TAXATION II

ACC 318

Course Guide

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INTRODUCTION

You are holding in your hand the course guide for ACC318 (Taxation II). The purpose of the course guide is to relate to you the basic structure of the course material you are expected to study as a B.Sc. Accounting Student in National Open University of Nigeria. Like the name 'course guide' implies, it is to guide you on what to expect from the course material and at the end of studying the course material.

COURSE CONTENT

The course content consists basically of the treatment of transactions according to the provisions of the Nigerian tax laws. Specifically, background of business taxation, taxation of sole traders, partnership, limited liability companies and specialized businesses were the main focus of this course material.

COURSE AIM

The aim of the course is to bring to your cognizance the practical treatment of taxation of businesses in line with the Nigerian tax laws.

COURSE OBJECTIVES

At the end of studying the course material, among other objectives, you should be able to know:

1. Overview of Business Taxation in Nigeria
2. Objectives/Aims of Business Taxation in Nigeria
3. Contribution of Business Taxation in Nigeria
4. Challenges/Problems of Business Taxation in Nigeria
5. Meaning of a Trade or Profession
6. Computation of Assessable Profit of a Trade or Profession
7. Taxable/Non-Taxable Incomes and Allowable/Non-Allowable Expenses
8. Determination of Basis Period for Assessment
9. Capital Allowance Computation
10. Loss Relief
11. Determination of Computation of Taxable and Non-Taxable
12. Income of a Partner
13. Identification and Computation of Allowable and Non-Allowable Expenses of Partnership
14. Computation of Assessable and Chargeable Profit of Partnership
15. Determination and Treatment of Tax under Admission and Resignation of a Partner
16. Introduction to Company Income Tax
17. Determination of Basis Period for Assessment
18. Capital Allowance Computation
19. Loss Relief
20. Taxation Provisions and Computation for Real Estate
21. Trust and Settlement Businesses in Nigeria
22. Tax Provisions and Computation for Transportation and Telecommunications Businesses in Nigeria

23. Criteria to be Eligible for Small Company Relief
24. Basis for Taxation of Enterprises in Free Trade Zones

COURSE MATERIAL

The course material package is composed of:
The Course Guide
The study units
Self-Assessment Exercises
Tutor Marked Assignment
References/Further Reading

THE STUDY UNITS

The study units are as listed below:

Module 1	Background of Business Taxation
Unit 1	Overview of Business Taxation in Nigeria
Unit 2	Objectives/Aims of Business Taxation in Nigeria
Unit 3	Contribution of Business Taxation in Nigeria
Unit 4	Challenges/Problems of Business Taxation in Nigeria
Module 2	Taxation of Sole Traders
Unit 1	Meaning of a Trade or Profession
Unit 2	Computation of Assessable Profit of a Trade or Profession
Unit 3	Taxable/Non-Taxable Incomes and Allowable/Non-Allowable Expenses
Unit 4	Determination of Basis Period for Assessment
Unit 5	Capital Allowance Computation
Unit 6	Loss Relief
Module 3	Taxation of Partnership
Unit 1	Determination of Computation of Taxable and Non-Taxable Income of a Partner
Unit 2	Identification and Computation of Allowable and Non-Allowable Expenses of Partnership
Unit 3	Computation of Assessable and Chargeable Profit of Partnership

Unit 4	Determination and Treatment of Tax under Admission and Resignation of a Partner
Module 4	Taxation of Limited Liability Companies
Unit 1	Introduction to Company Income Tax
Unit 2	Determination of Basis Period for Assessment
Unit 3	Capital Allowance Computation
Unit 4	Loss Relief
Module 5	Taxation of Specialized Businesses
Unit 1	Taxation Provisions and Computation for Real Estate Trust and Settlement Businesses in Nigeria
Unit 2	Tax Provisions and Computation for Transportation and Telecommunications Businesses in Nigeria
Unit 3	Criteria to be Eligible for Small Company Relief
Unit 4	Basis for Taxation of Enterprises in Free Trade Zones

ASSIGNMENTS

Each unit of the course has a self assessment exercise. You will be expected to attempt them as this will enable you understand the content of the unit.

