of market or stalls;
- (r) Appointment or election into public office.

Illustration

Alhaji Othman Ahmed is a resident of Lagos State. For tax purposes, the following information is given about him for use in the 2008 tax year:

- he is married with eight children; of which, two have graduated from high school, while the remaining six are still in school;
- he has an aged mother -fully under his care; he pays an annual premium of ₦24, 000 on a life policy for himself at a capital sum of ₦320, 000;
- he is a full-time executive director at Omar Computers Ltd., and therefore declared the following-

I. Rent Received:

		₦
Year ended	31/12/2006	160, 000
Year ended	31/12/2007	300, 000
Year ended	31/12/2008	440, 000

II. Remuneration as a Director:

			₦
Year ended	31/12/2006	160, 000	(tax deducted ₦40, 000)
Year ended	31/12/2007	140, 000	(tax deducted ₦50, 000)
Year ended	31/12/2008	180, 000	(tax deducted ₦60, 000)

III. Dividends Received (Net):

		N
Year ended	31/12/2006	45, 000
Year ended	31/12/2007	54, 000
Year ended	31/12/2008	63, 000

IV. Profits from Fish Farming:

		N
Accounting Year ended	31/12/2006	42, 000
Accounting Year ended	31/12/2007	50, 000
Accounting Year ended	31/12/2008	56, 000

V. Other investment incomes agreed for 2008, year of assessment (gross) is ~~N~~80, 000

VI. Gains from sale of shares on 1/2/2007 amounted to ~~N~~160, 000

You are required to compute Alh. Othman's tax liability for the 2008 YOA

Note: withholding tax rate is 10%

Solution**Alh. Othman Ahmed****(a) Computation of Taxable Income for the 2008 YOA**

	N	N
Earned income:		
Salary (gross) (180,000+60,000)	240,000	
Profit from fish farm	<u>50,000</u>	
		290,000
Unearned income:		
Rent (gross)	300,000	
Dividend (gross)	60,000	
Investment income	<u>80,000-440,000</u>	
Total statutory/assemble income	730,000	
Less personal reliefs:		
Personal allowance (5,000 + 20% of 290,000)	63,000	
Children allowance (2,500 x 4)	10,000	
Depended relative allowance	2,000	
Life assurance relief	<u>24,000</u>	<u>99,000</u>
Taxable/changeable income		<u><u>630,000</u></u>

(I) Computation of Tax Liability

		N
First	N30, 000 @ 5%	1,500
Next	N30, 000 @ 10%	3,000
Next	N50, 000 @ 15%	7,500

Next	N50, 000 @ 20%	10,000
Balance	N470, 000 @ 25%	<u>117,500</u>
Total tax payable		<u>139,500</u>

SELF-ASSESSMENT EXERCISE 6

Why would you need a Tax Clearance Certificate (TCC) for the past three years before contesting for an elective position?

4.0 CONCLUSION

In this unit, you learnt that the taxation of employees and sole traders is covered by *PITA* 1993. The act provides for the taxation of employees under the pay-as-you-earn (*PAYE*) system, while self-employed persons (sole traders)' income is assessed in the same way as companies except that the computations of tax liability is derived using graduated tax rates similar to the *PAYE* system. It is pertinent to note that tax is payable by every Nigerian citizen that earns income, no matter how small it is.

5.0 SUMMARY

In this unit, you have been exposed to the following:

- Taxation of employees and sole traders is covered by *ITMA* and *PITA*;
- Income tax is payable on any income accruing in, derived from, brought into and received in Nigeria;
- Benefits in kind covering the use of motor vehicle, furniture and accommodation, free food, water and electricity etc., all provided freely by an employer to an employee (the beneficiary) are taxable;
- Allowable deductions, which contrast heavily with non – allowable deductions, are expenses, which are deducted from income that should be assessable tax;
- Any expenses that are wholly, necessarily, reasonably and exclusively incurred are qualified as allowable deductions;
- Tax clearance certificate (TCC) is issued by the tax authority to a tax payer when he/she officially request for it.

6.0 TUTOR-MARKED ASSIGNMENT

1. Okwoli is resident in Benue State. The following information is given about him for use in the 2008 tax year:
 - (a) he is married with eight children of which, two have graduated from high school, while the remaining six are still in school;

- (b) he has an aged mother -fully under his care;
- (c) he pays an annual premium of ₦28, 000 on a life policy for himself at a capital sum of ₦640, 000;
- (d) he is a full-time managing director of a successful company in the state, known as Abro-Okoko Enterprises and therefore declares the following.

Rent Received-

		₦
Year ended	31/12/2006	320, 000
Year ended	31/12/2007	600, 000
Year ended	31/12/2008	880, 000

Remuneration as a Director-

		₦
Year ended	31/12/2006	320, 000 (tax deducted N80, 000)
Year ended	31/12/2007	280, 000 (tax deducted N100, 000)
Year ended	31/12/2008	360, 000 (tax deducted N120, 000)

Dividend Received (Net)-

		₦
Year ended	31/12/2006	90, 000
Year ended	31/12/2007	108, 000
Year ended	31/12/2008	126, 000

Profits from Abro-Okoko-

		₦
Accounting year ended	31/12/2006	84, 000
Accounting year ended	31/12/2007	100, 000
Accounting year ended	31/12/2008	112, 000

Other investment income agreed for 2008, year of assessment (gross) is ₦160, 000

Gains from sale of shares on 1/2/2007 amounted to ₦320, 000

You are required to compute Okwoli's tax liability for the 2008 YOA

Note: withholding tax rate is 10%

- ii. Compute the tax liabilities in respect of Manoach, Pacoa and Goodness for 2007 YOA, given the following information-

	Manoach	Pacoa	Goodness
	₦	₦	₦
Total earned income (All earned income)	12, 000	17, 000	23, 000
No of children	2	2	3
Dependant	1	2	1

7.0 REFERENCE/FURTHER READING

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UNIT 3 TAXATION OF PARTNERSHIP

CONTENTS

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- 3.0 Main Content
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 - 3.2 Computation of Partnership Income
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1.0 INTRODUCTION

A partnership is a business organisation where two or more persons pool their resources together with a view to making profit. The business is usually conducted in accordance with certain terms and conditions as agreed to by all the partners. However, where no fixed terms are agreed upon for the period of partnership, then the association is a partnership at will.

According to Soyode & Kajola (2006:229), partnership is a relationship subsisting between two or more persons agreeing to carry on business in common with a view to making profit under some arrangement, for the sharing of the resultant profit or loss for tax purposes. Partnership income is computed in the same way as that of sole trader and company income so as to ascertain the taxable profit for a given year of assessment. In computing the adjusted profit of a partnership, allowable income and deductions according to section 20 of *PITA*, and disallowable income and deductions according to section 2 are all taking into consideration.

In this unit therefore, you will be exposed to admission, retirement/resignation and succession of partnership- so as to understand how to bring out the differences between this form of business and the other forms of businesses.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define the term partnership
- describe the factors involved in partnership business
- analyse the different structures of partnership and their treatment
- explain the treatment of capital allowances and loss relief
- ascertain the tax liabilities of each partner.

3.0 MAIN CONTENT

3.1 Formation of Partnership

The Partnership act of 1897 and 1907 spelt out the procedures for forming general partnership and limited partnerships, respectively. Usually, a legal document called a “deed of partnership”; that is, if the partnership is not a “partnership at will”, it is drawn up to define the rights, duties and interests of the partners. This legal document is expected to contain clauses relating to:

- (a) capital contribution;
- (b) the interest (if any) to be paid to each partner on his capital or the interest that each partner will pay on loan or takings from the partnership;
- (c) the salaries(if any) to be paid to active partners;
- (d) the agreed division/sharing of profits and losses;

However, where there is no formal agreement or the partnership is at will, the following will be adopted:

- (a) partners share the profits and loss equally;
- (b) partners are not entitled to interest on capital;
- (c) partners will not be entitled to any salary; and
- (d) no interest is received from any partner for loan or takings from the partnership.

SELF-ASSESSMENT EXERCISE 1

Discuss the procedures for the formation of a partnership business?

3.2 Computation of Partnership Income

The income of a partnership, for a period, is computed in accordance with the provisions of *PITA* 1993- as though the income of an individual were being computed except that the cost of the following is allowed:

- (a) any partner's salaries;
- (b) any partner's interest on capital; and
- (c) any partner's leave or recreational passages.

Partnership expenses referable to a partner which would have been private or domestic expenses, if incurred by the partner himself are not allowed in computing the partnership income.

3.2.1 Income of a Partner

The income arrived at (as shown above) is called the computed income of the partnership. It is not, however, assessed on the partnership, or collectively, on the partners. The partners are individually assessed as though they are working individually. The income of each partner is the addition of:

- (a) his salary(if any), charged in the partnership accounts;
- (b) his interest on capital(if any) charged in the partnership accounts;
- (c) his private passage costs(if any) charged in the partnership accounts; and
- (d) his share of the computed income of the partnership.

The share of a partner in the computed income of a partnership shall be a proportion of the computed income accruing to him, under the provisions of the partnership agreement.

3.2.2 Capital Allowances

The provision of paragraph 23, 5th schedule of *PITA*, 1993 applies in the computation of the assessable profit of a partnership. The computed profit is then shared amongst the partners.

On the other hand, the computed capital allowances of the partnership are shared between the partners in the profit and loss sharing ratio.

A partner's share is then used to reduce his share of profit in order to ascertain his/her taxable income. Any appeal made by a partner against the amount of partnership income included in his total income assessed

is dealt with by the relevant tax authority of the place where the partnership is resident.

3.2.3 Resident and Responsible Tax Authority

A partner's place of residence is his/her place of abode where he/she must have resided for a period of not less than 180 days in the year of assessment. The tax authority within the territory of his/her residence is responsible for the collection of the tax.

It may happen that the head office of a partnership business is situated in one territory, while some of the partners are resident in other territories. In order to comply with the general provisions of *PITA*, 1979- as applicable to a place of residence, each partner receives his/her share of the profit and then pays the tax on it to the appropriate tax authority.

3.2.4 Loss Relief

The general principle of the provisions of loss relief in a sole proprietorship business is applicable to a partner in a partnership. Where the losses incurred were by the partnership itself, these are apportioned between the partners in the same way profits made from the partnership are shared.

SELF-ASSESSMENT EXERCISE 2

Explain how a partner's taxable income can be ascertained?

3.3 Registration of Partnership Agreement

A certified copy of the partnership deed or particulars of any partnership agreement must be registered with relevant tax authorities at will or on demand. Any later changes agreed between the partners are to be made known to the tax authority within 30 days of the agreement. The apportionment of income between partners is normally based on the particulars supplied. If particulars are not supplied, then the apportionment is made as the tax authority thinks just and reasonable.

SELF-ASSESSMENT EXERCISE 3

What are the advantages of registering a partnership deed?

3.4 Treatment of Changes in Partnership Structure

The following are some of the changes that may occur in a partnership structure and the treatment for tax purposes.

(a) Admission of a new partner

A new partner into any partnership is deemed to have commenced a new business and the commencement rule will fully apply in assessing him/her to tax.

(b) Death, retirement and resignation of an old partner

Where an old partner dies, resigns or retires, he/she will be deemed to have ceased business and will, therefore, be assessed to tax based on cessation rules.

(c) Amalgamation of two or more partnerships

Two or more partnerships can amalgamate to form a new partnership. In this situation, neither commencement nor cessation rules will apply, but the rules for existing businesses will be used for the new business. All the capital expenditures transferred to the new partnership are deemed to have been transferred at their tax written down values (TDWV) and there will be no balancing adjustments.

(d) Conversion of a partnership into a limited liability company

A partnership may decide to convert to a limited liability company in order to take advantage of limited liability. Where this occurs, a new business is deemed to have come into existence and consequently cessation rule will apply for the partnership that has folded up as it has ceased business as a partnership.

The transferring of qualifying capital expenditures of the old partnership into the new company will be at agreed values; therefore, balancing adjustments (that is, balancing allowance or balancing charge) will have to be computed. This is done by comparing the valuation with the tax written down values at the time of transfer. Computation of capital allowances on the transferred qualifying capital expenditure will be undertaken accordingly.

Illustration

A partnership of Nerat, Neta and Neken which has been in existence for some years submits accounts for the year ended 31st December, 2007- showing a net profit of ₦96,000 after the following charges.

	Nerat	Neta	Neken
	₱	₱	₱
Salaries	10, 400	-	20, 800
Interest on capital	-	960	-
Passages on leave	3,600	3,600	-

The partners' shares- under the deed of partnership are- Nerat $\frac{1}{2}$; Neta $\frac{3}{8}$; and Neken $\frac{1}{8}$.

Suggested Solution

For the year 2008, the business income assessed on each partner is as follows.

	Nerat	Neta	Neken
	₱	₱	₱
Salaries	10, 400	-	20, 800
Interest on capital	-	960	-
Share of passage	3, 600	3, 600	-
Computed income	<u>48, 000</u>	<u>36,000</u>	<u>12, 000</u>
Assessable incomes	<u>31, 000</u>	<u>20, 280</u>	<u>16, 400</u>

SELF-ASSESSMENT EXERCISE 4

A change in partnership structure leads to dissolution of the partnership business. Discuss

4.0 CONCLUSION

In this unit, you have learnt that partnership taxation is part of personal income tax. Also, it has been noted that partnership taxation has some common characteristics with the taxation of sole traders, except that profits derived from the firm are distributed to all partners after which, reliefs and allowances are granted to individual partners based on their entitlements. Consequently, taxable income and tax liability of each partner are ascertained. Another cardinal point you need to note is the issue of admission, retirement and conversion of partnerships into limited liability companies in which profits are shared proportionately and on pro rata basis.

