Grey Matter Tax Digest

A specialised newsletter providing strategic alerts and comprehensive analyses on tax matters in Nigeria

SPECIAL ISSUE: NOVEMBER 2019

EXAMINING THE LIMITS OF TAX PLANNING AND MANAGEMENT IN NIGERIA

Introduction

Tax planning and management refers to the processes and schemes by which taxpayers arrange their affairs and businesses in such manner as to attract the lowest possible tax rates under applicable tax laws. It is the art of limiting the amount of tax payable without breaking the law. It involves optimization of marginal tax rates using devices and tools such as trust arrangements, corporations, charitable entities, deductible expenses, tax exemptions, capitalization of profits, residency rules, and profit shifting arrangements. Tax planning and management differs from tax evasion[1], which is a crime under the law.

Nigerian law recognizes the right of taxpayers to arrange their affairs in such manner as to avoid or minimize their liability to tax. However, in exercising this right, taxpayers are obliged to maintain minimum ethical standards and observe the limits set under applicable tax legislation in Nigeria.

This article reviews the legal basis, limits, and ethics of tax planning and management activities in Nigeria. It also recommends options for effective management of the tax affairs of individuals and corporate entities, without breaching the law.

[1] Tax evasion, though not specifically defined in Nigerian tax law, generally refers to situations where taxable persons manipulate their accounts with intent to hide their actual taxable profits and in that manner, evade the tax which they ought to have paid on their taxable profits for relevant accounting years. (See Mobil Oil (Nig.) Ltd. v FBIR (1922 – 2014) All NTC 203.)

1. Legal basis for tax planning and management in Nigeria

In **G. M. Akinsete Syndicate v Senior Inspector of Taxes, Akure**,[2] the Supreme Court recognised that a person may use lawful means to avoid tax; what he may not do is to try to evade tax. This attitude of the Nigerian courts towards tax planning and management is traceable to Lord Clyde's famous "liquor for tax avoidance goons" in the English case of **Ayrshire Pullman Motor Services v IRC**[3] ("**Ayrshire**"), where His Lordship held that:

"… The Inland Revenue is not slow – and quite rightly – to take every advantage, which is open to it under the taxing statutes, for the purpose of depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Inland Revenue."

Nigerian courts have also followed the decision of the English court in **Duke of Westminster v CIR**[4] ("**Duke of Westminster**"), where Lord Tomlin made his famous "Holy Grail of Tax Avoidance" pronouncement thus:

"Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be".

Thus, the decision in **Duke of Westminster**, which was also decided on the strength of **Ayshire**, reaffirmed the position that once a tax planning scheme is valid, the courts would uphold the scheme on the basis that taxpayers are entitled to manage their affairs in such manner as to avoid or minimize tax. In JGC Corporation v FIRS (2016) 22 TLRN 37, the Federal High Court, Lagos Division, upheld the rights of taxpayers to embark on tax planning exercises and structure their business transactions in such manner as to reduce or eliminate their liability to tax.

2. Limits of tax planning and management activities in Nigeria

Tax planning and management is legal and acceptable under applicable Nigerian tax law. However, in order to prevent abuse or deliberate acts of tax evasion to the detriment of the Government, provisions are contained in relevant tax statutes in Nigeria; limiting the extent to which taxpayers may exercise their right to plan and manage their tax affairs. Specifically, the regimes limiting this right can be found in certain statutory instruments including:

(i) General Anti-Avoidance Provisions ("**GAAPs**")[5] set out in the various tax legislations;

---

[2] (2011) 4 TLRN 156

[3] (1929) 14 TC 754

[4] (1936) AC 1

[5] The GAAPs include sections 13(2)(d) and 22 of the Companies Income Tax Act, Cap. C21 Laws of the Federation of Nigeria ("LFN") 2004 (as amended in 2007) (the "CITA"), section 20 of the Capital Gains Tax Act, Cap. C1 LFN 2004 (the "CGTA"), section 15 of the Petroleum Profits Tax Act, Cap. P13 LFN 2004 (the "PPTA"), and section 17 of the Personal Income Tax Act, Cap. P8 LFN 2004 (as amended in 2011) (the "PITA").