TUTOR MARKED ASSIGNMENT

The Tutor Marked Assignments (TMAs) at the end of each unit are designed to test your understanding and application of the concepts learned. Besides the preparatory TMAs in the course material to test what has been learnt, it is important that you know that at the end of the course, you must have done your examinable TMAs as they fall due, which are marked electronically. They make up to 30 percent of the total score for the course.

SUMMARY

It is important you know that this course material was actually adapted from ICAN study pack. This provides you the opportunity of obtaining a BSc. degree in Accounting and preparation for your professional examinations. Therefore, it is very important that you commit adequate effort to the study of the course material for maximum benefit. Good luck.

TAXATION II

ACC318

Main Content

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MODULE 1: BACKGROUND OF BUSINESS TAXATION

UNIT 1 OVERVIEW OF BUSINESS TAXATION IN NIGERIA

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1.0 INTRODUCTION

In Nigeria and the world over, taxation has remained a conventional phenomenon. Most nations, especially developed economies cannot do without the imposition of taxes on the citizenry and corporate organizations. The resolve of tax imposition resulted from the increasing need to raise or boost the revenue base of governments at various levels and jurisdictions. Taxation has become a tool utilized by governments to share from the wealth of individuals or corporate entities. It is an obligatory levy imposed on individuals and corporate entities by the government to in order to increase the economy's revenue base that will enable government to offer social amenities, security and other amenities for the wellbeing of the society.

In this unit, tax legislation, developments in Nigerian taxation, types of income and those exempted among others shall be explored.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- An understanding of the developments in Nigerian tax system
- An explanation of the types of income in taxation

- Know the offences and penalties
- Identify the minimum tax
- Grasp the graduated tax bands in the tax tables

3.0 MAIN CONTENT

3.1 Developments in Nigerian Taxation

In Nigeria, the taxation systems and laws have undergone tremendous developments. These developments in no doubt changed or improved the tax principles, practices and the manner in which tax was levied on the citizens and corporate entities. A recap of the developments in Nigerian taxation shows that the improvements came into being in 1961 following the Income Tax Management Act. However, for the purpose of clarity and ease of understanding, the development in Nigerian tax system shall be discussed under different phases as follows:

(i) Period Between 1961 – 1975: This is the period that witnessed the promulgation of the Income Tax Management Act (ITMA) of 1961 which was however amended in 1975. The promulgation of ITMA came as a result of the recommendations of the Raisman Fiscal Commission (RFC)of 1958. Specifically, a major recommendation of the RFC was that as a country, Nigeria was supposed to have a uniform basic principle for taxing incomes throughout the federation. By 1975, ITMA was amended by the promulgation of the Unilorin Taxation Provision Decree No. 7. This amendment came into being to unify reliefs and tax rates all through the federation. To a large extent, ITMA spurred the propagation of several tax laws in the different states of the country. It was the promulgation of 1961(ITMA) that gave rise to distinct tax laws on income and profit of both individuals and companies. ITMA, 1961 is the predecessor of Company Income Tax Act (CITA) 1961, 1979 and 1990 as well as the Personal Income Tax Decree (now Act) of 1993.

(ii) Period Between 1985 – 1987: This is the era where the Finance Miscellaneous (Taxation Provisions) Decree of 1985 was amended. The amendment came as a result of the need to, among others, increase personal allowances; empower tax authorities to make requests for relevant information about customers from banks; change/modify the computation of capital allowance (from reducing balance to straight-line method); restriction of capital allowance claimable to 75% for manufacturing entities and 66 2/3% for other entities but with no limit for agricultural companies; limiting of losses carried forward to four (4) years for entities other than agricultural companies; and treatment of interest on loan for agricultural and export purpose as tax exempt. In 1987, there was also the amendment of the Nigerian tax laws. The 1987 amendment of Nigeria tax law brought about slight changes in personal allowances; treatment of withholding taxes on interest and dividend as Franked Investment Income (FII); and assessment of some capital allowance rates.