5.0 SUMMARY

In this unit, you have learnt the following:

- The income of a partnership is computed based on the provisions of PITA 1993;
- Capital allowances(if any) of the partnership is deducted from adjusted profit to arrive at the assessable profit before apportioning it to each partner;
- Partnership income is treated as arising in the territory of the partnership's tax authority;
- A loss that occurred in a partnership qualifies the entire partnership business to a relief which can be used for ascertaining the assessable profit- or shared as individual reliefs;
- Partnership deed is supposed to be registered with the relevant tax authority because it provides the bases for arriving at taxable profits;
- Admission, death, resignation or retirement of a partner, or amalgamation and conversion can all bring about changes in partnership;
- The use of graduated tax rates are employed for determining tax liabilities of partners.

6.0 TUTOR-MARKED ASSIGNMENT

1. A partnership of Dayo, Blessing and Charity which has been in existence for some years submits accounts for the year ended 31st December, 2007 showing a net profit of N48,000 after the following charges.

	Dayo	Blessing	Charity
	₦	₦	₦
Salaries	5, 200	-	10, 400
Interest on capital	-	480	300
Passages on leave	1, 800	1, 800	-

The partners' shares under the deed of partnership are- Dayo $\frac{1}{2}$; Blessing $\frac{3}{8}$; and Charity $\frac{1}{8}$.

2. Eaglet Construction Company is a firm of engineers in which Emmanuel and Okoye are partners. For convenience they employed Gyang- a qualified engineer, on a salary of ₦150, 000 per month. The firm makes up its accounts to 31st December, each year.

On 1st July 2007, Mr. Gyang who had worked for the firm for several years became a partner. The partnership agreement provides, among others, that the partnership's net profit will be shared as follows:

- (a) before the admission of Mr. Gyang into the partnership, Emmanuel takes 60% and
- (b) after the admission of Mr. Gyang, the sharing ratio changed to Emmanuel 50%; Okoye 30% and Gyang 20%.

The total earnings from January to December 2007 amounted to ₦22,500,000. According to the partnership agreement, Emmanuel is entitled to draw ₦225,000 every month, Okoye ₦300,000 and Gyang ₦100,000 every month from the date he became a partner. The partnership had assets on which ₦375,000 capital allowance was claimed and allowed.

The following expenses were incurred by the firm during the year.

	₦
Staff	4,536,000
Rent	3,600,000
Repairs	1,125,000
Electricity	240,000
Generator repairs & maintenance	525,000
Depreciation	1,500,000
Pension fund contribution approved	180,000
Industrial training fund levy	127,500
Bank charges	135,000
General expenses	240,000

Mr. Gyang's salary was not included in the above. Emmanuel is married with six children, while Okoye is married with only 2 children. Gyang, on the other hand, is not married. Emmanuel, Okoye and Gyang are the ones taking care of their aged parents, who have no income of their own. Emmanuel has a life Assurance Policy for ₦300,000 on which he pays ₦8,250 annually as premium.

You are required to compute the taxable income of each partner for the relevant Year Of Assessment (YOA).

7.0 REFERENCES/FURTHER READING

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UNIT 4 COMPANIES INCOME TAX

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- 7.0 References/Further Reading

1.0 INTRODUCTION

Company income tax has been distinguished from personal income tax by enacting a separate legislation to cater for it. The legislation is known as Company Income Tax Act 1979 (CITA) as amended. The act defines a company, under section 84, as a corporation established by or under any law (such as the Companies and Allied Matters Act (CAMA) 1990) in force in Nigeria-for instance, or elsewhere.

A Nigerian company is distinguished from a foreign company; the former is liable to company income tax on all its profits wherever they arise, whether or not they have been brought into or received in Nigeria. The profits of the latter, on the other hand, shall be deemed to be derived from Nigeria to the extent to which such profits are not attributable to any part of the operations of the company carried on outside Nigeria.

In other words, the profits of a foreign company are taxed to the extent that they are derived from sources within Nigeria. Therefore, this unit shall expose you to the profits that are subjected to tax, ways of ascertaining such profits and persons chargeable to tax.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- describe taxable incomes and profits as specified in the companies income tax act
- itemise allowable and non-allowable deductions in determining adjusted profits for tax purposes
- explain the differences between taxable and non – taxable persons
- discuss the power of the Federal Board of Inland Revenue (FBIR) to appoint an agent for a company who may be asked to pay any tax.

3.0 MAIN CONTENT

3.1 Profits Subject to Tax

Profit can be defined as the surplus of the receipts from the trade or business, over and above the expenditure/expenses necessary for the purpose of earning those receipts. Unless and until you have ascertained that there is such a balance, nothing exists to which the name profit can properly be applied.

In determining whether a particular activity is a trading transaction that gives rise to trading profits, the following factors are given by Arbico/FBIR (1968) in Soyode and Kajola (2006: 284):

- (a) Nature of assets;
- (b) Circumstances of purchase;
- (c) Vocation of taxpayer;
- (d) Number of like transactions;
- (e) The object clause of memorandum and article of association;
- (f) Length of time property was held by the company;
- (g) Circumstance of sale.

3.1.1 Taxable or Chargeable Profits

Section 8 of CITA imposes tax on the profits of any company accruing in, derived from, brought into or received in Nigeria. The taxable profits under this section are those in respect of the following:

- (a) Any
- (b) its gains arising from acquiring or trade or business for whatever period of time such trade or business may have been carried on;
- (c) Dividends, interests, discounts, royalties, charges or annuities;

- (d) Rent or any premium arising from a right granted to any other persons for the use or occupation of any property;
- (e) Fees, dues and allowances (wherever paid) for services;
- (f) Any source of annual profits or gains not falling within the preceding categories. The purpose of this clause is to ensure that no taxable profits escaped the tax net of the board;
- (g) Any amount deemed to be income under a provision of the act, or, with respect to any benefit;
- (h) Any amount of profit from disposing short – term instruments like proceeds arising from a pension or provident fund of the personal income tax act; federal government securities, treasury bills, treasury and savings certificates, debenture certificates and treasury bonds.

These taxable profits can be grouped into two broad categories- trading profits and investment income.

3.1.2 Profits Exempted from Tax

The act exempted the profit stated below from tax:

- (a) The profits of a statutory or registered friendly society, provided such profits are not from a trade or business carried on by such society;
- (b) The profits of registered co-operative society provided such profits are not from any trade or business carried on by that company other than cooperative activities solely carried out – with its members or from any share owned or other interest possessed by that company in a trade or business carried on by some other persons or authority;
- (c) The profits of any company engaged in ecclesiastical, charitable or educational activities of a public character, in so far as such profits are not derived from a trade or business carried on by such company.
However, where an institution meant for charitable purposes carries on a profitable business, that business is subject to taxation (Soyode & Kajola, 2006);
- (d) The profits of any company formed for the purpose of promoting sporting activities- where the profits are wholly expendable for such purpose, subject to such conditions as the board may prescribe;
- (e) The profits of any company being a trade union registered under any trade union act- in so far as such profits are derived from trade or business carried on by such trade union;
- (f) Dividends distributed by unit trust;

- (g) Dividends derived by a company from another company incorporated in Nigeria. This is subjected to the following conditions.
- (i) The equity participation of the recipient of the dividend in the company paying the dividend is either wholly paid for in foreign currency or by assets brought or imported into Nigeria between 1st January 1987 and 31st December 1992;
- (ii) The company receiving the dividend is the beneficial owner of not less than 10% of the equity share capital of the company paying the dividend;
- (iii) The dividend tax-free period shall commence from the year of

Assessment- following the year in which the new capital is brought into Nigeria for the purpose of trade or business.

The tax free period shall continue for five years, if the company paying the dividend is in agricultural business, or engaged in petro – chemicals or liquefied natural gas. The dividend tax free period for any other business apart from the ones mentioned shall be limited to three years.

- (h) The profits of any company engaged in petroleum operations whose profits are taxable under petroleum profits tax act;
- (i) The profit of any company established by or under any local government law or edit in force in any state of Nigeria;
- (j) The profit of any purchasing authority established by an enactment and empowered to acquire any commodity for export from Nigeria for the purchase and sale (whether for the purposes of export or otherwise) of that commodity;
- (k) The profits of any company or any corporation established by the law of the state for the purpose of fostering the economic development of the state, not being profits derived from any trade or business carried on by that corporation or from any share or interest possessed by that corporation in trade or business in Nigeria carried on by some other person or authority;
- (l) Any profits of a company other than Nigerian company, which for this paragraph, would be chargeable to tax by reason solely of their being brought into or received in Nigeria;
- (m) Dividend, interest, rent and royalty derived by a company from a country outside Nigeria, and brought into Nigeria through government approved channels. Government approved channel means the Central Bank of Nigeria(CBN), or any bank, or other corporate body appointed by the minister as authorised dealer under the foreign exchange act in force at a particular time;

- (n) The interest on deposit accounts of a foreign non-resident company- provided the deposits into the account are transfers wholly of foreign currencies to Nigeria on or after 1st January 1990 through government approved channels;
- (o) Dividend received from investments in wholly export – oriented business;
- (p) Dividend received from small companies in the manufacturing sector in the five years of their operation;
- (q) The profits of any Nigerian company in respect of goods exported from Nigeria, provided that the proceeds from such export are repatriated to Nigeria and are used exclusively of raw materials, plant, equipment and spare parts;
- (r) The profits of a company whose supplies are exclusively inputs to the manufacturing of products for export provided that the exporter shall give a certificate of purchase of the inputs of the exportable goods to the seller of the supplies.

3.1.3 Exemption of Company Profit from Tax by the Federal Executive Council

The Federal Executive Council may exempt by order:

- (a) any company or class of companies from all or any of the provisions of the act; or
- (b) all or any profit of any company or class of companies from any source on ground which appears to be sufficient.

The federal executive council may, by order amend all or repeal any exemption made by notice or order, in so far as it affects a company.

SELF-ASSESSMENT EXERCISE 1

Discuss how the taxable profit of a company registered in Nigeria is ascertained.

3.2 The Process of Ascertaining Profits

The process of ascertaining the profits of a company for a giving period begins with the preparation of financial statements in accordance with Generally Acceptable Accounting Principles (GAAP) and the provisions of CAMA 1990. Sections 19 & 20 of CITA provide that certain expenses and incomes shall not be included in the computation of profits. This will be discussed shortly.

The accounting profits will therefore, have to be adjusted to obtain the profits for tax purposes. This is called adjusted or assessable profits. Taxable profit is arrived at after the treatment of the following:

- (a) loss relief;
- (b) capital allowances and balancing allowances;
- (c) balancing charge.

3.2.1 Allowable Deductions

For the purpose of ascertaining the profits or losses of any company for any period from any source chargeable to tax under this act, the following expenses wholly, exclusively, necessarily and reasonably incurred in the production of those profits including but without otherwise expanding or limiting the generality of the followings shall be treated as allowable deductions:

- (a) Interest paid on money borrowed or employed as capital in acquiring the profits;
- (b) Rent paid in respect of land or building occupied for the purpose of acquiring profits, subject in the case of residential accommodation to a maximum of 100% of the basic salary of employees;
- (c) In the case of any property-holding company- expenses attributable to the maintenance of the property concerned;
- (d) Expenses incurred for the repairs of premises, plant, machinery or fixtures employed in acquiring the profits or for the renewal, repairs, or alteration of any implement, utensils or articles employed;
- (e) Bad debts written off and provision for doubtful debts of a specific nature. Any amount recovered in respect of debts written off previously is treated as profits of the year in which such amount was recovered and written back to profit and loss account;
- (f) Contribution to a pension, provident or other retirement benefits funds, society or scheme approved by the Joint Tax Board (JTB). Pension funds scheme is a scheme established by the state providing benefits for the old disabled by war or by work; or established by the former employer for employees after long service. Provident fund scheme, on the other hand, is a scheme established by an organisation providing for retirement benefits for the staff or contributors to the scheme;
- (g) Nigeria railway corporation deductions- such deductions as allowed under the authorised deductions (Nigeria Railway Corporation) rules 1959, which rule shall be in force for all purposes of this act;

- (h) Donations made under the following conditions; first, must be made to a body, or institution listed on schedule 5 of the act. Second, must not be of capital nature and must be made out of profit.

Funds, bodies and institutions in Nigeria to which donations may be made as provided by schedule 5 of the act are as listed below:

- (i) The Boys Brigade of Nigeria, the Boys Scouts of Nigeria and the Girls Guild of Nigeria;
- (ii) The Christian Council of Nigeria and the Islamic Education Trust;
- (iii) The Cocoa Research Institute of Nigeria
- (iv) Any educational institute affiliated under any law with any university;
- (iv) Any hospital owned by the government of the federation or a state or any university teaching hospital or any hospital which is carried on by a society or association otherwise than for the purpose of profits or gains to the individual members of that society or association;
- (v) The Institute of Medical Laboratory Technology
- (vi) The National Commission for Rehabilitation;
- (vii) The National Library, the Nigeria Museum and Monuments and the National Braille Library of Nigeria;
- (viii) The National Council for Medical Research;
- (ix) The National Science and Technology Development Agency;
- (x) The Nigeria Institution of International Affairs;
- (xi) The Nigeria Institute of Oil Palm Research;
- (xii) The Nigeria Institute of Trypanosomiasis Research;
- (xiii) The Nigeria Red Cross and Rotary International;
- (xiv) A public fund established and maintained for providing money for the construction and maintenance of a public memorial relating to civil war in Nigeria(which ended on 15th January, 1970);
- (xv) A public institution or public fund (including the Armed Forces Comfort Fund) established and maintained for the comfort, creation or welfare of members of the Nigeria Army, Navy or Air Force;
- (xvi) A public fund established and maintained exclusively for providing money for the acquisition, construction, maintenance or equipment of a building used or to be used as school or college by the government of the federal or a state or by public authority or by a society or association which is carried on otherwise for the purpose of profit or gain to the individual members of the society or association;

- (xvii) The National Youth Council of Nigeria and the Nigeria Youth Trust;
- (xviii) National Sport Commission and its state associations;
- (xix) The Nigeria Society for Deaf and Dumb;
- (xx) The Society for the Blind, the Nigeria National Advisory Council for the Blind, Association or Society for Blinds in Nigeria, and Training Centres and residential schools for the blind;
- (xxi) Van Leer Nigeria Educational trust;
- (xxii) Southern Africa Relief Fund;
- (xxiii) The Institute of Chartered Accountant of Nigeria Building Fund;
- (xxiv) Any public fund established or approved by the government of the federation or established by any of the state governments in aid of or for the relief of drought or any national disaster in any part of the federation;
- (xxv) Nigeria Conservation Foundation;
- (xxvi) Nigeria Accounting Standards Board;
- (xxvii) Kewalrams Chanrai Foundation Limited;
- (xxviii) Afriprint Foundation Limited;
- (xxix) Paterson Zochonis Nigeria Technical Education Trust Fund;
- (xxx) Educational Cooperative Society;
- (xxxi) National Science and Technology Fund.