(ii) Income Tax (Country by Country Reporting) Regulations 2018 (the "**CBCR Regulations**");

(iii) Income Tax (Transfer Pricing) Regulations 2018 (the "**TP Regulations**"); and

(iv) Income Tax (Common Reporting Standard) Regulations 2019 (the "**CRS Regulations**").

2.1 The GAAPs

The GAAPs are designed to prevent deliberate schemes for avoiding tax. To this effect, a tax authority is allowed to strike down a transaction, dip the full length of the largest taxing shovels into the taxpayer's accounts, and scoop therefrom the full amount of taxes due on the taxpayer's income; where the transaction:

- is fictitious, artificial, or a sham;
- presents no real commercial value;
- is specifically designed to avoid or minimize tax, or
- is not conducted at arm's length between related parties where one has control over the other.

Although GAAPs had been useful in the past, it appears that they are insufficient in addressing the complexities of modern tax planning and management; particularly in relation to Base Erosion and Profit Shifting ("**BEPS**") practices. BEPS practices refer to tax planning strategies that exploit gaps and mismatches in tax rules across different countries to artificially reduce tax base or shift profits from higher tax jurisdictions to low or no-tax locations where there is little or no economic activity, thus eroding the tax base of the higher tax jurisdictions. As BEPS generally revolves around arbitrage between domestic taxation rules, it was found that tackling its negative effects would require improvement in transparency and international cooperation on tax matters.

To this end, the Organization for Economic Cooperation and Development ("**OECD**") coordinated a reform process following which several action policies were proposed in its 2015 report, which include:

- Requiring taxpayers to disclose their aggressive tax planning arrangements;
- Making dispute resolution systems more effective;
- Preventing the artificial avoidance of Permanent Establishment ("**PE**") status for tax purposes;
- Strengthening controlled foreign company rules; and
- Re-examining transfer pricing documentation.

Nigeria participated in the OECD reform process and has been largely influenced by revolutionary tax policies proposed by the

OECD and this, in effect, has resulted in the issuance of the CBCR Regulations, the TP Regulations, and the CRS Regulations by the Federal Inland Revenue Service ("**FIRS**").

2.2 The CBCR Regulations

The CBCR Regulations, effective for reporting accounting years[6] commencing on or after January 1, 2018, generally require Multinational Enterprise Groups ("**MNE Groups**") [7] with Consolidated Group Revenue ("**CGR**") of ₦160,000,000,000 or above to furnish the FIRS with the tax and financial information of the MNE Group in a specified format, provided such MNE Groups are resident in Nigeria for tax purposes. CBCR reports are required to be filed not later than 12 months after the last day of the reporting accounting year of the relevant MNE Group. CBCR reports contain information such as revenue, the allocation of income, taxes, stated capital, number of employees, and the nature of the business activities of the relevant MNE Group across tax jurisdictions. The CBCR Regulations require Constituent Entities (CEs) of MNE Groups resident in Nigeria, to file certain returns with the FIRS; specifying their status (either as UPE or Surrogate Parent Entity).

There are prescribed penalties for non-compliance with the provisions of CBCR Regulations. Furthermore, where a person enters into any arrangement for the primary purpose of avoiding any obligation under the CBCR Regulations, the CBCR Regulations will apply as if the arrangement had not been made.

The CBCR reports can be accessed by tax authorities in tax jurisdictions which are signatories to the Country-by-Country Multilateral Competent Authority Agreement (**"MCCA"**), signed by Nigeria on January 27, 2016 and ratified by the Federal Executive Council on August 3, 2016[8].

[6] While "accounting year" means an annual accounting period with respect to which the Ultimate Parent Entity ("UPE") of the MNE Group prepares its financial statements, "reporting accounting year" means the accounting year of which an MNE Group's financial and operational results are reflected in the CBCR report for a particular year as defined in Regulation 7 of the CBCR Regulations (see Regulation 16 of the CBCR Regulations.).

[7] "MNE Group" means any Group that (i) includes two or more enterprises, the tax residence for which is in different jurisdictions, or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a PE in another jurisdiction, and (ii) is not an Excluded MNE Group. "Excluded MNE Group" means, with respect to any accounting year of the Group, a Group having a total CGR of less than ₦160,000,000,000 during the accounting year immediately preceding the reporting accounting year as reflected in its Consolidated Financial Statements for such preceding accounting year. "Consolidated Financial Statements" refers to the financial statements of an MNE Group in which the assets, liabilities, income, expenses, and cash flows of the UPE and Constituent Entities are presented as those of a single economic entity. (See generally, Regulation 16 of the CBCR Regulations.).

