

# IO & Co News

*A Bi-Annual Newsletter of Ifeanyi Opara & Company, Chartered Accountants and Tax Consultants*  
([www.iopara.com](http://www.iopara.com))

June 2009

## *Principal's Brief*

### **A New Tax Era**

The recent drastic fall in crude oil prices and the resultant reduction in the country's oil revenue flows are bound to compel governments at all levels to rely more on taxes in order to fund their annual budgets. Taxpayers must therefore brace up for the challenges of stringent tax compliance enforcement as tax authorities come under increasing pressure to meet high revenue targets.

Some taxes that have hitherto rested in the statute books with hardly anyone paying attention to them are now likely to be revived or reviewed, and the taxpayer who claims ignorance of the tax's existence would be promptly reminded that it is no excuse. Few people, for example, know that *capital gains tax* (at 10%) is payable if certain assets (including buildings, equipment and foreign currency) are disposed of at values that exceed their original cost of acquisition. Nor do our teeming numbers of tradesmen and businessmen, petty and big-time alike, know that the personal income tax law requires them to file annual income returns in order to enable the tax authorities assess their income tax liabilities.

This edition of IO & Co News attempts to highlight some of the important practical considerations pertaining to three of the commonest tax types, namely personal income tax, companies income tax and value added tax (VAT). What have been highlighted are just the important basic issues that affect most taxpayers, in the hope that affected persons would be guided in planning their tax compliance. Taxpayers who are in doubt about any matters affecting them would do well to consult a knowledgeable tax practitioner or seek appropriate clarification from the tax authorities.

### **More on Financial Crises**

The global economic crisis and the Nigerian stock market crisis provided the focus of the contents of our December 2008 edition. There have since been far reaching developments in the crises: in the global arena concerted and unprecedented actions by world leaders barely succeeded in saving the crisis from degenerating into of a major economic catastrophe, but matters are far from being normalized; more business failures have been recorded not only in the US and

Europe but in almost every other region of the world; unemployment levels have continued to rise, everywhere; government intervention in business has continued, effectively reversing much of past privatization efforts; the credit crunch has hardly eased, and experts are predicting that not much improvement should be expected in 2009.

On the local scene, investors' confidence in the Nigerian stock market has been dealt a further devastating blow by recent revelations of manipulation of stock prices and other unethical practices on the stock exchange; these revelations have confirmed what many people had long suspected to be part of the root cause of the stock market crisis. It has also become obvious that the local crisis is no longer restricted to the stock market: cases of business downsizing and outright closures (with attendant job losses) are being reported in different sectors of the economy; erstwhile buoyant enterprises are embarking on un-negotiated pay cuts; employment has been indefinitely embargoed in several public and private enterprises. It is fairly safe to predict that the local crisis is nowhere near an end. The times definitely call for the adoption of cost reduction measures and other sensible and legitimate survival strategies by all.

### **Complying with Pension Act Now a Condition for Undertaking Government Contracts.**

The National Pension Commission recently issued a public notice to the effect that Federal Government ministries, departments and agencies would no longer do business with suppliers and contractors who have not complied with the provisions of the Pension Reform Act, 2004. The notice quoted section 16(6) (d) of the Public Procurement Act of 2007 as its basis of authority.

Aside from the benefits of eligibility for government contracts, there are good reasons for embracing the contributory pension scheme that was introduced by the 2004 Pension Reform Act. Highlights of the Act are provided in the June 2008 edition of *IO & Co News*, and have also been summarized in our single page flyer that is available at our offices.

### **Missed Past Editions of IO & Co News?**

If you would like to read our past editions they are available at <http://www.iopara.com/newsletter>. You may also obtain copies, subject to availability, at our offices located at AHL House, no. 28/30 Bukuru Bye pass, British-America Area, Jos.

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# Bracing up for a New Tax Era in Nigeria

It has become quite obvious that governments at all levels in the country must now depend progressively more on taxes to fund their annual budgets: the drastic fall in crude oil prices in recent months and the unending militancy in the Niger Delta will translate to reductions in oil revenue. At the same time, the heightened and prolonged global economic crisis is likely to have adverse effects on capital inflows, export earnings and foreign aid, thereby worsening the budgeting dilemma. Falling oil and sundry revenue is bound to compel a shift in focus to taxes as primary revenue sources. Tax authorities would expectedly come under increasing pressure to meet high revenue targets, and taxpayers would in turn be pressured to honour their obligations. Taxes are covered by law and discharging tax duties is therefore a statutory obligation. Persons (corporate and individual) who have in the past been lax in matters of tax compliance could soon discover that they expose themselves to avoidable embarrassment, statutory sanction (even expensive litigation) and the financial inconvenience of paying back taxes.