(i) Legal expenses in relation to:

- general legal advisory services;
 - retainership fees;
 - cost of protecting or defending the company and/or its properties;
 - cost of renewing a short lease.
- (j) Any other expenses wholly, exclusively, necessarily and reasonable incurred for the purpose of trade or business;
- (k) The expenses proved, to the satisfaction of the board, to have been incurred by the company on research and development for the period including the amount of levy paid by it to the National Science and Technology Funds;
- (l) Deduction for research and development. There shall be deducted the amount of reserve made out of the profits of that period by that company for research and development.

However, the deduction to be allowed by any company for any year of assessment shall not exceed an amount which is equal to 10% of the total profits of that company for that year, as ascertained before any deduction is made. Companies and other organisations engaged in research and development activities for commercialisation shall be allowed 20% investment tax credit on their qualifying expenditure for that purpose.

3.2.2 Non-Allowable Deductions

The following deductions are disallowed for the purpose of ascertaining the profits of a company notwithstanding any other provision of the act. These are listed below:

- (a) Depreciation of any asset;
- (b) Capital repaid or withdrawn and expenditure of a capital nature.

The following payments are of capital nature, and therefore are disallowed-

- (I) Acquisition of new leases;
 - (II) Preliminary expenses on formation of a company
 - (III) Pre-production expenses;
 - (IV) Issue of shares and debentures.
- (c) Any sum recoverable under an insurance or contract of indemnity;
 - (d) Taxes on income or profits levied in Nigeria or elsewhere, other than tax levied outside Nigeria on profits which are also chargeable to tax in Nigeria where relief for double taxation of those profits may not be given under any other provision of the act;
 - (e) Any general reserve, general provision or contingent liability or an expense that cannot be ascertained with substantial accuracy;
 - (f) Any payments to a savings for widows and orphans, pension, provident or other retirement benefits fund, society or scheme-except as permitted by paragraph (g) of section 23 of *CITA*;
 - (g) Penalty for unlawful act, this is disallowed because it is not expenditure “necessarily” incurred. The business could perfectly be carried on without any infringement of the law;
 - (h) Any expense of any description incurred within or outside Nigeria for the purpose of earning management fees unless prior approval of an agreement given rise to such management fees has been obtained from the minister;
 - (i) Damages and compensation, may be allowable only if they satisfy the requirements of being expenses incurred wholly,

exclusively, necessarily and reasonably for the earning of the profits;

- (j) Advertisements which are for the purpose of promoting sales of goods meant for resale but advertisement for the sale of capital asset or to launch new product or for such expenses that are in the nature of capital are disallowed;
- (k) Any expense of any description incurred outside Nigeria for and on behalf of any company, except of a nature and to the extent as the board may consider allowable.

SELF-ASSESSMENT EXERCISE 2

Explain the process of ascertaining the assessable profits of a company under CITA, 1979

3.3 Taxable Person

A company shall be chargeable to tax:

- (a) in its name; or
- (b) in the name of a principal officer attorney, factor, agent or representative in Nigeria;
- (c) in the name of a receiver or a liquidator. The principal officer or manager of every company in Nigeria shall be answerable for doing all such acts, matters and things as are required to be done by virtue of the act. He is also liable to ensure that the company complies with the act, assessment of the company and the payment of the tax.

The reason for making the principal officer liable to a company tax liability is because a company- though a legal entity, is an artificial person and therefore can only act through its officers.

3.3.1 Powers of the Board (FBIR) to Appoint an Agent

The Federal Board of Inland Revenue (FBIR) has powers under the law to appoint any person by notice in writing as an agent of any company. For the purpose of CITA, he may be required to pay any tax which is or will be payable by the company from any moneys that may be due from him to the company.

Refusal to act by such an agent so appointed will result in the payment of the tax from his/her personal resources. For this purpose, the board may require any person to give information as to monies, funds or other assets which may be held by him for, or of any monies due to him on

behalf of the company. Where a company is being wound up, the liquidator of the company shall not distribute any of the assets of the company to shareholders, unless he has made provision for the payment in full of any tax which may be found payable by the company.

SELF-ASSESSMENT EXERCISE 3

Who is a taxable person under CITA, 1979?

3.4 Format for the Computation of Adjusted and Taxable profits

Name of Company (Example-Rocklink Integrated Ltd.)

Computation of adjusted profit for the year ended 2010

	₦	₦
Net profit as per account		XX
Add disallowed expenses		<u>XX</u>
		XX
Deduct:		
Allowable items not so treated	XX	
Income exempted	<u>XX</u>	<u>XX</u>
Adjusted profit		<u>XX</u>

Name of Company (Example-Rocklinks Integrated Limited)

Computation of Taxable Profit for the Relevant Year of Assessment

	₦	₦
Adjusted profit brought down		XX
Add balancing charge		<u>XX</u>
		XX
Less: capital allowances	XX	
Loss relief	<u>XX</u>	<u>XX</u>
Taxable or chargeable profit		<u>XX</u>

Supposing the corporation tax rate is 35%, the tax payable therefore, shall be 35% of taxable profit. Computation of adjusted profit can also be derived through re-computation or by repeating the accounts presented and ignoring non-allowable items, while at the same time, taking care of items that were not treated as such. This is shown in the illustration below.

Illustration

Gayas (Nigeria) Ltd. is a private limited liability company, which has been in business successfully for many years. The following is the summary of its profit and loss account for the year ended 31st December, 2008.

Gayas (Nig.) Ltd.Profit & Loss Account for the year ended 31st December, 2008

	N	N
Gross profit b/forward		89, 694
Profit on sale of investment		96
Dividends received (gross)		<u>2, 000</u>
		91, 790
Less other expenses:		
Audit fee	140	
Loan interest	400	
Bad debts	250	
Depreciation	3,125	
General expenses	1, 000	
Carriage	400	
Lighting	850	
Salaries & wages	20, 000	
Rent & rates	2, 500	
Repairs and maintenance	800	
Staff welfare	2, 000	
Telephone/postage	3, 000	
Motor running	4, 200	
Travelling expenses	2, 100	
Donation	<u>1,025</u>	<u>41, 790</u>
Net profit		<u>50, 000</u>

The following additional information is available:

(i)	Bad debt	N	
	Employee's loan written off	120	
	General provision	100	
	Specific debt	170	
	Bad debt recovered	<u>(140)</u>	
		<u>250</u>	

(ii) General expenses are made up as follows:

	N	N
Sundry expenses (allowable)		290
Luncheon vouchers		294
Subscription:		
Trade	80	
Social club	<u>96</u>	176
Printing		80
Legal cost:		

	Lease on new premises	120	
	Customer's claim on defective goods	<u>40</u>	<u>160</u>
			<u>1,000</u>
(iii)	Repairs and maintenance:		
	Decoration of new premises		360
	Repairs to plant		100
	Renovation of old Factory		340
(iv)	The loan interest shown in the profit and loss account is the interest on loan to a friend of one of the directors of the company. This friend is very useful as a link in the procurement of a lucrative contract by the company;		
(v)	Donation	₦	
	Political parties	300	
	ICAN	500	
	Boy's Scout of Nigeria	125	
	Society for the blind	<u>100</u>	
		<u>1,025</u>	
(vi)	Capital allowances as agreed with the tax authorities is	₦ 3,074	

You are required to compute:

- The adjusted profit; and
- The income tax liability for 2009 year of assessment.

Suggest Solution

Gavas (Nig.) Ltd.

- Computation of Adjusted Profit for the Year Ended 2008 (using direct method)*

	₦	₦
Gross profit b/forward		89, 694
Add dividend received		<u>2, 000</u>
		91, 694
Less operating expenses allowed:		
Audit fee	140	
Bad debts (170 – 140)	30	
General expenses (290 + 80 + 80 + 40 + 294)	784	
Carriage	400	
Lighting	850	
Salaries & wages	20,000	
Rent & rates	2,500	
Repairs & maintenance	440	
Staff welfare	2,000	
Telephone/postage	3, 000	
Motor running	4, 200	

Travelling expenses	2,100	
Donation (125 + 100)	<u>225</u>	<u>36,669</u>
Adjusted profit		<u>55,025</u>

Gavas (Nig.) Limited

(b) *Computation of Tax Liability*

	N
Adjusted profit	55,025
Less education tax @ 2% (55,025 X 2/102)	1,079
	53,946
Less capital allowances	<u>3,074</u>
Taxable profit	<u>50,872</u>
Tax liability @ 30% of 50,872 =	15,262

Gavas (Nig.) Ltd.

Computation of Adjusted Profit for the Year 2008 (using the indirect method)

	N	N	N
Net profit brought forward			50,000
Add back disallowable:			
Loan interest	400		
Bad debt:			
Employee's loan	120		
General provision	<u>100</u>	220	
General expenses:			
Subscription (social club)	96		
Legal cost (lease)	<u>120</u>	216	
Depreciation	3,125		
Repairs & maintenance:			
Decoration to new premises		360	
Donation:			
Political parties	300		
ICAN	<u>500</u>	<u>800</u>	<u>5,121</u>
			55,121
Less:			
Profit on sale of investment			<u>96</u>
Adjusted profit			<u>55,025</u>

SELF-ASSESSMENT EXERCISE 4

1. Distinguish between adjusted, assessable and taxable profits.
2. What forms of donations are allowed for tax purposes in Nigeria?

4.0 CONCLUSION

In this unit, it has been pointed out to you that the taxation of companies as legislated by CITA 1979 prepares tax assessment of incorporated companies. This is done by taking into consideration allowable incomes and expenses and disallowable incomes and expenses on the other hand, so as to ascertain the right profits to be used for tax purposes. Therefore, it is pertinent that you study and understand those allowable and non-allowable items to be able to calculate the correct tax liability for a company- given the appropriate prevailing corporation tax rate for the period.

5.0 SUMMARY

- Factors such as nature of business, circumstances of purchase, vocation of taxpayer, etc. are taken into consideration in determining trading profits
- Profits that are accruing in, derived from, brought into or received in Nigeria are subject to tax assessment in Nigeria
- Profits of registered friendly societies, cooperative societies, ecclesiastical, etc are exempted from tax in Nigeria
- The federal executive council, in formulating of fiscal policies, can exempt any company from all or any of the provisions of the Act
- The process of ascertaining profits of a company starts with the preparation of financial statements followed by the computation of adjusted profit
- Depreciation, general expenses, general donations, general provisions/ reserves are non-allowable deductions in computing adjusted profits
- Computation of adjusted profits can be done by either following the same pattern in which the financial statements are prepared and be eliminating or including some items that are allowed or not allowed (direct method) or adjusting the net profit from that financial statements by adding back the non-allowable expenses and deducting non-allowable incomes and allowable expenses not treated as such.

6.0 TUTOR-MARKED ASSIGNMENT

1. When will it become necessary for the Federal Board of Inland Revenue (FBIR) to appoint an agent for a company?
2. Persuasion (Nig.) Ltd. is a private limited liability company, which has been in business successfully for many years.

The following is the summary of its profit and loss account for the year ended 31st December, 2007.

Persuasion (Nig.) Ltd.

Profit & Loss Account for the Year Ended 31st December, 2007

	₦	₦
Gross profit b/forward		89, 694
Dividend received (gross)		<u>2, 000</u>
		91,694
Less other expenses:		
Audit fee	140	
Loan interest	400	
Bad debts	250	
Depreciation	3,125	
General expenses	1, 000	
Carriage	400	
Lighting	850	
Salaries & wages	20, 000	
Rent & rates	2, 500	
Repairs and maintenance	800	
Staff welfare	2, 000	
Telephone/postage	3, 000	
Motor running	4, 200	
Travelling expenses	2, 100	
Donation	<u>1,025</u>	<u>41, 790</u>
Net profit		<u><u>49,904</u></u>

You are required to compute:

- (a) The adjusted profit; and
- (b) The income Tax liability for the 2008 Year of Assessment.

7.0 REFERENCES/FURTHER READING

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UNIT 5 TAXATION OF INCOME FROM TRUSTS, SETTLEMENTS AND ESTATES

CONTENTS

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1.0 INTRODUCTION

Settlements, trust and estate administrations have given rise to issues of accounting and taxation. Usually, the administrators of deceased properties are expected to give detailed account of his stewardship to all the beneficiaries and tax authorities to their satisfaction. Hence, tax authorities use these accounts to assess the income of the deceased person arising from either the disposal or valuation of the property or assets.

In carrying out the tax assessment, individual beneficiaries pay tax according to their benefits (in terms of the property/assets) and not collectively from the entire property. This unit demonstrates to you the preparation of accounts of this nature and the apportionment of computed income arising there-from.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- state the differences between trusts, settlements and estates
- explain the preparation of accounts of this nature and identification of beneficiaries
- discuss the apportionment of computed income
- illustrate some basic terms that concern accounts and taxation of trusts, settlement and estates
- prepare computed incomes of beneficiaries.

3.0 MAIN CONTENT

3.1 Definition of Terms

Settlement – this is an agreement whereby a sum of money is set aside to make provision for another person. Settlement also is a device by which the enjoyment of an estate under the same deed or will may be had by persons in succession.

Trust – this is a mandate given in trust to one or more trustees to dispose or value property and apply the benefits arising out of the property for the advantage of the “beneficiaries”.