(iii) Period Between 1990 – 1993: This period witnessed the promulgation of new tax laws in addition to some amendments to existing tax laws in the country. First, there was a 1990 amendment that brought about substantial development in capital allowance rates and a 100% capital allowance claimable by manufacturing concerns. Second, was the 1992 amendments that brought about changes in the table of tax rates and upsurge in personal income tax reliefs and allowances. Third, in 1993, the Personal Income Tax Act (PITA) was established as Decree No. 4 and PITA replaced ITMA of 1961 up to the point of annulment. The 1993 PITA ensures that all taxable individuals, corporate entities (sole or group) are taxed nationwide and the relevant rates applied as appropriate. Also, the PITA 1993 gave room for increase in the table of taxes, especially for taxation of individuals under PITA.

(iv) Period Between 2000 – till Date: A reflection from the past showed that many tax laws have been passed to date in Nigeria. Several amendments have been made in line with the growing quest for better administration and management of the Nigerian Tax System. Between 2000 till date, several amendments have been made to the different tax laws in Nigeria.

SELF-ASSESSMENT EXERCISE 1

The Nigerian taxation systems and laws have undergone tremendous developments and amendments. Discuss the various developments in the Nigerian tax laws as well as the key highlights of each period.

3.2 Types of Income Recognized Under Tax

Basically, there are two (2) categories of income in the field of taxation – Earned and Unearned Incomes. **Earned income** specifically refers to all incomes that emanates from a trade, business, profession, vocation or employment, carried on or exercised by an individual. Earned income comprises of profits, salaries, wages, bonuses, commission etc. Whereas, **Unearned income** refers to income from sources other than those gotten from employment, business or reward for services rendered. Examples of such unearned income include earnings from royalty, trademark, patents right, rental, dividends, gifts, inheritance and bequeathals.

SELF-ASSESSMENT EXERCISE 2

List and explain the categories of income recognized under taxation?

3.3 Offences and Penalties

In a bid to maintain integrity in the tax system, encourage tax compliance and minimize the costs of tax collection, stipulated penalties are usually levied on different categories of tax offences. The offences and penalties comprises of the following:

(i) **False Statements and Returns:** The penalty for this offence is a fine of ₦1,000 or imprisonment for five years or both.

(ii) **Non-compliance with Notice:** The penalty for this offence is that the offender will pay an amount equal to the income tax chargeable on him for the preceding year of assessment.

(iii) **Failure to Submit Returns:** The penalty for this offence is that a further sum of ₦40 is payable daily for the period of continued failure, but in case of absolute default, the offender shall be sentenced to six (6) months imprisonment upon conviction.

(iv) **Inappropriate Returns:** The penalty attached to this is that the offender will pay a fine of ₦200 and double the amount of tax, which has been undercharged.

SELF-ASSESSMENT EXERCISE 3

i. In your own opinion, what is the purpose of penalties for tax defaulters?
ii. List and explain the offences and penalties in relation to tax offences in Nigeria.

3.4 Minimum Tax

Taxpayers at most times attempt to avoid tax in order not to alter or deplete their income level. In a bid to ensure that all taxpayers make remittances to the relevant tax authorities, the government initiated what is referred to as "Minimum Tax". Minimum tax was initiated to discourage tax avoidance with the use of heavy capital allowances and reliefs. Usually, minimum tax is chargeable for individuals where:

- ✓ An individual has no taxable income because of large personal reliefs: or
- ✓ Taxable income produces tax payable lower than minimum tax.

However, there has been improvement in the implementation of minimum tax in Nigeria. For instance, up to 1989 tax year, the minimum tax payable by a taxpayer was 1% of total income (especially where the taxpayer has no taxable income as a result of enormous relief). Amid 1990 and 1992, the minimum tax was lowered to 0.5% of total income. In addition, a taxpayer who earns ₦3,000 or below shall suffer minimum tax with no obligation to render returns on income. In 1993/1994, the minimum tax lingered at 0.5% of total income but taxpayers who earn ₦5,000 below shall be exempted from both the normal tax and the minimum tax but not required to file returns on income.

