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Proposed windfall tax on Nigerian Banks' foreign exchange gain

Introduction

The Federal Government of Nigeria (FGN) has taken formal steps to impose and charge a windfall tax ("the Tax") on Nigerian Banks via the Finance (Amendment) Bill, 2024 ("the Bill").

An executive bill was submitted to the National Assembly of Nigeria on 17 July 2024, accompanied with a letter specifically noting that the intendment of the Bill is to fund capital infrastructure development, education and health care access including other public welfare initiatives. The Bill was subsequently passed by the Senate on 23 July 2024 and expected to be submitted for President's assent.

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Highlights of the Bill

a) The Bill imposes a windfall tax of 50% on Nigerian banks' realized profits from all foreign exchange (FX) transactions within the 2023 financial year. Recent developments suggest that the rate has been increased to 70% by the Senate and the assessment period has been revised to commence from the effective date of the forex unification policy (i.e., 14 June 2023) to 31 December 2025.

b) Federal Inland Revenue Service (FIRS) shall assess, collect, account, and enforce payment of the Tax.

c) Nigerian banks, that are liable to pay the Tax, may enter into a deferred payment agreement with FIRS, which must be executed on or before 31 December 2024. As of the time of this publication, it is not clear if the Senate has revised this timeline.

d) Nigerian banks that fail to pay the Tax to FIRS and have not executed a deferred payment agreement before 31 December 2024, shall be liable to pay the Tax, plus a penalty of 10% of the Tax not paid per annum, plus interest at the prevailing Central Bank of Nigeria (CBN) minimum rediscount rate. It is not clear if the liability of maximum three (3) years imprisonment for principal officers of Nigerian banks that fail to pay the Tax in addition to the 10% penalty will remain in the Bill passed by the Senate.

Government's motivation for the Tax

There are, amongst others, two things that appear to be driving the proposed windfall tax:

a) **Super profits generated by Nigerian banks during the 2023 financial year**

The 2023 fiscal year was marked with a major devaluation of the Naira against other foreign currencies. This devaluation was largely driven by the unification of FX policies announced by President Bola Ahmed Tinubu on 29 May 2023.

For instance, the Naira closed at $1/₦461.1 on 28 May 2023 before the new policy regime was introduced. By 31 December 2023, seven (7) months after the new FX policy was announced, the Naira traded at $1/₦899.8, leading to a 49% decline of the currency. This significant decline of the Naira meant that Nigerian banks that held FX assets in their books reported significant unrealized FX gains on transactions in foreign currencies, upon translation to Naira and realized FX gains upon disposal of assets (e.g., cash, stocks, bonds etc.) or settlement of transactions in foreign currencies.

While the banks reported significant FX gains, many manufacturing and other businesses in the productive sector reported losses due to the impact of significant FX losses in their books.

b) Budget deficits and the need to find alternative revenue income streams

It became apparent, following the enactment of the 2024 FGN Budget, that the FGN would need to look to additional source of revenue to close the estimated ₦9.18 trillion budget deficit.

One way to fund the deficit is through additional borrowing, however, the FGN is already grappling with a worrying debt profile. Another way is through taxation; however, the macro-economic realities show that productivity has slowed in several industries and impacted the tax collected in real terms.

It appears the FGN has looked to other countries that have also imposed a windfall tax i.e., a special tax imposed on specific industries where macroeconomic events have allowed players in the industry to recognize greater than average profits. For instance, in May 2022, the United Kingdom introduced a windfall tax of 25% on energy profits. This was further increased to 35% in January 2023[1]. Also, on 8 August 2023, Italy imposed a windfall tax on profits earned by banks from high interest rates to assist mortgage holders[2].

The question is – is the windfall tax on the banking sector the best option to raise revenue for the FGN?

Matters arising

If successfully signed into law, the Bill would amend the Finance Act 2023, which was signed into law by former President Muhammadu Buhari on 28 May 2023. Besides the impact the Bill may have on the banking sector and whether this is the right time to introduce such a tax, we outline below the tax implications of the Bill.

a. Retrospective application

Nigerian fiscal policy has been known to frown against the retrospective application of tax laws mainly due to the uncertainties and unpredictability it poses to investors and general business operations.