Estate – this is a property of a deceased person or the aggregate of the things possessed by a person such as money, goods and property of any kind. These three concepts, according to their definitions, refer to some kind of benefits which are arranged, kept or left for the benefit of some person(s), and administered by another person who may not necessarily be one of the beneficiaries.

The following terms are defined so as to avoid misinterpretation or confusion with every day usage of such words.

Executor – this is a representative appointed by a deceased person (as stated in a will) to administer his estate after his death. When a person dies, his estate passes into the possession of his personal representatives, executors or administrators.

Administrator – this is a person appointed by the court to administer the estate of an intestate or of a testator where an executor has not been appointed or if appointed, does not act.

Administration – under this context, it means the dealing with the estate of a deceased person. That is, collecting assets, paying the debts and distributing any surplus amongst the beneficiaries.

The period in between the date in which the deceased person passes on and the date in which the administrator finishes the distribution of the estate is known as administrative period.

Intestate – when a person dies and leaves no valid will or leaves a will but has not disposed off all his property by the will, he is said to have died intestate, while the person who died leaving a will is known as a testator.

Settler – in relation to a settlement, include any person by whom the settlement was made or entered into directly or indirectly; and in particular, it includes any person who has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement.

Beneficiaries – these are types of persons that may benefit from the income of an estate; examples include the following:

- (a) **Legatee** – one to whom a legacy is bequeathed; that is, a person receiving a specific bequest from the estate;
- (b) **Annuitant** – a person receiving an annuity that may be charged on the income of the estate, on income and capital or on particular assets.

A beneficiary, as a person, is entitled to income (or part of it). He holds a limited interest; the capital passes to some other person known as a remainder-man at the death of such a beneficiary.

SELF-ASSESSMENT EXERCISES 1

1. Enumerate the differences between settlement, trust and estate.
2. Analyse the similarities between a settler, an executor and an administrator.

3.2 Preparation of Accounts

Accounts are prepared for a trust, settlement or an estate to demonstrate that funds relating to any of them have been applied in accordance with the instruments setting them up. With the preparation of such accounts, the beneficiaries, trustees as well as other interested parties such as relevant tax authorities are provided with information about the transactions and the current state of affairs of the trust.

3.2.1 Responsibility for Preparation of Accounts

It is the responsibility of a trustee of a settlement or trust, or the executor of an estate in Nigeria to prepare accounts of the income from all sources for successive periods to 31st December of each year, and to the date in which the assets of the settlement, trust or estate are finally distributed. The trustee of a settlement or trust or executor of an estate shall be answerable for all things to be done in connection with related tax issues.

Income of trust, settlement and estate, according to PITA 1993, schedule 2, part 1, section 1 and 2, shall for all purposes of the act be deemed to be the income of the person creating the trust, as the case may be; and this shall be so much of that income as is derived from a source in Nigeria and any of the income brought into Nigeria.

3.3 Computation of Income of Trust, Settlement and Estate

From the prepared accounts, income subject to income tax is computed in a manner similar to sole traders and partnerships. PITA part 3 provisions deal with deductions allowed in computing income of this nature in the same way as that of all individuals if:

- (a) the settler or person retains or acquires an immediate exercisable general power of appointment over the capital assets of the settlement or trust or over income derived therein;
- (b) that settler or person makes use of, directly or indirectly by borrowing or otherwise, any part of the income arising under the settlement or trust;
- (c) the settlement or trust is revocable in circumstances where the settler or person or his spouse resumes control over any of the income or assets;
- (d) paragraph 4 (1) states that during the life of the settler, if any income in excess of N500 is paid to or for the benefit of an infant, unmarried child of the settler in any year of assessment, the income is treated as the income of the settler.

3.3.1 Special Deductions for a Trust, Settlement and Estate

Besides the deductions allowed listed in PITA part 3, the following deductions are unique to income of this nature:

- (a) any expenses of the trustee or executor relative to the settlement, trust or estate which is authorised by the terms of the deed of settlement, trust or estate or of the will as the case may be;
- (b) any annuity of fixed annual amounts paid out of the income of the settlement, trust or estate, in accordance with the provisions of the deed or will.

Where the income includes any gain or profit from a trade, business or vocation or any rent or premium, there shall be added or deducted- as the case may be, any sum which would have been added or deducted for the next following year of assessment under the provisions of part 5 of the act, if the income from those sources had been the assessable income of an individual for that year of assessment under the provisions of section 36.

3.3.2 Apportionment of Computed Income

Paragraph 3, part 1 of PITA states that the computed income of a year of assessment of a settlement, trust or estate shall be apportioned for the settlement in the following manner:

- ai. The terms of the deed of settlement or trust or of a will provide that the whole income of the settlement, trust or estate after deduction of any authorised expenses or annuity of fixed amount is to be divided in specific proportion among the beneficiaries entitled thereto, from time to time; or
- ii. By operation of the law of intestacy, the income of an individual is to be divided as above (i), the income of each beneficiary of any year from the settlement trust or estate shall be his similarly apportioned share of the computed income;
- bi. A trustee or executor has discretion to make any payment (other than a payment on account) to a beneficiary out of the income of a settlement trust or estate in such amount as he sees from time to time, then the amount of the payment be treated as income of that year which is assessable to tax in the hands of that beneficiary and
- ii. Out of the remainder of the computed income after deducting the aggregate amount of all the payments during any year, there shall be apportioned to each beneficiary who has any specified proportion to the remainder, provided that if the aggregate amount exceeds the computed income, the amount of each payment to be treated as income in the hands of a beneficiary under this sub-paragraph shall be reduced proportionally so that

the aggregate of the amount so reduced does not exceed the computed income.

- c. Any remainder of the computed income of a settlement, trust or estate of any year after deducting all amount apportioned to beneficiaries or treated as income in the hands of beneficiaries under this sub-paragraph shall be reduced proportionally. Income paid for the benefit of a child of the settler in a year of assessment shall be treated for the purpose of the act as the income of the settler and not the income of any other person if at the time of payment; the child is an infant and unmarried- except where:
- (i) in a year of assessment, the aggregate amount of the income paid to or for the benefit of that child does not exceed N500 only;
 - (ii) the income arising under a settlement in a year preceding a year of assessment if the settler is not in Nigeria at any time during that year of assessment, or is not in Nigeria for a period or periods amounting to 183 days or more in any twelve months period, commencing in the calendar year and ending either in the same year or the following year.

SELF-ASSESSMENT EXERCISE 2

Who is saddled with the responsibility of preparing an estate account, and why is this necessary?

3.4 Basis of Tax Assessment

The assessment of income from settlements, trust and estates to tax is governed by the provisions of part 2 and part 3 of PITA 1993 as follows.

- (a) Individuals receiving a fixed annuity- an individual on receipt of an annuity of fixed annual amount paid out of the income of a settlement, trust or an estate shall be assessable to tax on the full amount of the annuity; the income is assessed to tax on preceding year basis and is included in his/her income tax assessment.
- (b) Beneficiary, trustee or executor- part of the computed income received by any beneficiary, trustee, executor or annuitant for a year of assessment shall be assessed on preceding year basis. The following should, however, be noted-

- (i) The income of a beneficiary is included in his income tax assessment in the same way as income from other sources accruing to him;
- (ii) The income of a trustee or executor is not included in any assessment on him as an individual, but is assessed separately in his name as trustee or executor. He cannot therefore, as a trustee or executor, claim personal relief.

3.4.1 Where Aggregate Apportionment Exceeds Computed Income

If the aggregate amount apportioned exceeds the computed income, the amounts of payments made to all beneficiaries are proportionally reduced so that the total amounts equal the computed income.

Illustration 1

Appropriation of Computed Income (Hypothetical)

Case One-	₦
Computed Income	10,000
Discretionary Payments (Admin Expenses)	(2,000)
Specific payments (Beneficiaries)	<u>(7,500)</u>
Non-apportioned balance	<u>500</u>

Specific payments are payments made to beneficiaries of which each beneficiary will pay tax based on graduated tax rates. For the non-apportioned balance of ₦500, the executor/administrator will be assessed to tax based on that amount using graduated tax rates that are applicable to individuals.

Case Two-	₦
Computed income	10,000
Discretionary payments (Admin Expenses)	(5,000)
Specific payments (beneficiaries)	<u>(7,500)</u>
Excess apportionment	<u>(2,500)</u>

In the second case, the apportionment must be re-apportioned, that is, the specific payments can be altered and not the administrative expenses that have been made. But you will explain to the beneficiaries of the necessity of the alteration.

	N
Thus, the re-apportionment-	
Computed income	10,000
Discretionary payments	(5,000)
Specific payments	<u>(5,000)</u>
	<u>0</u>

3.4.2 Double Taxation Relief

A double taxation relief shall be available to any settlement, trust or estate that the income includes any income which has suffered tax in Nigeria or elsewhere. The relief shall be computed in accordance with provisions of paragraph 3 of 2nd schedule, and in accordance with the rules for apportioning the computed income of the year in proportion to the respective shares.

Where there is no computed income, that is, where the income of the settlement, trust or estate is exhausted through expenses, annuities and other deductions, the relief or repayment shall be given or made to the trustee or executor for the account of the settlement, trust or estate.

3.4.3 Appeals

An appeal against the inclusion of an income of settlement, trust or estate in an assessment to tax by any tax authority is governed by the appeal provisions of the income tax laws of the territory to the tax authority of which the trustee or executor is answerable for the relevant year of assessment, [schedule 2, paragraph 5, *PITA* 1993).

3.4.4 Loss Relief and Capital Allowances

If the income includes profits from a trade, business, profession or vocation, or any rents or premiums, the same sum deducted would have been allowed as loss relief in the next year of assessment to an individual carrying on that trade etc., and assessed on *PYB*. For capital allowances, the treatment is the same as that of any trade.

3.4.5 Format for Computing Distributable Income

(1) Sunu (Nig.) Ltd. Trust or settlement	Computed Income for the		
Year Ended December	31 st 2008-		
		N	N
Earned income:			
Trading profit			XX
Sundry income		<u>XX</u>	<u>XX</u>
Unearned income:			

Dividends	XX	
Rent	XX	
Royalty	<u>XX</u>	<u>XX</u>
		XX
Less allowable expenses:		
Annuity of fixed amount	XX	
Trustee remuneration	<u>XX</u>	<u>XX</u>
		XX
Less: loss relief	XX	
Capital allowances	<u>XX</u>	<u>XX</u>
Total taxable income of trust		XX
Tax liability computed	XX	
Less withholding taxes	<u>(XX)</u>	<u>(XX)</u>
Distributable income		<u>XX</u>

(2) Sunu (Ltd.) Trust or Settlement Computed Income for the Year Ended December 31st 2008

	₦	₦
Income:		
Earned	XX	
Unearned	<u>XX</u>	XX
Deduct:		
Allowable expenses	XX	
Annuity of fixed amount	XX	
Trustees remuneration	<u>XX</u>	<u>(XX)</u>
Computed income		XX
Less discretionary payments		<u>XX</u>
Net computed income (available for sharing)		<u>XX</u>

Amount due to each beneficiary

	A	B	C	D
	₦	₦	₦	₦
Annuity of fixed amount	XX	XX	XX	XX
Discretionary payments	XX	XX	XX	XX
Share of net computed income	<u>XX</u>	<u>XX</u>	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>	<u>XX</u>	<u>XX</u>

Illustration 2

Gyang Mayare lived in Plateau State for many years and died in 2006. He was survived by a widow and four children – three sons and one daughter. Gyang Mayare left a will appointing Chung Pam as his executor to administer his estate. Pam obtained the necessary powers under the will and has since 2006 been administering the estate. The

executor's account showed the following income and expenses during the year ended 31st December, 2009:

Income:		₦
Rent income received from properties		750, 000
Dividends paid by Rocklinks Ltd. (gross)		375, 000
Expenses:		
Rates and ground Rents		85, 000
Commission on rent collected		37, 500
Repairs and upkeep of properties		92, 500
Wages of staff		60, 000
Executor's professional fees		40, 000

Under the will, Chung Pam has discretion to make an ex-gratia payment, in case of need, to any of the beneficiaries- but should not exceed ₦100, 000 in any one year. During the year ended 31 December 2009, Chung Pam paid ₦90, 000 to the three sons in equal amounts in this connection. The beneficiaries' share of the estate is determined by the will to be in the following ratios.

Wife	1.5
1 st son	2.5
2 nd son	2.5
3 rd son	2.5
Daughter	<u>1</u>
	<u>10</u>

You are required to show the amounts which the beneficiaries will include in their respective income tax returns of the 2009 year of assessment, in respect of the income for the estate.

Suggested Solution

Estate of Gyang Mayare

(1) Computation of income for the year ended 31st Dec. 2009.

	₦	₦
Income: gross rent		750, 000
Less: rates & rent	85, 000	
Commission on rent	37, 500	
Repairs	<u>92, 500</u>	<u>215, 000</u>
		535, 000
Add dividends received (gross)		<u>375, 000</u>
		910, 000
Less other expenses:		
Wages	60, 000	

Fees	<u>40,000</u>	<u>100,000</u>
Amount due to beneficiaries		810,000
Less executor's discretionary payments		<u>90,000</u>
Net computed income to be shared		<u><u>720,000</u></u>

(2) ***Distribution of computed income***

	Wife	1 st son	2 nd son	3 rd son	Daughter
	₹	₹	₹	₹	₹
Discretionary payment	-	30,000	30,000	30,000	-
Share of computed income	<u>108,000</u>	<u>180,000</u>	<u>180,000</u>	<u>180,000</u>	<u>72,000</u>
(1.5: 2.5: 2.5: 2.5:1)					
Amount to be taxed	<u>108,000</u>	<u>210,000</u>	<u>210,000</u>	<u>210,000</u>	<u>72,000</u>
(Using Graduated Tax Rate in 2010)					

SELF-ASSESSMENT EXERCISE 3

Critically explain the basis of tax assessment for a settlement.