During 1995 – 1996, the minimum tax lingered at 0.5% of total income but taxpayers with earned income of below ₦7,500 were exempted from normal tax only. Furthermore, in 1997, the earned income exempted from tax increased to ₦10,000 and afterward to ₦30,000 in 1998. It is worthy to mention that this was applicable to only taxpayers whose source of income in a year of assessment emanates from employment.

With the Personal Income Tax (Amendment) Act 2011, the rate of minimum tax was again, increased from 0.5% of total income, to 1% of gross income.

SELF-ASSESSMENT EXERCISE 4

i. In your own view, what do you understand by the term "Minimum Tax"?
ii. Itemize the various minimum tax with respect to the years as they occur.

3.5 Applicable Tax Rates

The applicable tax rates employed in computing the tax payables by a taxpayer from 1996 tax year to date are given as follows:

(i) Between 1996 and 1997

1st ₦10,000 @ 5%
Next ₦10,000 @ 10%
Next ₦20,000 @ 15%
Next ₦20,000 @ 20%
Above ₦60,000 @ 25%

(ii) Between 1998 and 2000

1st ₦20,000 @ 5%
Next ₦20,000 @ 10%
Next ₦40,000 @ 15%
Next ₦40,000 @ 20%
Above ₦120,000 @ 25%

(iii) With effect from 2001

1st ₦30,000 @ 5%
Next ₦30,000 @ 10%
Next ₦50,000 @ 15%
Next ₦50,000 @ 20%
Above ₦160,000 @ 25%

(iv) Effective From 14th June 2011

1st 300,000 @ 7 %
2nd 300,000 @ 11%
Next 500,000 @ 15%
Next 500,000 @ 19%
Next 1,600,000 @ 21%
Above 3,200,000 @ 24%

SELF-ASSESSMENT EXERCISE 5

Provide the applicable tax rates from 1996 tax year to date

4.0 SUMMARY

The unit has drawn attention to the development of taxation in Nigeria. Efforts were made to have an overview of the concept of earned and unearned income and the applicable tax rates employed since 1996 tax year to date was outlined. Precisely, the following aspects have been dealt with:

- The developments in Nigerian taxation
- Types of income in taxation
- Offences and penalties
- Minimum tax
- Applicable Tax Rates

6.0 TUTOR-MARKED ASSIGNMENT

1. In not more than three (3) pages, discuss the historical development of Nigerian taxation
2. What is the essence of the applicable tax rates?

7.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

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MODULE 1: BACKGROUND OF BUSINESS TAXATION

UNIT 2: OBJECTIVES/AIMS OF BUSINESS TAXATION IN NIGERIA

CONTENTS

1.0 INTRODUCTION

All levels of government need funds to finance their activities. Note that for government institutions/organizations/establishments/parastatals to function or survive, they must incur cost in one form or the other. This therefore calls for the need for the government to look for ways to raise funds/revenues that would be required to take care of the expenditure and financial obligations of such government institutions/organizations or parastatals. Interestingly, various sources of finance are available to the government and these include taxes, royalties, levies, fines, penalties, loans, grants, and donations given to the government, proceeds from the sale of government-owned companies, lands, buildings and other assets, profits or surpluses made by government-owned enterprises, dividends paid to government on shares owned in companies, interest received on loans made by the government, rent received on government-owned properties, income from the sale of government services, etc. Our major concern under this section is on the concept “taxes” which is a veritable source of revenue for every government.

Tax refers to levies made by public authorities with a tax jurisdiction. It also include any compulsory contributions by the citizenry targeted at defraying parts of the costs incurred by governments n the course of providing the needs of the society.