Being knowledgeable about tax matters puts the taxpayer in a position not only to properly discharge his fiscal obligation but also to be able to reject improper tax demands, for it is a common dictum that while the tax man is entitled to collect all that is legitimately due from a taxpayer, the taxpayer must not pay even a kobo more than he should.

The practical basics of common Nigerian taxes are discussed below. These taxes are *personal income tax*, *companies' income tax* and *value added tax* (others such as petroleum profits tax and capital gains tax are considered uncommon, and have therefore not been treated).

## 1. Personal Income Tax

This applies to individual taxpayers as opposed to incorporated entities, and has two main components namely, income from employment (or 'pay-as-you-earn', PAYE) and income from trade or business (also referred to as 'direct assessment').

**PAYE:** The country's personal income tax laws require that persons in employment should have PAYE tax deducted from their emoluments by their employers, who must thereafter remit the deducted tax to the *relevant tax authority*. Even if an employer itself is not liable to income tax (e.g. a religious organization) its employees must pay PAYE tax on their emoluments. PAYE procedures apply even where there is only one

employee, and regardless of the size of the person's salary.

**Direct Assessment:** This applies to self employed persons including professionals, artisans, traders and all businessmen/women other than those doing business as incorporated entities. The tax liability of this category of personal income tax payers should normally be calculated on the basis of the annual net income or profit (income less related expenditure) of the tax payer's trade or business. This means that self employed persons should file annual income returns with the tax authorities, but in practice the tax authorities expediently assess these persons' tax liability on estimated income basis; not many direct assessment tax payers would ever file the required income returns and tax authorities are unable to compel them, owing mainly to difficulties in tracking this category of tax payers and the tax authorities' lack of capacity for the task.

Below are some of the important practical considerations pertaining to personal income tax:

- i). Personal income tax is payable to the 'relevant tax authority'; this is usually the Board of Internal Revenue of the state of residence of a taxpayer, or the state where a taxpayer's (main) business is located, except that members of the armed forces, the police and officers of the Nigerian foreign service are all deemed to reside in the Federal Capital Territory (whose relevant tax authority is the Federal Inland Revenue Service).
- ii). The calculation of personal income tax is based on graduated scales, after deduction of the taxpayer's entitlement of *personal reliefs*, in a manner that ensures that people pay progressively higher taxes in relation to the amounts of their income. The prevailing rates of personal tax reliefs and the scale of personal income tax rates are shown on page 4.
- iii). A personal income tax payer must pay at least 0.5% (one half per cent) of his total income as *minimum tax*. A taxpayer whose calculated tax liability is less than 0.5% of his total income therefore pays the *minimum tax* of 0.5%.
- iv). It is an offence, punishable by law, to evade the payment of income tax. A defaulting self employed person is personally liable to statutory sanctions, while in the case of a person in employment the

employer (who fails to deduct PAYE, or having deducted fails to remit) bears the sanction.

v). Some categories of income are statutorily exempt from tax, including: income received by a government or government institution; religious, charitable or public educational institution; trade union; friendly society; cooperative society. The exemption is however subject to the proviso that such income is not derived from a trade or business. If, for example, a religious organization engages in a trading or business activity it would have to pay income tax on the profit that it makes from that activity.

## 2. Companies Income Tax

Companies income tax is payable by incorporated companies, commonly referred to as 'limited liability' companies. The tax is charged on a company's trading income after deduction of expenditure that was incurred exclusively and necessarily in earning that income. Companies that are engaged in activities similar to the ones that are tax exempt in respect of personal income tax (as listed in paragraph v above) also have their income exempt from tax, subject to the same proviso as in personal income tax. The relevant tax authority in respect of companies income tax is the Federal Inland Revenue Service (FIRS), whose *integrated tax offices* are located in all states of the federation and in the Federal Capital Territory. Each local tax office covers tax paying companies in its geographic area of jurisdiction.