4.0 CONCLUSION

In this unit, you have learnt that taxation of income of trusts, settlements and estates is covered by *PITA* 1993 and the taxing system is similar to that of individual employees and business persons. Income accruing to beneficiaries is added to their other individual incomes less personal reliefs and allowances. Therefore, any net amount is taxed using graduated tax rates.

For the executor, trustee or administrator, any residue left in his/her hands after meeting all the requirements of any will and other basic expenses will be taxed using graduated tax rates but without deducting any personal relief or allowance. Therefore, tax assessment of this nature should be studied along side with taxation of individuals and partnerships besides executorships and trust law and accounts as the three intertwined.

5.0 SUMMARY

In this unit, you have been taught the following:

- The concepts trust, settlement and estate refer to some kind of benefits which are arranged, kept or left by a person for the benefit of some other person(s)
- A trustee or an executor is expected to prepare annual or terminal accounts for the consumption of all beneficiaries and the relevant tax authorities
- In trust, settlement and estates, income assessment, expenses of the trustee or executor plus any annuity of fixed annual amount

are deducted from the income in addition to other allowable deductions as specified for individual taxpayers

- A trustee or executor has discretion to make any payment that is not captured in the will as he/she may deem necessary
- Tax liability is paid by individual beneficiaries on the income accruing to them
- A trustee or executor must pay tax on any balance of money left with him/her after all necessary payments, net balance can be re-distributed.

6.0 TUTOR-MARKED ASSIGNMENT

1. A trustee has discretion to make any payment that is not captured in the will as he/she deems necessary. Explain this statement.
2. Tunde lived in Ogun State for many years and died in 2007. He was survived by a widow and three children – two sons and one daughter.

Tunde left a will appointing Dele Tola as his executor to administer his estate. Dele obtained the necessary powers under the will and has, since 2007, been administering the estate.

The executor's account showed the following income and expenses during the year ended 2008:

Income:	₦
Rent income received from properties	1,500, 000
Dividends paid by Rocklinks Ltd. (gross)	750, 000
Expenses:	
Rates and ground rents	170, 000
Commission on rent collected	75,000
Repairs and upkeep of properties	185,000
Wages of staff	120, 000
Executor's professional fees	80, 000

Under the will Dele has discretion to make an ex-gratia payment in case of need to any of the beneficiaries, but should not exceed ₦400, 000 in any one year. During the year ended 31 December 2008, Dele paid ₦180, 000 to each of the two sons, in equal amounts in this connection. The beneficiaries' share of the estate is determined by the will to be in the following ratios:

Wife	2
1 st son	3
2 nd son	3
Daughter	<u>2</u>
	<u>10</u>

You are required to show the amounts which the beneficiaries will include in their respective income tax returns of the 2008 year of assessment in respect of the income for the estate.

7.0 REFERENCES/FURTHER READING

CITN Nigerian Tax Guide Statutes. (2002). Lagos: The Chartered Institute of Taxation of Nigeria.

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MODULE 3

Unit 1	Taxation of Banks
Unit 2	Taxation of Insurance Companies
Unit 3	Taxation of Construction Companies
Unit 4	Taxation of Airline and Shipping Companies
Unit 5	Double Taxation Relief

UNIT 1 TAXATION OF BANKS

CONTENTS

1.0	Introduction
2.0	Objectives
3.0	Main Content
3.1	Banks' Excess Profit
3.1.1	Meaning of Excess Profit
3.1.2	Excess Levy (Tax)
3.2	Interest Exempted from Tax
3.2.1	Details to be Disclosed by Banks for Agricultural Loans
3.3	Format for Computing Excess Profit
4.0	Conclusion
5.0	Summary
6.0	Tutor-Marked Assignment
7.0	References/Further Reading

1.0 INTRODUCTION

Bank's taxation falls within the provisions of the Companies Income Tax Act of 1993 (CITA). Therefore, it shares the same corporation tax rate prevailing in every fiscal year with other companies. However, banks pay extra tax on any excess profit that emanates from their assessments.

Therefore in this unit, you will be exposed to the computational aspects of bank taxation.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the term "excess profit"
- identify the provisions of CITA that relate to the banking sector
- compute taxable and excess profits for tax purposes
- ascertain tax liability of banks.

3.0 MAIN CONTENT

3.1 Banks' Excess Profit

CITA, 1979 provides that banks shall pay tax for each year of assessment in respect of any taxable profit computed. In addition to this tax which applies to all companies under CITA, there shall, as from the year of assessment commencing on 1st April, 1978, be levied and paid a special levy of 10% on excess profits of all banks as defined by section 41 of the Banking act, 1969.

3.1.1 Meaning of Excess Profit

Excess Profit means the difference between taxable profits as computed, using approved incomes and expenses, and the expected normal profit which ascertaining it is based on some prescribed percentages of all capital sources of the business (bank).

3.1.2 Excess Levy (Tax)

After the ascertainment of excess profit, by comparing the taxable profit with the normal profit, an excess levy rate of 10% is applied and excess tax emerges. When this occurs, the excess tax is added to the corporation tax, which rate has fluctuated between 30% and 45% over the years, to arrive at the total tax liability (tax due). However, with effect from 1st January 1991, the excess profit tax was abolished.

SELF-ASSESSMENT EXERCISE 1

Explain how excess tax liability is determined.

3.2 Interest Exempted from Tax

Banks in Nigeria are encouraged to grant agricultural loans to farmers at low interest rates. It is on this note that the Central Bank of Nigeria (CBN) has selected some commercial banks as channels for the issuance of agricultural loans to farmers in Nigeria. The banks are also encouraged to grant loans to exporters.

Therefore, any interest earned by banks on loans granted for agricultural/export business is exempted from tax as follows:

Payment Period (Including Moratorium)	Grace Period	Proportion of Interest Exempted from Tax
Above 7 Years	Not less than 2 years	100%
5 – 7 Years	Not less than 18 Months	70%
2 – 4 Years	Not less than 12 Months	40%
Below 2 Years	Nil	Nil

3.2.1 Details to be Disclosed by Banks for Agricultural Loans

Section 7 (A), Part II of CITA, LFN 1998 No. 18 states that “where a bank grants a loan to a company, it shall disclose to the board the following information:

- (a) The amount of the loan;
- (b) The moratorium period;
- (c) The date repayment is due to commence;
- (d) The amount of repayment showing capital and interest; and
- (e) The full particulars of the recipient and its permanent address.

Until a bank fulfils these requirements, it shall not be entitled to tax free interest received on agricultural loans.

SELF-ASSESSMENT EXERCISE 2

What is the rationale behind exempting interest on agricultural loans from tax in Nigeria?

3.3 Format for Computing Excess Profit

	₦	₦
Taxable profit		xx
Less normal profit:		
40% of Paid-up share capital	xx	
20% of Statutory reserve	xx	
20% of General reserve	xx	
20% of Long-term liabilities	<u>xx</u>	<u>xx</u>
Excess profit		<u>xx</u>

With effect from 1989 year of assessment, excess profit tax became applicable to all the companies operating in Nigeria. Apart from the fact that the rate was changed, there was the introduction of a minimum normal profit of N6 million. Thus, the format became as follows:

A Nigerian Company

		₦	₦
	Taxable profit		xx
	Less the higher of		
(i)	Normal profit:		
	40% of Paid-up share capital	xx	
	20% of Capital reserve	xx	
	20% of General reserve	xx	
	20% of Long-term liabilities	<u>xx</u>	
		xx	
	OR		
(ii)	Minimum of	<u>₦6million</u>	<u>xx</u>
	Excess profit		<u>xx</u>

Illustration

T

he following is given of Success Bank (Nig.) Plc for the year 1987-

	₦
Adjusted profit	750,000
Paid-up capital	500,000
Capital/Statutory reserve	250,000
General/Revenue reserve	100,000
Long-term liabilities	800,000
Capital allowances	100,000

You are required to compute the excess profit and tax liability of the bank, assuming 40% is the corporation tax rate.

Suggested Solution**Success Bank (Nig.) Plc**

	₦	₦
Adjusted profit		750,000
Less capital allowances		<u>100,000</u>
Taxable profit		
650,000		
Less Normal Profit:		
40% of ₦ 500, 000	200,000	
20% of ₦ 250, 000	50,000	
20% of ₦ 100, 000	20,000	
20% of ₦ 800, 000	<u>160,000</u>	<u>430,000</u>
Excess profit		<u>220,000</u>
Tax liability:		
Corporation tax (40% of ₦ 650, 000)		
260,000		
Excess profit tax (10% of ₦ 220, 000)		<u>22,000</u>
		<u><u>282,000</u></u>

SELF-ASSESSMENT EXERCISE 3

The following is given of Zion Bank (Nig.) Plc for the year 1987-

	₦
Adjusted profit	2,250,000
Paid-up capital	1,500,000
Capital/Statutory reserve	750,000
General/Revenue reserve	300,000
Long-term liabilities	240,000
Unrelieved losses	245,000
Capital allowances	300,000

You are required to compute the excess profit and tax liability of the bank, assuming 35% is the corporation tax rate.

4.0 CONCLUSION

In this unit, as you would have noticed, the taxation of banks has posed some unique challenges because of some provisions in the Banking Act of 1969. However, these provisions have been repealed in the current banking act now known as Banks and Other Financial Institutions Act of 1991 (BOFIA 1991). Therefore, the assessment of banks to tax in Nigeria is solely based on the provisions of CITA, 1993.

5.0 SUMMARY

In this unit, it has been made known to you that:

- the term “Excess Profit” means taxable profit Minus normal profit
- most of the provisions of CITA, 1993 apply to the banking sector
- the summation of corporation tax and excess profit tax will give the tax liabilities of banks
- corporation tax rate is determined by fiscal policies on yearly basis. It is used on taxable profits, while excess profit tax rate was determined by the various amendments of the Banking act of 1969
- in 1989, excess profit tax became applicable to all companies under CITA. However, it was repealed with effect from 1st January 1991.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the conditions for enjoying a tax free agricultural loan?
2. Solid Bank of (Nig.) Ltd. had been incorporated for many years and makes up its account as at June 30th of every year. The following information was extracted from the audited financial statements of the bank for the year ended June 30th, 1987-

	N'000	N'000
Paid-up capital	16,000	17,500
Statutory reserve	7,000	8,250
General reserve	2,250	2,750
Debenture stock	-	7,000

A summarised statement of the bank's profit and loss account is given below-

	N'000	N'000
Income from banking operations		39,000
Profit on sale of fixed assets		<u>19</u>
		39,019
Less operating expenses:		
Depreciation	1,000	
Interest paid to other banks	750	
Stamp duty on landed property	125	
Provision for possible and specific		
Losses in respect of loans	750	
General provisions for loan losses	50	
Other operating expenses	<u>12,000</u>	<u>14,675</u>
Net profit		<u>24,344</u>

The following additional information was provided.

- (a) Capital allowance- claimed as N1,750,000
- (b) Income from banking operations (interest on agricultural loans) amounting to N950, 000, a breakdown of the interest income is as follows.

Period	Grace Period	Amount of Interest N
Over 7 years	Not less than 2 years	380,000
5 – 7 years	Not less than 1½ years	285,000
2 – 4 years	Not less than One year	190,000
Below 2 years	Nil	<u>95,000</u>
		<u>950,000</u>

- (c) Two rural branches of the bank were opened during the year ended June 30th 1986 and the total expenditure in setting up the branches amounted to N162, 500.

You are required to compute the tax liability of the bank for the relevant year of assessment.

7.0 REFERENCES/FURTHER READING

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UNIT 2 TAXATION OF INSURANCE COMPANIES

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 - 3.1.1 Format for Computing Taxable Profit in Respect of Non-Nigerian Insurance Companies(Non-Life)
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 - 3.2 Nigerian Insurance Companies
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 - 3.2.2 Taxation of Life Assurance Companies in Nigeria
 - 3.3 Permanent Establishment
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1.0 INTRODUCTION

Insurance companies are owned either wholly by foreigners or Nigerians, or partly owned by both foreigners and Nigerians. These companies can either be for life or non-life insurance businesses. Section 14 (1 – 5) of *CITA* 1990 provides for the taxation of such companies, which gives them certain unique principles and methods that are adopted for the ascertainment of their taxable profits and subsequently, their tax liabilities.

This unit, therefore, exposes you to those unique intricacies and the computations of taxable profits for both life and non-life insurance companies.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- distinguish between life and non-life insurance companies
- explain how the profits of life and non-life insurance companies are ascertained
- discuss the term “permanent establishment”
- explain the general procedures for ascertaining tax liabilities in respect of all insurance companies, irrespective of their nature.

3.0 MAIN CONTENT

3.1 Assessment of Non–Nigerian Insurance Companies for Taxation

In the case of a non–Nigerian insurance company that carries on business in Nigeria and which its profit partly accrues outside Nigeria, the profits on which tax may be imposed are ascertained as shown below.

- (a) Aggregating interest and premium and other incomes received in Nigeria (less premium return to the insured or premium paid on re-insurance);
- (b) Adding, there to, reserves of unexpired risk at the beginning of the year.
- (c) Deducting therefrom:
 - (i) reserve for unexpired risk at the end of the year;
 - (ii) the actual losses in Nigeria (less amount to be recovered from any re-insurance);
 - (iii) agency expenses incurred wholly and necessarily in the pursuance of business in Nigeria;
 - (iv) a fair proportion of head office expenses as approved by *FBIR*.

3.1.1 Format for Computing Taxable Profit in Respect of Non–Nigerian Insurance Companies (Non-Life)

Let us look at a sample format below; take note of each stage of the process.

XYZ Insurance Company		
<i>Computation of Taxable Profit for 200x Year of Assessment</i>		
	N	N
Interest, premium and incomes		XX
Less: Premium returned	XX	
Premium paid	XX	
Re – Insurance	<u>XX</u>	<u>XX</u>
		XX
Add unexpired risk at the beginning of the year		<u>XX</u>
		XX
Deduct:		
Reserves for unexpired risk at the end of the year	XX	
Actual losses in Nigeria (less amount recovered under re-insurance)	XX	
Agency expenses	XX	
Headquarter expenses	XX	<u>XX</u>
Taxable profit		<u>XX</u>

3.1.2 Foreign (Non-Nigerian) Life Assurance Company

In the case of a life assurance business, whether proprietary or mutual, other than a Nigerian company, which carries on business through a permanent establishment in Nigeria, the profits on which tax may be imposed shall be the total investment income less management expenses, including commission.