Taxation is “the process or machinery by which communities or groups of persons are made to contribute in some agreed quantum and method for the purpose of the administration and development of the society”. “Taxation is the transfer of real economic resources from the private sector to the public sector to finance public sector activities”

Although, as of the present day Nigeria, the major source of revenue to the federal government is simply revenue from the sale of crude oil. Also worthy of mentioning is the fact that the various states and local governments in Nigeria are financed mostly through the statutory allocations from the federation account. Nevertheless, taxation is still a very important source of revenue to both the federal, state and local governments.

2.0 Objectives

The aims/objectives of this unit are to:

- Understand the objectives/aims of taxation
- Know the canons/principles of taxation

3.0 MAIN CONTENT

3.1 Objectives/aims of business taxation

Government impose tax not just for revenue generation but to accomplish various economic objectives. Tax is imposed in order to achieve the following objectives by the government:

i) Taxes can be levied to cover the cost of administration, internal and external defence, maintenance of law and order as well as social services required by the citizens.

ii) Taxes are instruments used by governments to protect companies in their infant stages. This is done by reducing specific tariffs which will invariably reduce the cost of production relative to imported products that may be substitutes.

iii) Taxes can also be used to discourage the consumption of dangerous/harmful products.

iv) Taxes are employed to control the importation, production and consumption of certain goods and services thereby preventing dumping. This can be achieved by increasing tax payable on such goods and services.

v) Taxes are important instruments of government in the area of redistribution of wealth and income among various income earners through progressive tax system. This helps to reduce income inequality.

vi) Taxes are also used to counter inflation by reducing volume of purchasing power.

vii) Taxes can as well be used to provide subsidies in favour of preferred sectors of the economy, e.g agriculture and selected industries.

viii) Another important reason for the imposition of taxes is for government to generate the required resources that would be utilized to service national debt and provide retirement benefit etc

SELF-ASSESSMENT EXERCISE 1

1. Highlight the aims/objectives of taxation?

3.2 Canons of taxation

The Canons of taxation are the basic principles of taxation that guide tax administration as well as the implementation of the provisions of relevant tax laws. For a tax system to achieve its objective, it must possess certain principles which include:

i) **Principle of Equity:** A good tax system should be equitable in the distribution of tax burden. To ensure this, person's ability to pay is to be borne in mind by the authority. Progressive tax system possess this quality.

ii) **Principle of Convenience:** this is in respect of timing and mode of payment. The timing and mode of payment should be convenient to the tax payer. Any inconvenience caused by the mode of payment and timing should be avoided.

iii) **Principle of Certainty:** this stipulates that the time, mode and amount to be paid as tax should be clear to the taxpayer. The procedure for computation should be stated.

iv) **Principle of Simplicity:** A good tax system should be coherent, simple and straight forward. It should be well understood by both the tax payer and tax administrators. It should not be complicated or ambiguous.

v) **Principle of Economy:** this relates to cost of administering tax. It provides that the imposition of tax is uneconomical if the cost of collection is in excess of revenue generated. A tax can be considered economical if the cost of administration is not excessive so that a loss is not incurred in the process. This means that tax administration must be cost effective.

vi) **Principle of Impartiality:** This advocates that a tax system should not discriminate between tax payers under similar circumstances. It requires that all persons in similar status/characteristics and circumstances should similarly be placed under the same condition, to pay the same tax.

vii) **Principle of Productivity/Fiscal Adequacy:** This recognizes that the yield from a tax should be adequate to cover government expenditure in terms of promoting economic growth and development. The essence of economic growth and development is to improve the living standard of the citizens (tax payers).

viii) **Principle of Flexibility:** A good tax system should be responsive to changing realities especially in a federal and democratic country where there are always changes in government. It proposes that a tax system should be adjustable to allow for scrapping of obsolete tax system and replacing same with meaningful tax process.

