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Minimum tax rule
Assessing the lingering controversies

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Introduction

Imagine a company having to pay taxes on its assets or equity. Eventually, the assets and/or equity would be eroded, right? Such was the fate of Nigerian companies until the signing into law on Monday, 13 January 2020, of the Finance Act 2019 (FA'19). FA'19 made amendments to several provisions of the Companies Income Tax Act (CITA), one of which is Section 33 relating to the payment of minimum tax.

Based on the amendment introduced by FA'19, Nigerian companies are no longer required to pay a minimum tax on their assets or equity capital. The revised Section 33 of CITA now requires minimum tax to be computed as 0.5% of **gross turnover**, less franked investment income. Gross turnover is defined as the "gross inflow of economic benefits (cash, revenues, receivables, other assets) arising from the operating activities of a company, including sales of goods, supply of services, receipt of interest, rent, royalties or dividend". This amendment created new controversies with respect to minimum tax computation for Nigerian companies.

In a bid to guide taxpayers on the revised minimum tax rules, Federal Inland Revenue Service (FIRS) issued Information Circular No. 2020/04, titled 'Clarification on Sundry Provisions of the Finance Act 2019 as it relates to Companies Income Tax Act (the Circular)', wherein FIRS clarified that gross turnover includes all operating income or revenues anywhere embedded. The definition of gross turnover in Section 105 of CITA was further amended by the Finance Act 2020 (FA'20). Section 105 of CITA defines gross turnover as "gross inflow of economic benefits during the period arising in the course of the operating activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants, including sales of goods, supply of services, receipt of interest, rents, royalties or dividends".

While FA'20 attempted to clarify ambiguities that may result from the definition of gross turnover, there are lingering concerns especially as it relates to application of this new definition for minimum tax purpose. This article highlights some of the lingering controversies attributable to the definition of gross turnover, impacts on businesses, and our recommendations.

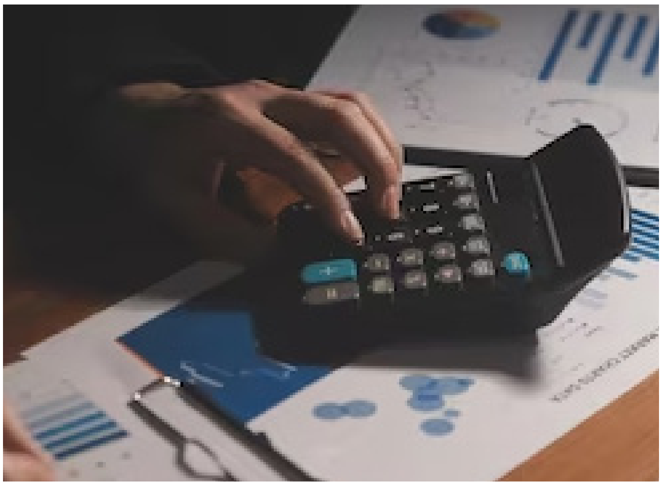
a Definition of gross turnover

We noted that FA'20 definition of gross turnover appears to have been predominantly borrowed from IFRS[1] 15 which defines income as "increases in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases of liabilities that result in an increase in equity, other than increases relating to contributions from equity participants". Further, IFRS 15 defines revenue as income arising in the course of an entity's ordinary business. In light of the foregoing definition, it is safe to assume that the drafters of FA'20 equate gross turnover (as used in Finance Act) with income/revenue (as used in IFRS). If this is the case, one would expect that "gross turnover", for the purpose of minimum tax, equals a company's revenue as reported in the financial statements in line with IFRS.

Based on FA'20, it is imperative to state that, for an inflow to qualify as part of a company's gross turnover and thus subject to minimum tax, such inflow must:

- result in an economic benefit;
- arise from operating activities; and
- result in increased equity.