This principle was supported in the case between Accugas Limited Vs FIRS, where the Federal High Court of Nigeria ruled that a law should not apply retrospectively except where its language clearly intends the statutes to apply retrospectively. The Bill clearly states that its provisions is expected to apply retroactively.

It is important that FGN considers the impact on investors' confidence, if a bill seeking to retroactively tax profits is signed into law.

b. Multiplicity of taxes

The fiscal hallmark of the current administration in Nigeria, has been one aimed at addressing the problem of multiplicity of taxes, which begins by not adding any new taxes on businesses and individuals.

This is also one of the tenets of the Presidential Committee on Fiscal Policy and Tax Reforms as well as the pronouncement of the Executive Chairman of FIRS, where Dr. Zaccheus Adedeji noted that the FGN would not introduce new taxes but intends to reduce the number of taxes to a maximum of nine (9).

The Bill appears to be a clear departure from this policy pronouncement and further erodes trust in the economy.

c. Double taxation and increased tax rate

Nigerian banks typically operate a 31-December year-end and would have recently filed their respective income tax returns for 2023 financial year in June 2024. This implies that banks would have already paid tax on its realized FX profits at an average rate of 33%. This is because realized foreign exchange gains would have formed part of a Nigerian bank's assessable profit for the 2023 financial year.

However, FGN's proposal to further tax the realized FX gains may be considered as double taxation of the same income. This may further increase the tax rate on realized FX gains of Nigerian banks in 2023.

d. Modalities of assessment

The Bill stipulates that FIRS shall assess and collect the Tax. However, the manner the assessment would be carried out was not clearly stated by the Bill thus, leaving room for a few unanswered questions such as:

i. Would the Tax be assessed in the same manner as the companies income tax (CIT) such that Nigerian banks can claim tax credits (losses, capital allowance, withholding tax credits etc.) against the Tax?

ii. How would FIRS determine the realized foreign exchange gains? Would FIRS rely on the reporting classification by Nigerian banks or would further checks be carried out?

iii. Would the Tax also apply on realized foreign exchange gains on exempt income?

If passed into law, the FGN and FIRS would need to conduct stakeholder engagements to provide clarifications to the above questions.

Conclusion

The Tax set to be introduced by the FGN may have left little or no legal wiggle room for Nigerian banks. This is so as financial statements for 2023 financial year have been prepared and the relevant tax returns already filed with FIRS. So, it may just be a case of compute the tax based on information submitted to FIRS and pay before the due date.

However, it is important to reflect on the prevailing economic realities, decreasing investors' confidence and the unintended increment of the difficulty in doing business in Nigeria through the volatility of recent fiscal policies and retroactive applicability of laws.

For instance, following the unification of the FX policies and the increased profits from FX transactions by Nigerian banks, the CBN, on 11 September 2023, issued a directive to Nigerian banks not to utilize FX gains for dividend pay-out or meeting operational expenses albeit, with certain exemptions. Additionally, the CBN, on 28 March 2024, raised the minimum capital requirement for Nigerian Banks, which has necessitated several banks to approach the capital market to raise capital in line with CBN's directive.

These are recent policy directives that the Nigerian banking sector has had to navigate and more directives, especially a retroactive tax, will only make the sector (and others) evaluate their continued business presence in Nigeria.

Nigerian banks are advised to quickly evaluate the impact on their business and get involved in the legislative process ongoing at the National Assembly, leveraging platforms such as the Bankers' committee to engage further. It is in the overall interest of the economy to ensure that no sector is brought to its knees through fiscal measures.

If you require further clarification or seek to understand how this would impact your business, please reach out to ngtaxpartners@deloitte.com.

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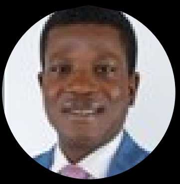

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