SELF-ASSESSMENT EXERCISE 2

1. Briefly explain six (6) canons of taxation known to you?

4.0 Summary

The unit has drawn attention to background knowledge on the concept of tax and taxation in Nigeria. Specifically, the following aspects have been dealt with:

- The aims/objectives of business taxation in Nigeria
- The canons of taxation

5.0 Tutor-Marked Assignment

1. Attempt a broader definition of tax and taxation?

2. Highlight the objectives/uses/purpose of taxation?

3. Briefly explain five (5) canons of taxation known to you?

6.0 References/Further Reading

David, K.E. (2012). *The tax manual: Principles and practice of taxation in Nigeria, (2nd ed.).*

Fasoto, F. (2007). *Nigerian taxation.* Lagos: Hosrtosaf Limited

ICAN Study Pack (2009). *Advanced taxation for Professional Examination II.* Ibadan: VI Publishing Limited

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MODULE 1: BACKGROUND OF BUSINESS TAXATION

UNIT 3: CONTRIBUTION OF BUSINESS TAXATION IN NIGERIA

CONTENTS

1.0 INTRODUCTION

As clearly stated in the earlier part of this module, the Nigerian tax system has undergone significant changes. The tax laws have been reviewed and are being reviewed with the aim of repelling obsolete provisions and simplifying the main ones. Under current Nigerian law, taxation is enforced by the three (3) tiers of government, i.e. Federal, State, and Local Government with each having its sphere clearly spelt out in the Taxes and Levies (approved list for Collection) Decree, 1998. Of importance at this juncture however are the contributions of business taxation in Nigeria.

Taxation is recognized as a fundamental tool for national development and growth in most countries of the world. One of the major indices by which development and growth can be measured in society is the amount of wealth, which is created by economic activities undertaken in that society. Furthermore, another means of creation of wealth for citizens is through meaningful employment, so that citizens are able to earn income to cater for their needs and also contribute taxes to the government as part of their contribution to national development. Thus, the contribution of business taxation in Nigeria cannot be overemphasized. This is because it has aided the Nigerian government in the area of financing developmental activities, wealth creation, employee generation as well as economic growth and development.

In order to attain the optimum level in the income emanating from business taxation, tax clearance certificates are now been given to taxpayers. Tax clearance certificate certifies that all taxes due for the three immediately preceding years of assessment have been settled in full. This unit dealt with the contribution of business taxation as well as a glance at tax clearance certificate in Nigeria.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know the contribution of business taxation to financing development activities in Nigeria
- understand the contribution of business taxation to wealth creation and employment generation in Nigeria
- ascertain the contribution of business taxation to economic growth in Nigeria
- describe tax clearance certificate in Nigeria

3.0 MAIN CONTENT

3.1 Contribution of Business Taxation to Financing Development Activities in Nigeria

Although the general belief is that the impact of business taxation has not been felt by taxpayers, a situation that has indeed put a majority of the populace in doubt and confusion as to the extent in which funds so generated by the government through taxation have been channeled to the financing of developmental activities in Nigeria. Inspite of this, it is worthy to note that business taxation has contributed to the financing of developmental activities in Nigeria in no small measure.

Presently, there is a shift in the sources of government revenue towards greater reliance on business taxation. This is occasioned by the series of reforms in taxation in Nigeria in recent times. Thus, most developmental projects or activities are said to have been financed by the revenues generated from taxes especially in the area of business taxation emanating from company tax.

SELF-ASSESSMENT EXERCISE 1

1. Briefly explain how business taxation contributes to financing development activities in Nigeria?

3.2 Contribution of Business Taxation to Wealth Creation and Employment Generation in Nigeria

Business taxation can play a vital and pivotal role in the creation of wealth and employment in Nigeria in the following dimensions:

(i) Stimulating growth in the economy, by increased trade and economic activities. In this regard, tax revenues can be used to provide basic infrastructure such as roads, transportation and other infrastructure which would facilitate trade and other economic activities.

(ii) Stimulating domestic and foreign investment - where the tax system creates a competitive edge for investments in the economy, local investments would be retained in the country, while attracting foreign investments. Increased investment would also generate employment and provide wealth in the hands of individuals.

(iii) Revenue generated from taxes can also be applied directly to identified sectors of the Nigerian economy. This will go a long way to stimulate such identified sectors. In this regard, the sectors should be those which have potentials for creating employment, developing the economy and creating wealth for the greater benefit of citizens and government of this country.