While economic benefits are reflected in cash, revenues, and assets; and self-evident in equity increases, the varying interpretations of 'operating activities' have sustained the controversies relating to gross turnover and the impact on minimum tax computation.



b Matters arising - the controversies

The major difference between the IFRS 15 definition of revenue and FIRS' definition of gross turnover is the inclusion of "...arising from the course of operating activities..." in the FIRS' definition. As CITA or the Circular does not define "operating activities", it will not be out of place to refer to IFRS definition since FIRS adopted the definition of gross turnover from IFRS.

IAS[2] 7 defines operating activities as principal revenue-producing activities of an entity and other activities that are not investing or financing in nature. In this context, **principal** means activities that are core, while **revenue-producing activities** are activities undertaken by an entity to generate income. Combining both, principal revenue-producing activities are the core set of activities that a company performs to generate its main source of income.

While FIRS defined gross turnover within the context of operating revenue, we noted from its definition that the phrase "increase in equity other than those resulting from equity participant" sought to expand the scope of gross turnover to include all sources of income, save for the express exclusion of franked investment income. To this end, FIRS' online tax returns filing platform[3] has been configured to subject all forms of income, except franked investment income, to minimum tax.

While some taxpayers have aligned with FIRS by including all forms of income in their minimum tax computations,

[1] International Financial Reporting Standards
[2] International Accounting Standard
[3] TaxPro-Max platform

others have argued for the exclusion of incomes that do not meet the definition of operating activities, notwithstanding FIRS' interpretation. Taxpayers who disagree with FIRS' position argue that certain incomes such as interest, rent, and royalties should only be subjected to minimum tax if they are earned by way of a company's operating activities. For example, miscellaneous income, such as interest on bank balance and rental income earned by a manufacturing company on its unoccupied premises, do not constitute operating income. However, based on FIRS' interpretation, these items of income would be subject to minimum tax.

Further, it is imperative to state that the inclusion of certain income items, such as profit on disposal of assets, in the computation of minimum tax may create a 'double tax' situation. This situation mostly arises when the gain on the disposed asset is also subjected to capital gains tax in line with the Capital Gains Tax Act.

A conflict in the application of CITA may also be witnessed with respect to interest income on domiciliary accounts. In line with Section 23 of CITA, interest on foreign currency domiciliary accounts in Nigeria is exempted from income tax. However, based on the definition of gross turnover, interest income, without the exclusion of exempted interest income, is expected to be included in the computation of minimum tax.

Other examples of controversial items for minimum tax purposes include write-back of provisions, unrealised exchange gains, government grant income[4], export income, and pioneer profits. These items are normally non-taxable incomes under CITA, hence, subjecting or attempting to subject the same incomes to income tax based on the minimum tax rule is contradictory.

C Recommendation

Considering these lingering controversies regarding gross turnover for minimum tax purposes, until the courts who have the legal powers to interpret legislation do so, it would be difficult to have a consensus between FIRS and taxpayers. Therefore, we recommend that future amendments to the tax laws should be made with a conscious attempt to resolve the controversies created by the non-definition of "operating activities".

As embedded in the national tax policy, tax laws are expected to, inter alia, be fair, equitable, simple, and certain. Income items which are exempted from taxes should not, inadvertently, or otherwise, be subject to tax.

In light of the foregoing, we recommend a review of the minimum tax provision in CITA with a view to removing the ambiguity in the definition of gross income for minimum tax purposes. We consider this review critical in timing, as companies continue to navigate challenges created by the prevailing tough business climate. In doing this, the government would not only resolve the lingering controversies and deepen the fundamental tax principles of fairness and simplicity but also give a measure of relief to entities doing business in Nigeria.

[4] Essentially a notional income recognized to cater for the difference between commercial rate interest and concessionary interest for borrowings priced at below market rate.

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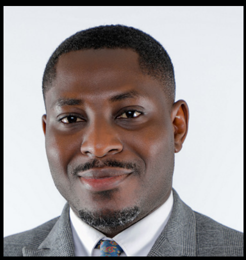

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