Where the profits of such a company accrue in part outside Nigeria, the profit on which tax may be imposed shall be that proportion of the total investment income of that company.

That is, premium receivable in Nigeria x investment income = Total premium receivable.

Where the insurance company has its head office outside Nigeria, a fair proportion of the head office expenses may be approved by the revenue board in addition to the agency's expenses as deduction for tax purposes provided that:

- (a) the board may substitute some basis, other than the one prescribed above, for ascertaining the required proportion of the total investment income;
- (b) any amount distributed in any form as dividend from the actual re-evaluation of unexpired risks or from any other re-evaluation shall be deemed to be part of the total profits to the company.

SELF-ASSESSMENT EXERCISE 1

Explain briefly the process of ascertaining the taxable profit of a non-Nigeria insurance company.

3.2 Nigerian Insurance Companies

In the case of an insurance company which is a Nigerian company, the profits on which tax may be imposed shall be ascertained in accordance with the provisions for non-Nigerian insurance companies earlier mentioned as though the whole investment and premium income of the company were received in Nigeria; even though the insurance company has branches outside Nigeria.

3.2.1 Non-Life Nigerian Insurance Companies

As stated in *CITA* 1990 Section 14(1), a non-life insurance company shall have tax imposed on its profit ascertained as follows:

	N	N
Gross premium, interest and other premium paid on re-insurance		xx
Less: Reserve for expired risk (That is, % adopted x premium recovered)		<u>xx</u>
		xx
Add: Reserve for unexpired risk brought forward	xx	
Less actual loss	<u>xx</u>	
	xx	
Add actual loss recovered	<u>xx</u>	<u>xx</u>
		xx
Less: Allowable expenses		<u>xx</u>
Adjusted profit (Taxable profit since there is no capital allowances)		<u>xx</u>

3.2.2 Taxation of Life Assurance Companies in Nigeria

Section 14 (1) of *CITA* 1990, states that profit on which tax may be imposed shall be the total investment income of the company less management expenses including commission. Where a life assurance company declares a dividend to be paid to shareholders, which has its head office abroad from the increase arising from actuarial revaluation, the company shall pay tax on the dividend as if such dividend is the total profit of the company.

In practice, the formula to be adopted for actuarial valuation can be discussed and agreed with the *FBIR* and it will be subject to review from time to time. Again, if a life assurance company has its head office abroad with an agency in Nigeria, the income to be imposed to tax is only that portion that is accrued in Nigeria.

Illustration 1

Tabashi Insurance Company has its head office abroad and a branch (agent) in Nigeria:

- total investment income ₦140, 0000
- total premium receivable ₦80,000 of which ₦20, 000 is receivable in Nigeria
- agency expenses in Nigeria ₦14, 000
- head office expenses chargeable to Nigerian branch ₦6, 000
- disallowable expenses in agency expenses amounting to ₦2, 000
- capital allowances available - ₦6,000

You are required to compute the chargeable profit of the agency in Nigeria.

Suggested Solution

<u>Tabashi Insurance Company</u>		
<i>Computation of chargeable profit</i>	₦	₦
Income		35, 000
<u>(Premium Receivable in Nig. x Total Investment = 20,000 x 140,000</u>		
Total Premium Received	80,000	
Deduct: Agency expenses in Nigeria	14, 000	
Head office expenses	<u>6, 000</u>	<u>20, 000</u>
		15, 000
Add back disallowable expenses		<u>2, 000</u>
Adjusted/assessable profit		17, 000
Less capital allowances		<u>6, 000</u>
Chargeable profit		<u>11,000</u>

SELF-ASSESSMENT EXERCISE 2

Trust Insurance Company is a Nigerian company and the following is presented to you:

- Total investment income ₦70,0000
- Total premium receivable ₦40,000 of which ₦10, 000 is receivable in Nigeria
- Agency expenses in Nigeria ₦7,000
- Allowable expenses ₦3,000
- Disallowable expenses in agency expenses amounting to ₦4,000
- Capital allowances available ₦3,000

You are required to compute the taxable profit of the company.

3.3 Permanent Establishment

The term “permanent establishment” in relation to an insurance company means a branch, management or a fixed place of business in Nigeria, but does not include an agency in Nigeria unless the agent has, and habitually exercises a general authority to negotiate and conclude contracts on behalf of such a company.

Illustration 2

Okoye Insurance Nigeria Plc engaging in non-life business has the following details of its transactions for the year ended 30th April 2008.

	₦
Premium received	135, 000
Dividend received (Net)	1, 275
Profit on sale of fixed assets	550
Re-insurance premium	34, 500
Subscription as a member of Nigeria Insurance Association (NIA)	500
Contribution to state education funds	1, 500
Unexpired risk – 1/5/2007	31, 000
30/4/2008	27, 500
Claims	12,000
Amount recovered under re-insurance	7, 500
Salary and other administrative expenses	14, 500
Capital allowances are:	
Initial allowance	4, 000
Annual allowance	3, 800
Balance charge	550

You are required to compute the tax payable by the company for the relevant year of assessment, assuming Company Income Tax Rate is 35%.

Suggested Solution**Okoye Insurance Nigeria*****Computation of Tax Liability for 2009 Year of Assessment***

	₦	₦	₦
Premium received			135,000
Dividend received (gross)			<u>1,500</u>
			136,500
Less: Premium on re –insurance			<u>34,500</u>
			102,000
Less: Provision for unexpired Risk (at the end)			<u>27,500</u>
			75,500
Claims paid	12, 000		
Less amount received	<u>7, 500</u>	4,500	
Membership of NIA		500	
Contribution to SEF		1,500	
Salary and other admin expenses		<u>14,500</u>	<u>21,000</u>
			54,500
Less capital allowance:			
Initial		4, 000	

Annual	3,800	
	7,800	
Less balance charge	<u>550</u>	<u>7,250</u>
Taxable profit		<u><u>47,250</u></u>

Tax liability = ~~N~~47,250 x 35% = ~~N~~16,537.50

SELF-ASSESSMENT EXERCISE 3

What is the striking difference in the computation of taxable profit of Nigerian and non-Nigerian insurance companies?

4.0 CONCLUSION

Insurance companies can either be wholly owned by Nigeria citizens, by foreigners or by both. Whatever the structure of ownership, its profits must be subjected to the Nigerian taxation system and be assessed by the FBIR. It is covered by CITA 1990. Therefore, you are expected to be conversant with the principles and methods of computations so as to be able to ascertain the correct chargeable profits and consequently, the tax liability.

5.0 SUMMARY

In this unit, you have learnt the following:

- Insurance companies are categorised into those wholly owned by Nigerians, those wholly owned by foreigners and those owned by both Nigerians and foreigners;
- Insurance companies can specialise in either life or non-life insurance services for individuals and corporate organisations. It can also render re-insurance services to other insurance companies;
- Life assurance deals with individual persons who have insured their lives against death or specific periods, whichever comes first;
- Non-life insurance business deals with other insurance services that may cover other things that are material in nature. Examples of such things include buildings, motor vehicles, equipment, aircraft and ships, etc.
- The term permanent establishment means a branch, management or fixed place of business in Nigeria;
- All computations of taxable profits for insurance companies take into consideration claims paid, premium on re-insurance/assurance, provision for unexpired risk etc.

6.0 TUTOR-MARKED ASSIGNMENT

1. Emma Insurance Nigeria Plc engaging in non-life business has the following details of its transactions for the year ended 30th April, 2007.

	₦
Premium received	270,000
Dividend received (Net)	2,550
Profit on sale of fixed asset	1,100
Re-insurance premium	69,000
Subscription as member of Nigeria Insurance Association (NIA)	1,000
Contribution to state education funds	3,000
Unexpired risk – 1/5/2006	62,000
30/4/2007	55,000
Claims	24,000
Amount recovered under re-insurance	15,000
Salary and other administrative expenses	29,000
Capital allowances were:	
Initial allowance	8,000
Annual allowance	7,600
Balance allowance	1,100

You are required to compute the tax payable by the company for the relevant year of assessment, assuming company income tax rate is 35%.

2. Bobby Ltd. is a life assurance company incorporated in Nigeria, but managed and controlled abroad. It has branches in Togo, Ghana and Benin Republic.

The profit and loss account ended 31/12/2008 is as follows:

	₦	₦
Life fund (1/1/2008)		1,750,000
Premium		2,650,000
Investment income		<u>360,000</u>
		4,760,000
Deduct:		
Claims paid	145,000	
Reserve for outstanding claims	420,000	
Surrenders	22,000	
Bonuses	25,000	
Expenses	72,000	
Commissions	876,000	
Life fund (31/12/2008)	<u>2,500,000</u>	<u>4,070,000</u>
		<u>690,000</u>

Additional information:

- i. Premium received outside Nigeria ₦500, 000
- ii. Commissions and expenses attributable to operations outside Nigeria were ₦176, 000 and ₦15, 000, respectively.
- iii. Depreciation attributable to Nigerian business

You are required to compute chargeable profit or loss for the year.

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UNIT 3 TAXATION OF CONSTRUCTION COMPANIES

CONTENTS

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
 - 3.1 Methods of Computing Profits of Construction Companies
 - 3.1.1 The Completed-Contract Method
 - 3.1.2 The Percentage- of- Completion Method
 - 3.2 Types of Construction Contracts
 - 3.3 Computation of Taxable Profit
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- 5.0 Summary
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1.0 INTRODUCTION

Construction Companies that are registered in Nigeria and even those that operate in the country pay tax under the Nigeria tax system. The legislation that regulates them is the Companies Income Tax Act, 1993. Section 13 (2) of LFN, 2004 states that profits of a company from any trade or business shall be deemed to be derived from Nigeria. Construction companies often engaged in contract work, which involves the execution of building and civil engineering projects, mechanical and electrical engineering installations and other fabrications normally evidenced by an agreement between two or more parties.

These companies engage in both short and long-term construction contracts that should be completed within twelve months or expected to take more than twelve months to be completed. Thus in this unit, you will be exposed to the ascertainment of profits arising from both short and long-term construction works that are subjected to tax.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- distinguish between construction company taxation and other companies' taxation
- explain percentage-of-completion method and completed-contract method of revenue recognition
- discuss the difference types of construction contracts
- compute taxable profit in proportion to the degree of construction work done.

3.0 MAIN CONTENT

3.1 Methods of Computing Profits of Construction Companies

Construction companies are usually engaged in contracts that are long term in nature. It can undertake a contract work that lasts for years. The payment for such contracts is either in installments (as the degree of completed work is ascertained) or at the end of the entire work. Whatever the case, the tax authority expects these companies to declare their profits or losses (by means of returns) on yearly basis. Thus, the accounting standard board has provided two methods for this purpose.

3.1.1 The Completed-Contract Method

Under the completed-contract method used for construction companies, revenue is recognised when the contract is completed. Cost incurred on the contract and billings are accumulated until the contract is completed. Sometimes, there are costs to be incurred at the end of the contract, which may not be material to warrant regarding the contract as uncompleted. Such costs are provided for and the contract is treated as completed. In the construction industry, this is referred to as practical completion stage.

Usually, the completed-contract method for long-term contracts is used by enterprises in a situation where there are no dependable estimates or where there are inherent uncertainties, which make forecasts unreliable. Until the point at which contract is identified as completed, revenue is not recognised.

A major drawback of the completed contract method when applied to long-term contracts is that periodic revenue is subject to distortion and this is not accepted in tax assessment. Revenue prior to completion is not reflected in the accounts of the reporting enterprise even if operations on the contract are uniform over the construction period.

SELF-ASSESSMENT EXERCISE 1

When will it become necessary to accept the complete contract method for tax purposes?

3.1.2 The Percentage-of-Completion Method

Under the percentage-of-completion method used in construction companies, costs that are incurred on a contract are accumulated in an

asset account. The proportion of revenue in relation to the work done may be ascertained by one of the following two methods:

- (a) the percentage of estimated total revenue that the incurred costs to date bears to the estimated total costs;
- (b) the percentage of total contract value that the engineering and architectural work done to date bears to the engineering and architectural estimate of the whole contract.

Where the percentage-of-completion method is used, it is usual to establish that computing the estimated total cost to completion and comparing it with the total estimated revenue do not overstate the revenue. The percentage-of-completion method is used when:

- (a) there is a contract in which the following terms are included:
 - (i) the goods or services to be provided and received;
 - (ii) the frequency of inspection of work-in-progress and the certification procedures for billing purposes;
- (b) the contractor has an adequate estimating process and the ability to estimate reliably both the cost to completion and the percentage of contract executed;
- (c) the contract has a cost accounting system which adequately accumulates and allocates costs to final work in a manner consistent with his estimating process.

The percentage-of-completion method is considered more reliable because it gives both the accountant and the tax authority a fair measure of activities performed in each accounting/basis period and the resultant revenue and profit. Thus, revenue is adequately matched with costs in the accounting period. Suffice it to say that this is the method tax authority prefers to use for assessing construction companies to tax in Nigeria.

SELF-ASSESSMENT EXERCISE 2

Compare and contrast complete and percentage-of-completion methods of computing profits of construction companies

3.2 Types of Construction Contracts

There are several types of contracts, which can either be fixed sum, cost-plus a fixed rate, re-measure or variable-price. For the purpose of clarity, these will be followed with brief descriptions.

(a) Fixed sum (lump sum) contract

The contractor undertakes or agrees to execute specific projects or works in consideration for a fixed sum. It excludes variations, escalations, etc.

(b) Cost-plus a fixed rate contract

This allows for reimbursement of agreed costs incurred plus a fixed fee or percentage boost up on the agreed costs incurred.