(iv) Revenue earned from taxes can be used to develop effective regulatory systems, strengthen financial and economic structures and address market imperfections and other distortions in the economic sector. Taxes realized from specific sectors of the economy can be channeled back to those sectors to encourage their continued growth and development.

(v) Redistribution of income, whereby tax revenue realized from high income earners is used to provide public infrastructure and utilities to the lowest income earners. Taxes may also be used to create a social security net for short and long terms relief to indigent members of society and other classes of persons who may require such intervention by the government.

SELF-ASSESSMENT EXERCISE 2

1. Briefly explain how business taxation contributes to wealth creation and employment generation in Nigeria?

3.3 Contribution of Business Taxation to Economic Growth in Nigeria

The process of nation-building is slow and complex but is now increasingly recognized as the necessary condition for harnessing economic growth. The state-building approach to business taxation, therefore, recognizes tax as one of the few core capabilities that any state needs in order to attain economic growth. The belief is that an effective tax system operated by a country should achieve economic growth.

Revenues generated from business taxation are now utilized by most governments to fund economic activities such as promoting health, education, security and a host of others. This scenario is not different in Nigeria such that the revenues obtained from business taxation are plunged back into the economy by a way of allocating more resources to federal government spending on health, education, transportation, security, telecommunication and a host of others which drive economic growth in the country.

SELF-ASSESSMENT EXERCISE 3

1. Briefly explain how business taxation contributes to economic growth in Nigeria?

3.4 Tax Clearance Certificate (TCC) in Nigeria

This is a certificate that is issued by the tax authority to any taxpayer who may have fully paid the assessed tax in the last three (3) consecutive years immediately preceding the current year of assessment. The relevant tax authority is obliged to issue a TCC within a maximum period of two weeks of its demand or give reasons for the denial in writing. A current year tax can be accepted as a condition for TCC if the person is leaving the country. TCC shall disclose (in respect of the last three years of assessment):

(a) chargeable income;
(b) tax payable;
(c) tax paid; and
(d) tax outstanding, or alternatively, a statement to the effect that no tax is due;

TCC is usually required for the following reasons.

(a) Application for government loan for industry or business;
(b) Registration of motor vehicles;
(c) Application for firearms license;
(d) Application for foreign exchange or exchange control permission to remit funds outside Nigeria;
(e) Application for Certificate of Occupancy (C of O);
(f) Application for award of contracts by government, its agencies and registered companies;
(g) Application for approval of building plans;
(h) Application for trade/business license;
(i) Application for import and export license;
(j) Application for license as agent;
(k) Application for pool and gaming license;
(l) Application for registration as a contractor;
(m) Application for distributorship;
(n) Confirmation of appointment by government as chairman or member of public board;
(o) Stamping of guarantor's form for the Nigerian passport;
(p) Application for registration of a limited liability company;
(q) Application for allocation of market or stalls;
(r) Appointment or election into public office.

SELF-ASSESSMENT EXERCISE 4

1. What do you understand by Tax Clearance Certificate?

4.0 SUMMARY

The unit has drawn attention to background knowledge on the contribution of business taxation in Nigeria. Specifically, the following aspects have been dealt with:

- The contribution of business taxation to financing development activities in Nigeria
- The contribution of business taxation to wealth creation and employment generation in Nigeria
- The contribution of business taxation to economic growth in Nigeria
- Tax Clearance Certificate in Nigeria

5.0 TUTOR-MARKED ASSIGNMENT

1. Briefly explain how business taxation contributes to financing development activities in Nigeria?

2. Briefly explain how business taxation contributes to wealth creation and employment generation in Nigeria?

3. Briefly explain how business taxation contributes to economic growth in Nigeria?

4. What do you understand by Tax Clearance Certificate?

6.0 REFERENCES/FURTHER READING

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MODULE 1: BACKGROUND OF BUSINESS TAXATION