Below are some of the important practical considerations pertaining to companies income tax:

- i). A company becomes liable to income tax with effect from the date that it commences business; until it commences business a company only pays *pre-operation levy* if and when it applies for a tax clearance certificate, provided that a period of six months has elapsed since the date of incorporation. Pre-operation levy is N20,000 for the first year that a company applies for a tax clearance certificate, and N25,000 for each subsequent year.
- ii). A company's financial statements for its first accounting period would normally be used to determine the tax liability for two or three fiscal years. A proper thought should be given to this concept in choosing the dates of the first accounting period, so as to optimize the company's tax position from the point of view of the amount of tax liability as well as the timing of payment.
- iii). The current companies income tax rate is 30%; however if tax that is calculated at this standard rate is less than the *minimum tax* (this is calculated based on turnover, net assets/gross profit/paid up capital) the minimum tax is payable. A company does not pay minimum tax in the first four calendar years after it commenced business, or if it is engaged in agricultural trade or business. In addition to income tax companies also pay education tax at 2%.

iv). If a company's annual tax returns are filed late the company is liable to a penalty of N25,000 for the first month of lateness, and N5,000 for each subsequent month. For most companies annual tax returns become late if filed after six months from the relevant accounting year end. In addition to late filing penalty, a company may also be charged interest if the due tax is not paid on time.

v). A company that has suffered withholding tax from its income can normally set off the withholding tax against its calculated income tax liability for the relevant year; in practice the FIRS does not allow this set-off until it is satisfied that the withheld tax has been duly remitted to it. A company that suffers withholding tax should therefore prevail on the deducting agency to make the remittance in time to enable the claim of a set-off before the due date for filing annual tax returns (the remittance must be made to the FIRS and not to a state Board of Internal Revenue).

vi). The FIRS takes various measures to verify the tax returns that companies submit to it. These include desk verification (at the FIRS offices) and field verification (at the tax payer's premises). It is necessary that a company keeps proper accounting records from which, if necessary, the tax returns can be authenticated; the minimum necessary accounting records should show details of a company's income, expenditure, assets and liabilities. The FIRS may reject a company's tax returns if the accompanying financial statements are not professionally prepared and audited in accordance with applicable accounting standards so as to show a *true and fair* view. If this happens, the FIRS could exercise its *best of judgment* (BOJ) to assess the company's tax liability, and the company would then have the onus of disproving the FIRS derived figures. A BOJ assessment may also be raised if a company's tax returns do not reach the FIRS by the due date.

**Be wiser than other people if you can, but do not tell them so.** (Lord Chesterfield)

### 3. Value Added Tax (VAT)

Value Added Tax (VAT) is chargeable at a flat rate of 5% on several categories of goods and services, but the following are **exempt**:

Medical services; pharmaceutical products; basic food items (i.e. food items in their raw, unprocessed form); books and educational materials; baby products; plant, machinery and goods purchased for use in an export processing zone or free trade zone (provided that 100% production is for export); all exports; services of Community (now Microfinance) Banks and mortgage institutions; plays and performances conducted by educational institutions as part of learning

The following goods and services are **zero-rated**:

Goods and services purchased by diplomats; non-oil exports; goods purchased for use in humanitarian donor-funded projects (*'humanitarian donor-funded projects' are defined as including projects undertaken by NGOs or religious organizations, and social clubs or societies, recognized by law whose activities are in the public interest and not for profit*).

The practical implication of the zero-rate status is that although the goods and services are ordinarily subject to VAT at the rate of 5% they would be invoiced at 0% VAT rate when purchased by any of the designated consumers. Qualifying organizations should take advantage of their zero-rate status and spend less on the goods and services they buy.

VAT is collected by the FIRS. Every enterprise that sells VATable goods or services is expected to register at the local Integrated Tax Office (ITO) of the FIRS. An enterprise that has branch operations at different locations in the country will register each branch separately at the respective local ITO. The registered enterprise (or branch

office) is given a tax identification number which it must quote on its invoices and bills and also on the VAT returns that it would make monthly to the FIRS.

The VAT that an enterprise collects (by inclusion in its bills or invoices) is output VAT, while the VAT that it suffers (that is charged on goods and services that it buys) is input VAT. The total output VAT for every month is to be reported by the enterprise in its monthly VAT returns, so also the total input VAT (provided that the input VAT was in respect of goods or services that were directly related to production or the generation of the output VAT). Input VAT on overheads is not to be reported, but included in expenditure in the income statement of the enterprise; input VAT on fixed assets is also not to be reported, but should be included in the fixed assets costs on which (in respect of income tax-paying enterprises) capital allowances can be claimed.