(c) Re-measure contract

This allows final contract price to be determined by the measurement of final quantities.

(d) Variable-price contract

This contains one or more clauses regarding:

- (i) price variation that allows adjustments to base price;
- (ii) work variation for an additional work order from an employer;
- (iii) prolongation that takes care of additional costs resulting from delays not caused by the contractor.

SELF-ASSESSMENT EXERCISE 3

In your opinion, what is the best type of construction contract?

3.3 Computation of Taxable Profit

The computation of taxable profit for a construction company is the same with other companies in the sense that allowable and non-allowable expenses applicable to the latter also applies to the former. This is more so if the contract work being undertaken by the company is short-term contract and the amount for the contract is payable within a reasonable time frame.

However, where the contract is contrary to the above description or long-term in nature, certificate of work done and the amount payable thereto shall be considered as revenue/turnover for the relevant year of assessment and the expenses to be matched with revenue shall be determined based on the degree of completion or work done which must be in proportion to the revenue realised due to certification.

3.3.1 Capital Allowances

Capital allowances for construction companies are pro rated according to the degree of work done and according to the number of months in the basis period. However, for the initial allowance, it is given wholly in the year of assessment in which the qualifying expenditure was procured. Any equipment procured for the construction contract but not used within the basis period that covers the year of assessment shall not be considered for any capital allowance for the purpose of taxation for the relevant tax year.

Illustration

Zion Construction (Nig.) Limited was awarded a contract of constructing the Kabong-Gada Biu Road in Jos at a cost of N450,000,000 on the 1st January, 2007. A mobilisation fee of 15% of the contract price was given to the company; the company moved to site, immediately.

The following data relate to what transpired for two years:

	2007	2008
	₦'000	₦'000
Work certified	180,000	400,000
Equipment purchased	80,000	80,000
Wages for casual workers	20,000	25,000
Salaries of permanent staff	30,000	32,000
Payments to subcontractors	30,000	40,000
Rent and insurance	3,000	3,000
Electricity	300	300
Motor vehicle maintenance	1,500	1,000
Depreciation on motor vehicles	1,400	1,400
Equipment	24,000	28,000
Equipment running costs	6,000	6,500

- Note:** (i) Capital allowances have been agreed with the tax authority as follows:
 2007 - ₦36,000,000
 2008 - ₦35,000,000
- (ii) Contract work given to the subcontractors is priced at ₦100, 000,000 in total, and there are certificates of valuation for ₦25, 000,000 and ₦65, 000,000 for the two years, respectively.
- (iii) Corporation tax rate is 35%

You are required to compute the tax liabilities for all the relevant years of assessment.

Suggested Solution**Zion Construction (Nig.) Ltd****Computation of Tax Liabilities for two Years of Assessment (2008 & 2009)**

	2008		2009	
	N'000	N'000	N'000	N'000
Income as per certificate		180,000		220,000
Less allowable deductions:				
Personnel cost	50,000		72,000	
Subcontractors	25,000		40,000	
Rent & insurance	3,000		3,000	
Electricity	300		350	
Motor maintenance	1,500		1,000	
Equipment r/costs	<u>6,000</u>	<u>85,800</u>	<u>6,500</u>	<u>122,850</u>
Adjusted profits		94,200		97,150
Less capital allowance		<u>36,000</u>		<u>35,000</u>
Taxable profits		<u>58,200</u>		<u>62,150</u>

Therefore, tax liabilities @ 35% are given as:

2008 (35% of N58, 200,000) = **N20, 370,000**

2009 (35% of N62, 150,000) = **N21, 752,500**

SELF-ASSESSMENT EXERCISE 4

Explain the key difference in the computation of construction company taxation with that of other businesses, as seen above.

4.0 CONCLUSION

In this unit, you have learnt that taxation of construction companies is based on income derived mostly from contract works, which come occasionally. That is, some years of assessment may not have income at all, except losses. Contract work may continue for more than twelve calendar months before they are completed and payment made. Therefore, the need to certify the degree of completion at the end of every year of assessment becomes imperative because every company files yearly returns with the *FIRS*.

5.0 SUMMARY

In this unit, you have learnt the following:

- The unit has defined the meaning and scope of construction contracts.
- Completed-contract method recognises revenue at the end of the whole contract while percentage-of-completion method recognises the degree of work at the end of every year of assessment as per certification;

- Construction contracts are of several types. They can either be fixed sum, cost-plus a fixed rate, re-measure or variable-price contract
- Computation of taxable profit for construction companies follow the same pattern with that of other companies, except that the degree of completion must be taken cognizance of in matching revenue with expenses.

6.0 TUTOR-MARKED ASSIGNMENT

1. Critically explain how taxable profit of a construction company is computed.
2. Eagle Construction (Nig.) Limited was awarded a contract of constructing the Kabong-Gada Biu Road in Jos at a cost of N900,000,000 naira on the 1st January, 2008. The following data relate to what transpired within the year:

	₦'000
Work certified	500,000
Equipment purchased	80,000
Wages for casual workers	50,000
Salaries of permanent staff	32,000
Payments to subcontractors	40,000
Rent and insurance	25,000
Electricity	350
Motor vehicles maintenance	1,000
Depreciation on: motor vehicles	1,400
Equipment	28,000
Equipment running costs	6,500

Note:

- (i) Capital allowances have been agreed with the tax authority as ₦71, 000,000
- (ii) Contract work given to the subcontractors is priced ₦80, 000,000 in total, and there is a certificate of valuation for ₦60, 000,000 for the year.
- (iii) Corporation tax rate is 35%

You are required to compute the tax liabilities for all the relevant years of assessment.

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UNIT 4 TAXATION OF SHIPPING AND AIRLINE COMPANIES

CONTENTS

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
 - 3.1 Ascertainment of Taxable Profit
 - 3.1.1 Gross Adjusted Profit Ratio
 - 3.1.2 Depreciation Relief Ratio
 - 3.1.3 Procedures for Computing Tax Liability
 - 3.2 Computations of Taxable Profit and Tax Liability
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- 5.0 Summary
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1.0 INTRODUCTION

Section 12(1) of CITA 1990 states that the profit or loss of a foreign company which carries on the business of transport by sea or by air, and any ship or aircraft owned or chartered by it and calls at any seaport or airport in Nigeria- its income or loss is deemed to be derived from Nigeria- shall be the full profit or loss arising from the carriage of passengers, mails, livestock or goods, shipped or loaded into an aircraft in Nigeria. This provision does not apply to passengers, mails, livestock or goods which are brought to Nigeria, solely for transshipment or for transfer from one aircraft to another or in the direction between an Aircraft and a ship.

Hence, the assessment of companies such as these to taxation differs a little in terms of the principles and methods from other assessments. The unit shall expose you to the detailed issues involved.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- state the issues involved in taxation for shipping and airline companies
- explain the ratios required for the determination of taxable profits
- distinguish between the ratio of adjusted profit and ratio of depreciation relief
- illustrate the process of arriving at tax liability using the relevant tax rate.

3.0 MAIN CONTENT

3.1 Ascertainment of Taxable Profit

Where the Board (FBIR) is satisfied that the tax authority of any other country computes and assesses taxable profits on a basis not materially different from that prescribed by the act, then the profits of a company which operates a ship or an aircraft shall be taxed based on the procedure of ascertaining the gross adjusted profit ratio and the depreciation relief ratio.

3.1.1 Gross Adjusted Profit Ratio

It is the ratio that the adjusted profit or loss before depreciation allowance bears to the total sum receivable in respect of carriage of passengers, mails, livestock or goods. In other words, it is the ratio of profit or loss before any allowance by way of depreciation of an accounting period bears to the total sum receivable in respect of the carriage of passengers and other items.

3.1.2 Depreciation Relief Ratio

Depreciation relief ratio is the ratio used in ascertaining the amount of capital allowances to be allowed. It uses the ratio of total depreciation to total sum received multiply by the total amount receivable in respect of the carriage of passengers and other items loaded in Nigeria.

3.1.3 Procedures for Computing Tax Liability

Take note of the following steps:

- (i) Ascertain adjusted profit;
- (ii) Identify depreciation made, if any;
- (iii) Ascertain total sum receivable;
- (iv) Determine adjusted profit ratio (%)

$$= \frac{\text{Adjusted profit}}{\text{Total sum receivable}} \times \frac{100}{1}$$
- (v) Determine depreciation relief ratio (%) (if necessary)

$$= \frac{\text{Depreciation}}{\text{Total sum receivable}} \times \frac{100}{1}$$
- (vi) Identify income derived from or received in Nigeria;
- (vii) Determine the assessable profit by applying 4 to 6;
- (viii) Determination of depreciation relief in lieu of capital allowance by applying (5) to (6);
- (ix) Determine total profit by deducting (8) and (7);
- (x) Then finally determine the tax liability by applying the relevant tax rate.

SELF-ASSESSMENT EXERCISE 1

What is the essence of computing depreciation ratio? Explain with example.

3.2 Computations of Taxable Profit and Tax Liability

Let us look at some hypothetical situations to explain the above.

Illustration 1

Sogo Airline limited is a foreign company registered in Egypt. It is involved in the carriage of passengers, mails, and livestock into and out of Nigeria. You are given the financial results of the year ended December 31st, 2007 as follows:

	₦	₦
Income from passengers' flight on other routes		100,550.00
Income from cargo loaded into aircraft on other routes		102,720.00
Income from passengers' flight from Nigeria		25,600.00
Income from cargo loaded into aircraft from Nigeria		<u>23,500.32</u>
		252,370.92
Deduct:		
Depreciation	330.00	
Staff salaries	4,764.22	
General provision	101.20	
Other expenses	<u>72.90</u>	<u>5,268.32</u>
		<u>247,104.60</u>

The following additional information is given:

- (a) Capital allowances were agreed with the relevant authority at 120% of depreciation charged.
- (b) Other expenses include disallowable expenses of ₦30.

You are required:

- (a) to compute the total profits of Sogo Airline Limited for Nigerian income tax purposes;
- (b) to calculate the income tax liability for the relevant assessment year; assuming rate of tax of 35%

Suggested solution**SOGO AIRLINE LTD****(a) Income Tax Computation**

	N	N
Income from passengers' flight/cargo out of Nigeria		
Income from passengers' flight from Nigeria		25,600.00
Income from cargo loaded into aircraft from Nigeria		<u>23,500.32</u>
		49,100.92
Deductions allowed:		
Staff salaries	4,764.22	
Other expenses allowed	<u>42,90</u>	
	<u>4,807.12</u>	

Proportion of allowable deductions applicable to Nigerian operations:

$$\frac{49,100.92 \times 4,807.12}{252,370.92} = 935.19$$

Capital allowance (120% of depreciation)	<u>396</u>	<u>1,331.19</u>
Total Profits		<u>47,769.73</u>

(b) Income Tax Liability

Income tax at 35% of total profits = 16,717.41
 The minimum tax payable is 2% of N49, 100.92 that is N982.02.
 Since the tax computed is higher than the minimum tax, the tax payable is N16, 717.41.

Alternative suggested solution

	N	N
Reported Net Profit		247,104.60
Add back:		
General provisions	101.00	
Depreciation	330.00	
Other disallowable expenses	<u>30.00</u>	<u>461.20</u>
Adjusted profit		<u>246,643.40</u>

$$\text{Adjusted Profit Ratio} = \frac{246,643.43 \times 100}{252,370.92} = 97.730515\%$$

(a) Total profits of the airline that will be liable in Nigeria is the adjusted profit ratio multiply by total Nigerian income less capital allowance

$$= 97.730515\% \times \text{N}49, 100.92 = \text{N}47, 986.58$$

Less capital allowances 386

N47, 590.58

(b) Income tax liability = 35% of N47,590.58
 = N16, 656.70

Illustration 2

The profit and loss of Nerat Airways Ltd. for the year ended 31/12/2007-

	N'000	N'000
Income from pre-freight into Nigeria		40,000
Income from pre-freight out Nigeria		5,000
Income from pre-freight another routes		110,000
Income from livestock freight Kano/Lagos – Amsterdam		<u>60,000</u>
		215,000
Salary	116,250	
Depreciation	15,500	
Other disallowable	<u>9,250</u>	<u>(141,000)</u>
		<u>74,000</u>

You are informed that the airline company is a foreign airline and you are required to prepare a statement showing the total profit for Nigerian tax purposes.

Suggested Solution

Nerat Airways
Computation of Taxable Profit and Tax Payable in 2008 Tax Year

(a) Determination of Adjusted Profit

	N	N
Net Profit		74,000
Add Back:		
Depreciation	15,500	
Other disallowable	<u>9,250</u>	<u>24,750</u>
Adjusted Profit		<u>98,250</u>
Depreciation as given		15,500,000
Total sum receivable		215,000,000
Adjusted profit Ratio	= $\frac{89,750,000}{215,000,000} \times 100$	= 46%
Depreciation relief ratio	= $\frac{15,500,000}{215,000,000} \times 100$	= 7.2%

Identification of income from Nigeria (N5, 000,000+~~N60, 000,000~~) N65, 000,000

Therefore, assessable profit = 46% x 65,000,000 = N29, 900,000

Depreciation relief in lieu of capital allowances

7.2% x N65, 000,000 = N4, 680,000

Total taxable profit (N29, 835,000 –~~N4, 686,500~~) = N25, 148,500

Tax liability at 35% of taxable profit = N8, 801,975.

SELF-ASSESSMENT EXERCISE 2

Seme Airways Limited is a foreign company registered in Benin Republic. It is involved in the carriage of passengers, mails, and livestock into and out of Nigeria. You are given the financial results of the year ended December 31st, 2007 as follows.

	N	N
Income from passengers' flight on other routes		100,000
Income from cargo loaded into aircraft on other routes		102,000
Income from passengers' flight from Nigeria		25,000
Income from cargo loaded into aircraft from Nigeria		<u>23,000</u>
		250,000
Deduct:		
Depreciation	330	
Staff salaries	4,000	
General provision	100	
Other expenses	<u>370</u>	4,800
		<u>254,800</u>

The following additional information is given:

- (c) Capital allowances were agreed with the relevant authority at 60% of depreciation charged.
- (d) Other expenses include disallowable expenses of ₦70.

