Inside Tax

Deemed profit assessment on non-resident Companies – Is the end in sight?

It is beneficial for taxpayers if Tax Authorities keep within the provisions of the law. While we await further directives from FIRS, it is advisable for NRCs to take steps to regularize their tax positions in Nigeria so as not to be caught unawares

The Companies and Allied Matters Act (CAMA) requires every foreign companies intending to do business in Nigeria to take steps to incorporate a local subsidiary. By so doing, the incorporated Nigerian entity becomes tax resident in Nigeria. The company is expected to submit tax returns under the Companies Income Tax Act, Cap C.21, Laws of the Federation of Nigeria (LFN) 2007 (CITA) as stipulated under section 55. CITA require companies, including those granted exemption, to file self-assessment returns with Federal Inland Revenue Service (FIRS) on an annual basis. The section further provides that the returns shall contain among other things, audited accounts and a statement containing the amount of profit from each source.

However, in practice, this has not been the case, as there are instances where non-resident companies (NRC) carry out businesses in Nigeria without incorporating a Nigerian subsidiary. Interestingly, CITA seems to have anticipated this possible violation of the provisions of CAMA as it clearly laid out the basis for assessing a NRC to tax in Nigeria.

Based on the provision of CITA, the profits of a NRC is taxable in Nigeria, if it is deemed to have been derived in Nigeria. CITA further provides for four circumstances under which the profits of a NRC will be deemed to have been derived from Nigeria. This include (1) having a fixed base of business in Nigeria and to the extent that the profit is attributable to the fixed base. (2) Habitual trading through a Nigerian agent authorised to conclude contracts on its behalf, to the extent that the profit is attributable to the business or trade or activities carried on through that person. (3) Profit from execution of turnkey project - a single contract for surveys, deliveries, installations or construction (4) Profits adjusted by the Tax Authority to reflect arm's length transaction in related party arrangements.

While there is a clear provision in CITA on the requirements for submission of audited financial statements to accompany annual income tax returns, most NRCs do not prepare separate sets of financial statements for their Nigerian operations. It is on this basis that FIRS tend to tax such companies on turnover basis.

Section 30 (1) of CITA empowers FIRS to charge tax on turnover of trade or business carried out in Nigeria where FIRS is of the opinion that the profit made by the company is not in line with industry margin or where the profit of the company cannot be easily ascertained. It is expected that the tax levied on such companies should reflect a fair and reasonable percentage of the part of the company's turnover attributable to its Nigerian operations.

In recent times, FIRS has been discouraging the filing of returns based on deemed profit as it strives to ensure that all companies doing business in Nigeria including NRCs file annual returns in accordance with the provisions of CITA.

The current practice is for FIRS to deem 20% of the turnover as profit and subject such profit to income tax at the rate of 30%. The cost incurred is assumed to be 80%. This eventually translates to an effective tax rate of 6%, with most NRCs making a cash payment of 1% of the turnover, since taxes would have been withheld from their invoices at an average rate of 5%.

The questions that has often been asked is the legal basis for the 20% deemed profit. Is this assessment method adopted for administrative convenience? Could this be the reason FIRS is recently discouraging the filing of returns based on deemed profit? Is the assumption of 80% deemed cost the same for all companies irrespective of their industry, nature of service and peculiarity of business?

Does 6% effective tax rate for companies taxed on deemed profit reflect the true tax positions of such companies when compared to companies which have rendered returns based on full set of financial statements? For example, oil and gas

industry in Nigeria is perceived by many to be highly profitable, albeit highly risky and capital intensive. Does this deemed margin reflect the industry average for companies operating in the oil and gas, manufacturing, consumer market, service and other sectors of the economy?

In a situation where most of the NRCs operate a cost plus arrangement with their customers, it is expected that the direct cost of carrying out the projects are recovered while the company earns a mark-up on the cost. In those instances, is the 80% deemed cost still relevant?

There is also an argument by those who feel that jettisoning the deemed profit approach could indeed lead to loss of revenue by the Government. They argue that many businesses do not offer a guaranteed margin of 20%. Where the financial statements are prepared and the total cost matched with the revenue, how certain are we that NRCs would continue to report more than 20% margin? In those instances, would the government not be on the losing end, since lower taxes would be realised?

NRCs understandably may be reluctant to incorporate a local company in Nigeria. This may be based on the cost implications of incorporating and running a full legal entity in Nigeria. However, it is necessary to ensure that laws of the land are respected. It may be helpful to review the penalty regime in CAMA for violation of non-incorporation as the current provision appear to be incentivizing its abuse. The current drive by FIRS to ensure that all companies file their returns in line with the provisions of S.55 of CITA should be applauded. It is beneficial for taxpayers if Tax Authorities keep within the provisions of the law.

While we await further directives from FIRS, it is advisable for NRCs to take steps to regularize their tax positions in Nigeria so as not to be caught unawares. The provisions of CAMA, which requires NRCs willing to do business in Nigeria to incorporate a local subsidiary should not merely exist in the statute books but should be complied with.

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