[8] See Regulation 1(a) of the CBCR Regulations

We note that the MCCA, which the CBCR Regulations purport to give effect to, falls in the class of international treaties required under section 12(1) of the Constitution[9] to be domesticated by an Act of the National Assembly, before they become enforceable in Nigeria. Although, the MCCA was issued by the OECD pursuant to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the **"Convention"**), which was signed by the President in 2013 and ratified by the Federal Executive Council in April 2015; neither the Convention nor the MCCA has been domesticated by an Act of the National Assembly in Nigeria. Since this constitutional requirement of domestication is yet to be met, the validity of the CBCR Regulations remains uncertain and it is only proper that legislative backing be sought for the instrument.

2.3 The TP Regulations

The TP Regulations revoked the 2012 TP Regulations. Effective from financial years commencing on or after March 12, 2018, the TP Regulations seek to provide the legal framework for Transfer Pricing ("**TP**")[10] in Nigeria. The TP Regulations apply to controlled transactions[11] between connected persons, including (i) sale and purchase of goods and services, (ii) sales, purchase, or lease of tangible assets, (iii) transfer, purchase, license, or use of intangible assets, (iv) manufacturing arrangements, and (v) loan transactions.

The TP Regulations require connected persons engaged in controlled transactions to transact at arm's length and ascertain their taxable profits in compliance with the arm's length principle. The TP Regulations set out different pricing mechanism that can be used in determining whether the result of a transaction or series of transaction is consistent with the arm's length principle. In relation to intra-group services, the TP Regulations expects that the FIRS will ascertain if certain factors exist in order to determine the arm's length nature of intragroup services and service charges. These include an economic/commercial benefit analysis and a shareholder activity test. In undertaking the

[9] Constitution of the Federal Republic of Nigeria, 1999 (as amended)

[10] TP refers to how related parties price transactions between them. The TP regime seeks to ensure that related parties transact at arm's length in a manner that does not erode the national tax base. Arm's length transaction for TP purposes refers to transactions between related parties, conducted as if the parties were unrelated; thereby eliminating conflict of interest, or parties' accrual of unwarranted tax benefits at government's expense.

[11] "Controlled transaction" means a commercial or financial transaction between connected persons (see Regulation 27 of the TP Regulations.).

economic/commercial benefit analysis, the FIRS will amongst other things consider if an independent person in comparable circumstances would have been willing to pay an independent party for the service or would have performed in-house for itself. The Regulations also prescribe that shareholder costs should not be charged to subsidiaries as same will be disallowed for tax purposes.

The TP Regulations include a safe harbour provision that states that taxpayers would be exempted from preparing TP documentation where their related party transactions are priced in accordance with specific guidelines that the FIRS may publish from time-to-time.

From our analysis, concerns remain around implementation of the TP Regulations. For instance, the capping of tax deductions at 5% of Earnings Before Interest, Tax, Depreciation, and Amortization (EBITDA) derived from the commercial activity in which the right was exploited, where there is transfer of rights in an intangible asset other than the alienation of an intangible, is inconsistent with the applicable tax statute in Nigeria on allowable deductions. It should be noted that the TP Regulations were issued to give effect to the GAAPs in the relevant statutes. Hence, the specified 5% cap on tax deductions is unfair to related parties transacting duly at arm's length when compared to allowable deductions applicable when transacting with unrelated parties. This is also inconsistent with the arm's length principle specified in the TP Regulations to the effect that related parties should transact with each other in like manner and under same circumstances as they would ordinarily do with unrelated third parties.

The TP Regulations prescribe penalty for non-compliance with its provisions of fines up to ₦10 million or 1% of the value of the relevant controlled transaction, where necessary. There are also other penalties ranging from a fine of ₦10,000 to ₦25,000 daily, depending on the circumstances of the infringements committed.