You are required:

- (c) to compute the total profits of Seme Airways Limited for Nigerian income tax purposes;
- (d) to calculate the income tax liability for the relevant assessment year; assuming rate of tax of 35%

4.0 CONCLUSION

In this unit, it has been made known to you that the computation of taxable profit of shipping, airline and even cable companies considers income, amongst other things, derived in Nigeria. It has, basically, two methods in ascertaining the taxable profit, which are the direct and indirect methods. The indirect method involves the computations of ratios. Therefore, you are to be conversant with the formulae needed for determining the required ratios, otherwise, the application of the second method may be difficult for you.

5.0 SUMMARY

In this unit, you have learnt the following:

- Gross adjusted profit and depreciation relief ratios, which concern shipping and airline companies
- Computations of adjusted profit ratios is the adjusted profit divided by the total amount of receivables and the depreciation relief ratio is the depreciation amount divided by the total amount of receivables
- Ratio of adjusted profit is used to ascertain gross adjusted profit, while depreciation relief ratio is used to ascertain depreciation allowance, and the two when contrasted, give the taxable profit
- Tax liability is arrived at after taxable profit has been determined, by applying the prevailing corporation tax rate.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the procedure for computing the tax liability of a company engaged in shipping and airline business.
2. Assume the following in respect of a Canadian Airways, which operates several international airlines, some which call in Nigeria. The profit and loss account for the year ended 31st December, 2006 has the following entries.

	₦'000	₦'000
Income from passengers' flight from other routes		26,000
Income from passengers' flight into Nigeria		4,000
Income from passengers' flight out of Nigeria		<u>1,000</u>
		31,000
Less:		
Depreciation	3,100	
Salaries	23,250	
Other expenses	<u>1,850</u>	<u>28,200</u>
		<u>2,800</u>

Prepare the taxable profit for the year.

7.0 REFERENCES/FURTHER READING

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UNIT 5 DOUBLE TAXATION RELIEF

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- 3.0 Main Content
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 - 3.2 Double Taxation Agreement
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1.0 INTRODUCTION

Company income tax act requires that income received in or brought into Nigeria should be subjected to tax and any Nigerian who earns his income from abroad will be taxed in the country where the income originates and at the same time such income would also be taxed in Nigeria where the recipient resides. The implication of this is that the same income received is being taxed twice. To lessen the burden imposed by double taxation on recipients, various countries have therefore, made provisions for double taxation relief.

Part VI of CITA contains the provisions relating to double taxation relief. Section 32 in this part deals with circumstances where there are no specific double taxation agreements while section 33 and 34 cover cases where there are agreements. The double taxation relief is also applicable to individuals and is governed by section 23, 24, & 25 of ITMA 1961. The incomes of both individuals and companies are assessable to tax on the basis of their residences. It is possible for an individual to be regarded as resident in more than one country for income tax purposes in any particular year of assessment. As a result of this, an individual's income, if remitted or taken to another country from its country of origin may be taxed in the same tax year.

It is for this purpose of lessening this burden of double taxation that various tax laws provide for double taxation relief. In Nigeria, we have the Commonwealth income tax relief and the Double taxation

agreement. Arrangements or agreements are usually made between countries on reciprocal basis. Presently, Nigeria has agreements with the United Kingdom, USA, Denmark, Norway, Sweden, New Zealand, Ghana and Sierra Leone. This unit will expose you to the two categories of double taxation relief, that is, the commonwealth income tax relief and the double taxation agreement.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- discuss the concept of double taxation reliefs in clear terms
- describe the conditions for granting the reliefs to taxpayers
- explain the meaning of resident and non-resident taxpayers
- discuss, in details, matters to be dealt with in a double taxation agreement
- state the kind of incomes that are exempted from double taxation relief.

3.0 MAIN CONTENT

3.1 Commonwealth Income Tax Relief

The tax payable in a commonwealth (foreign) country is referred to as commonwealth income tax. This is defined in section 32 (3) of the act as “any tax on income or profit of companies charged under a law in force in any country within the commonwealth or in the Republic of Ireland which provides for relief from tax charge both in that country and Nigeria, in a manner corresponding to the relief granted by this sector.

3.1.1 Conditions for Granting Commonwealth Relief

Take note of the following:

- (a) The income of the foreign taxpayer must be taxable in Nigeria. That is, a foreign taxpayer or any taxpayer must be resident in Nigeria in that year of assessment;
- (b) The income must have also been subjected to tax in another country;
- (c) There must be no double taxation agreement between Nigeria and the other country. That is, the double taxation relief and the double taxation arrangement cannot be negotiated by one country with Nigeria, simultaneously;
- (d) The concession must be mutual between the countries.

3.1.2 Relief for Resident Taxpayers

- (a) If the Commonwealth Rate of Tax (CTR) does not exceed one-half of Nigerian Rate of tax (NR), the rate which relief is to be given shall be the Commonwealth Rate of tax (CR).

$$CR \leq \frac{1}{2} NR: \quad \text{Relief} = CR$$

- (b) If the CR exceeds $\frac{1}{2}$ NR: Relief = $\frac{1}{2}$ NR

3.1.3 Relief of Non-Resident Taxpayers

In the case of an individual who is not resident in Nigeria, the relief is provided as follows:

- (a) If the CR does not exceed the NR, relief shall be one half of the CR.

$$CR < NR: \quad \text{Relief} = \frac{1}{2} CR$$

- (b) If the CR exceeds the NR, relief shall be equal to the difference between the NR and one-half of the CR

$$\text{that is- } CR > NR: \quad \text{Relief} = NR - \frac{1}{2} CR$$

3.1.4 Double Taxation Agreement (DTA)

Double Taxation Agreement (DTA) is an international treaty set up by the United Nations for the avoidance of double taxation and to prevent evasion of taxation on income and capital goods between countries. The taxes that are subject to this agreement in Nigeria include personal income tax, capital gains tax, companies' income tax, and petroleum profit tax.

Double taxation agreement also applies to any identical or substantially similar taxes which are imposed by either contracting countries. Notifications of any substantial changes which have been made in their respective taxation laws are strictly observed by the contracting countries. Termination of this agreement is through diplomatic channels by giving of audience notice. The thrust of double taxation agreement is essentially to provide that a contracting state should give credit for taxes paid in the other contracting country.

SELF-ASSESSMENT EXERCISE 1

Clearly spell out the conditions for granting double taxation relief.

3.2 Double Taxation Agreement

The following matters are taken into consideration in double taxation agreement:

- (1) Taxes to be covered by the agreement e. g income tax, corporation tax , profit tax, Nigeria tax , etc;
- (2) Industrial and commercial profits- that is, enterprises engaged in business partly in other countries and vice versa;
- (3) Profits exempted from tax- profits from some specified trades and businesses;
- (4) Connected business enterprises in the two countries under common control or where one has control over the other and profits affected;
- (5) Dividend, interest and royalties to persons resident in the other country who are not engaged in business in the paying company's country;
- (6) Director's fees and other personal or earned incomes;
- (7) Methods which the effect of double taxation is eliminated e.g. by tax credits
- (8) Appeal procedures;
- (9) Exchange of information by the tax authorities for the prevention of fraud and prevention of tax avoidance;
- (10) Diplomatic privileges;
- (11) Dates of coming into force and termination date;
- (12) Parties and scope, that is, the two countries concerned and the meaning of residence, persons involved in industrial and commercial enterprises, etc.

It should be noted that if there is a DTA between the other country and Nigeria, the amount of foreign tax payable is allowed as a credit against the tax payable in Nigeria. Only a Nigerian company is entitled to claim the credits, the total of which must not exceed the total tax payable by that company in that year of assessment. The major condition of granting this relief is that a written agreement must exist between the treaty partners.

SELF-ASSESSMENT EXERCISE 2

List, at least, five countries in which Nigeria has a treaty on double taxation relief.

3.3 Claim for Relief or Credit

In the case of Commonwealth income tax, any claim for double taxation relief must be made not later than 6 years after the end of that year of

assessment. If the claim is granted, the amount of tax to be relieved will be repaid out of the tax paid for that year of assessment or set off against the tax payable for that year of assessment.

In the case of the double taxation arrangement, any claim for an allowance by way of credit must be made not later than 2 years after the end of the year of assessment.

SELF-ASSESSMENT EXERCISE 3

Why is there a claimable period for double taxation relief?

3.4 Exemption from Double Taxation Relief

Income from the following sources and persons are exempted from double taxation relief:

1. The remuneration of a professor or a teacher who is resident for not more than 2 years in the other country for teaching purpose;
2. Government pensions, except the recipient is ordinarily resident in Nigeria;
3. Airlines and shipping profits;
4. Dividends paid by a *UK* company to a Nigeria resident who has no permanent establishment in the *UK*;
5. Payments to a student or apprentice during his full time education or training in Nigeria;
6. The income is derived by a resident in *UK* provided he/she is not in Nigeria for at least 183 days and the services are rendered for a *UK* employer.

Illustration 1

Dina Williams, who is resident in Nigeria, has the following income for the year ended 31st December 2002-

	<i>Income</i>	<i>Tax</i>
Salaries (both UK and Nigeria)	₦160, 000	₦40, 000
UK income	₦20, 000	₦24, 000

You are required to compute the double taxation relief due to the lady in 2002 year of assessment. That is, you are to compute the tax relief in respect of his foreign income.

Suggested Solution**Dina Williams****Computation of Double Taxation Relief for the 2002 Year of Assessment**

$$\text{Nigeria Rate} = \frac{(40,000)}{160,000} \times \frac{100}{1} = 25\%$$

$$\text{UK Rate} = \frac{2,400\text{U}}{20,000} \times \frac{100}{1} = 12\%$$

The *UK* rate does not exceed half of the Nigeria rate and the relief therefore will be given at 12% which is the *UK* rate.

$$\text{Relief} = 12\% \times 25 = \text{N}2,400$$

Therefore, the tax liability = ~~N~~40,000 – ~~N~~2,400 = ~~N~~37,600

Illustration 2

Kope Babalola has the following income for the year ended 30th June 2001

	<i>Income</i>	<i>Tax</i>
	N	N
Income (Nigeria and Canada)	140,000	42,000
Income (Ghana)	60,000	12,000

You are required to compute the double taxation relief due.

Suggested Solution**Kope Babalola****Computation of Double Taxation Relief Due for the 2002 Year of Assessment**

$$\text{Nigeria} = \frac{42,000}{140,000} \times \frac{100}{1} = 30\%$$

$$\text{Ghana} = \frac{12,000}{60,000} \times \frac{100}{1} = 20\%$$

The Ghanaian rate exceeds one-half of the Nigeria rate; and relief, therefore, is given half of Nigeria rate.

$$\text{Relief} = 15\% \times \text{N}60,000 = \text{N}9,000$$

Therefore, the tax liability = ~~N~~42,000 – ~~N~~9,000 = ~~N~~33,000

Illustration 3

Gyang Botsha resides in the *USA* but is very familiar with Nigeria. His (a non-resident) income for the year ended 30th June, 2003 are as follows.

	Income	Tax
	₦	₦
Nigerian income	180, 000	45, 000
USA Income	200, 000	40, 000

You are required to compute the double taxation relief for the relevant tax year.

Suggested Solution**Gyang Botsha*****Computation of Double Taxation Relief for 2003 Year of Assessment***

$$\text{Nigerian Rate} = \frac{45,000}{180,000} \times \frac{100}{1} = 25\%$$

$$\text{US Rate} = \frac{40,000}{200,000} \times \frac{100}{1} = 20\%$$

United States (*USA*) Rate does not exceed Nigeria rate; relief, therefore is half of commonwealth rate.

$$\text{Relief} = \frac{1}{2} \times 20\% \times \text{₦}200,000 = \text{₦}20,000$$

SELF-ASSESSMENT EXERCISE 4

Bukola has the following income for the year ended 30th June 2003-

	Income	Tax
	₦	₦
Income (Nigeria and Canada)	240, 000	142, 000
Income (Ghana)	160, 000	112, 000

You are required to compute the double taxation relief due.

4.0 CONCLUSION

In this unit, you have seen that the above analyses and explanation of the concept and the main objective of double taxation relief are very important in the quest to avoid over taxing a taxpayer. Therefore, it is very essential for tax consultants and accountants to be conversant with double taxation arrangement so as to assist their clients in minimising tax liabilities.

5.0 SUMMARY

In this unit you have been exposed to the following:

- The meaning and essence of double taxation relief;
- The two reliefs available in the Nigerian context are the Commonwealth income tax relief and the double taxation agreement;
- Under the Commonwealth income tax relief, computation of *CR* and *NR* is undertaken; and usually, $\frac{1}{2}$ *NR* is compared to *Cr*, whichever is lower is accepted for the relief
- Under the DTA, the relief covers any personal income tax, companies income tax that has been paid by any Nigerian taxpayer to a foreign country in which this agreement has been made with;
- Nigeria has commonwealth income tax relief agreement with all Commonwealth countries.

6.0 TUTOR-MARKED ASSIGNMENT

1. Goodness Kim, a resident of *USA* had the following income in 2005.

	Income	Tax
	₦	₦
Income (Nigeria)	60, 000	4, 000
Nigeria (USA)	80, 000	7, 500

You are required to calculate his double taxation relief in the relevant tax year.

2. Mr. Pam Bwos is an employee of a Canadian company based in Toronto; in an attempt to widen its market scope, the company decided to second Mr. Bwos to Nigeria in January 2008- to open the Lagos office on the following terms.
 - (a) He is entitled to receive an equivalent amount of ₦560, 000 and this is subjected to Nigerian income tax;
 - (b) The tax paid on his income in Canada amounted to ₦120, 000; and
 - (c) He has four children and two dependents staying with him in Nigeria.

You are required to compute the credit to be given to Mr. Bwos on his income made in Canada assuming a double taxation agreement between Nigeria and Canada.

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