An enterprise that sells goods or services that are all exempt from VAT would nonetheless pay VAT if it buys goods or services that are VATable and are not zero-rated. That enterprise would have no output VAT, and its input VAT is entirely unrecoverable.

If the reported output VAT exceeds the reported input VAT for any month, the taxpayer pays the difference to the FIRS; where the reported input VAT exceeds the output VAT, the taxpayer should get a refund or be allowed a carry forward of the difference to the next reporting period (after due verification of the returns by the FIRS).

There are statutory penalties for failure to make returns, for late returns, for wrong/falsified returns and for failure to remit collected VAT at the appropriate time. A company that defaults in making VAT returns may also be denied a tax clearance certificate even if its income tax status is faultless.

#### Tax Tip

Goods and services that are *purchased for use in humanitarian donor funded projects* no longer bear VAT (they are zero-rated for VAT purposes). Most registered NGO's and religious and social clubs and societies may therefore purchase goods and services at zero VAT rate, if they inform the vendors of their status.

# SOME IMPORTANT NIGERIAN TAX RATES

## 1. Withholding Tax

	W/Tax rate (%) for companies	W/Tax rate (%) for others
Rent, Dividend, Interest, Directors' fees	10	10
Commissions/Agency arrangements	10	5
Consultancy/Professional services	10	5
Technical services and Management fees	10	5
Contracts for supplies and services	5	5
Royalties	15	15

## 2. Rates of Personal Tax Reliefs/Allowances

### Reliefs/Allowances

- a) Personal allowance
- b) Additional Personal allowance for Disabled Persons
- c) Children
- d) Dependent Relative
- e) Life Assurance Relief

### Rates/Amounts

N5,000 plus 20% of earned income  
 N3,000 or 20% of earned income, whichever is higher.  
 N2,500 per child, subject to a maximum of 4 children.  
 N2,000 per tax payer's relative, subject to a maximum of 2 relatives  
 Actual premium paid  
 Transport allowance- N20,000 per annum;  
 Housing allowance- N150,000 per annum;  
 Meal subsidy- N5,000 per annum;  
 Utility allowance- N10,000 per annum;  
 Entertainment allowance- N6,000 per annum;  
 Leave allowance- 10% of annual basic salary.

f) Other Allowances  
 (If emoluments exceed these amounts, the excess is taxed)

## 3. Scale of Rates for Personal Income Tax

First N30,000 of income	5%
Next N30,000 of income	10%
Next N50,000 of income	15%
Next N50,000 of income	20%
Amount in excess of N160,000	25%

(A person whose computed income tax liability is less than the **minimum tax** of 0.5% (1/2%) of his total income pays the minimum tax).

## 4. Company Tax Rates

**a. Income Tax** 30% of assessable profit (subject to minimum tax calculated on turnover, net assets/gross profit/paid-up capital)

**b. 'Small Companies'** (manufacturing, agricultural, mining & export businesses with annual turnover not exceeding N1m).

20% for the first seven years of assessment, and 30% thereafter.  
 2% of assessable profit.

**c. Education Tax**

**d. Pre-operation levy** (for companies that have not commenced business 6 months after incorporation)

N20,000 for the first year that the company applies for a tax clearance certificate, and N25,000 for each subsequent year.

**e. Penalty for late filing of tax returns**

N25,000 for the first month of lateness, and N5,000 for each subsequent month.

## 5. Value Added Tax (VAT)

5% flat rate on all qualifying goods and services.

## 6. Capital Gains Tax

10% on capital gains arising from disposal of qualifying capital assets.

## 7. Rates of Capital Allowances

	Initial Allowance	Annual Allowance
Building	15%	10%
Housing estate	50%	25%
Mining	95%	Nil
Plant-agricultural and industrial	95%	Nil
Plant-others	50%	25%
Furniture and fittings	25%	20%
Motor vehicle for public transportation	95%	Nil
Motor vehicle for other uses	50%	25%
Plantation equipment	95%	Nil
Ranching & Plantation pre-operation expenditure	30%	50%
Research and Development	95%	Nil

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