2.4 The CRS Regulations

The CRS Regulations, effective July 1, 2019, seek to give effect to the provisions of (i) the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, (ii) the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (signed by Nigeria on August 17, 2017) and the Common Reporting Standards contained in the Standard for Automatic Exchange of Financial Account Information in Tax Matters (approved by the OECD on July 15, 2014) (altogether, the "**Multilateral Agreements**").

The objective of the CSR Regulations is the curbing of tax evasion and tax avoidance activities in Nigeria by means of automatic exchange of financial information between tax administrations, amongst different countries where Nigerian tax residents maintain banking accounts. The CSR Regulations generally require Reporting

Financial Institutions ("**RFIs**")[12] to file annual financial accounts report, in a standardized format that will facilitate automatic exchange of information between Nigeria and other foreign tax jurisdictions, which are signatories to the Multilateral Agreements. In this manner, the CSR Regulations effectively allow the FIRS to receive specified information on banking accounts held by Nigerian tax residents in countries that are parties to the Multilateral Agreements. In exchange, the FIRS is obliged to provide similar information to the relevant tax authorities of those countries.

The CRS Regulations contain significant penal sanctions for non-compliance, ranging from a fine of ₦5million to ₦10million, depending on the nature and severity of the infringement committed by the taxpayer. There are also other applicable fines charged where the infringement persists, ranging from ₦1million monthly. The penalties specified above are inapplicable where the FIRS is satisfied that there is reasonable excuse for such failure or omission.

Just like the CBCR Regulations, the legality of the CRS Regulations is questionable within the context of the provisions of section 12(1) of the Constitution; which provides that no treaty between the Federation and any other country shall have the force of law except to the extent to which any such treaty has been enacted into law by the National Assembly. However, it should be noted that these instruments will remain in force unless and until judicially challenged and validly set aside by a court of competent jurisdiction in Nigeria.

Conclusion

To efficiently plan and manage their tax affairs, businesses must consider business exigencies (including possible future changes in applicable law) and seek professional advice. Where a taxpayer is successful in convincing the court otherwise, the likelihood that the court will apply the **Duke of Westminster** doctrine (which is taxpayer-friendly) is very strong[13]. In addition to the modern rules of tax planning and management, intricate rules such as the CBCR, TP and CRS Regulations have been developed by tax authorities around the globe to combat tax planning and management activities particularly by HNIs and MNE Groups. In response to this, taxpayers, more than ever before, now require the advice and guidance of skilled tax planning and management experts; to enable them exercise their rights to efficiently plan and manage their tax affairs, without breaching the law.

[12] By Regulation 13(1) of the CSR Regulations, RFI means (i) any financial institution that is resident in Nigeria but excludes any branch of that financial institution that is located outside of Nigeria, and (ii) any branch of a financial institution that is not resident in Nigeria, where that branch is in Nigeria.

[13] See JGC Corporation v FIRS (2016) 22 TLRN 37, where the Federal High Court effectively upheld the Duke of Westminster doctrine in favour of taxpayers.

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo.

DISCLAIMER: This article is only intended to provide general information on the subject matter and does not by itself create a client/attorney relationship between readers and our Law Firm or serve as legal advice. We are available to provide specialist legal advice on the readers' specific circumstances when they arise.

EDITORIAL TEAM

Ken Etim
(Managing Partner)
ketim@banwo-ighodalo.com

Abimbola Akeredolu, SAN, FCIArb.
(Partner)
aakeredolu@banwo-ighodalo.com

Azeezah Muse-Sadiq
(Partner)
asadiq@banwo-ighodalo.com

Kemi Ajayi
(Chief Operating Officer)
kajayi@banwo-ighodalo.com

Oluwatoba Oguntuase
(Practice Support Lawyer)
ooguntuase@banwo-ighodalo.com

Emmanuel Onyeabor
(Associate)
EOnyeabor@banwo-ighodalo.com

Enquiries:
taxteam@banwo-ighodalo.com

OUR OFFICES

48, AWOLOWO ROAD,
SOUTH WEST IKOYI
LAGOS, NIGERIA

AFRI-INVESTMENT HOUSE
50, AGUIYI-IRONSI STREET, MAITAMA
ABUJA, NIGERIA

234 9060003561-2; 8050875883; 8092714452; 9020524921
(ABUJA - 09 2912127)
BANWIGHO@BANWO-IGHODALO.COM
WWW.BANWO-IGHODALO.COM