UNIT 4: CHALLENGES/PROBLEMS OF BUSINESS TAXATION IN NIGERIA

CONTENTS

1.0 INTRODUCTION

One of the major challenges of business taxation in Nigeria is that of tax evasion and avoidance. The twin problem of evasion and avoidance have become a major challenge to business taxation due to the diversity and complexity in human nature and activities, thus, no tax law can capture everything; loophole will exist and can only be reduced and not completely eliminated. However, this unit explored the challenges/problems of business taxation in Nigeria.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know the challenges of business taxation in Nigeria
- understand tax evasion and avoidance and its challenges to equitable tax system
- identify other problems militating against business taxation in Nigeria

3.0 MAIN CONTENT

3.1 Challenges of Business Taxation in Nigeria

The twin-problem (tax evasion and avoidance) is one of the most challenging issues of business taxation in Nigeria. This twin problem has led to loss of revenue for the Nigerian government in recent times. The proliferation of tax evasion and tax avoidance strategies have increasingly made honest taxpayers to lose faith in the tax system in

Nigeria and are tempted to join the league of tax dodgers if it becomes too widespread and unchecked. A high degree of tax evasion has unpleasant repercussions on government revenues in Nigeria. These challenges of business taxation in the country have manifested in the following areas:

- it has affected wealth redistribution and economic growth;
- it creates artificial biases in macroeconomic indicators;
- it runs counter to the distributional or equity goals of taxation

Another challenge of business taxation in Nigeria is that of not having a fair tax system. The tax system in operation in Nigeria is a tax system that appears to be on paper and it lacks the standard of equity.-

SELF-ASSESSMENT EXERCISE 1

1. Briefly explain the challenges facing business taxation in Nigeria?

3.2 Tax Evasion and Tax Avoidance and the Challenge to Equitable Tax System

3.2.1 Tax Evasion

Tax evasion is a deliberate and willful practice of not disclosing full taxable income so as to pay less tax. In other words, it is a contravention of tax laws whereby a taxable individual or entity neglects to pay the tax due or reduces tax liability by making fraudulent or untrue claims on the income tax form. Tax evasion can manifest in different measures such as:

(i) Refusing to register with the relevant tax authority;

(ii) Failure to furnish a return, statement or information or keep records required;

(iii) Making an incorrect return by omitting or understanding any income liable to tax or refusing or neglecting to pay tax;

(iv) Overstating of expenses so as to reduce taxable profit or income, which will also lead to payment of less tax than otherwise have been paid;

(v) A taxpayer hides away totally without making any tax returns at all; and

(vi) The use of artificial transactions to increase expenses and reduce taxable income or to attract reliefs.

It is worthy to note that tax evasion is illegal and when caught, it is punishable under the law of the Federal Republic of Nigeria.

3.2.2 Tax Avoidance

Tax avoidance has been defined as the arrangement of taxpayers' affairs using the tax shelters in the tax laws, and avoiding tax traps in the tax laws, so as to pay les tax than he or she would otherwise pay. That is, a person pays less than he ought to pay by taking advantage of loopholes in a tax system. Tax can be avoided in various dimensions:

(i) Incorporating the taxpayers' sole proprietor or partnership into a limited liability company;

(ii) The ability to claim allowances and relief's that are available in tax laws in order to reduce the amount of income or profit to be charged to tax;

(iii) Minimizing the incidence of high taxation by the acquisition of a business concern which has sustained heavy loss so as to set off the loss against future profits;

(iv) Minimizing tax liability by investing in capital asset (e.g. corporate financing such as equipment leasing), and thus sheltering some of the taxpayers income from taxation through capital allowance claims;

(v) Sheltering part of the company's taxable income from income tax by capitalizing profit through the issue of bonus shares to the existing members at the (deductible) expenses to the company;

(vi) Creation of a trust settlement for the benefit of children or other relation in order to manipulate the tyrant tax rate such that a high income bracket taxpayer reduces his tax liability;

(vii) Converting what would ordinarily accrue to the taxpayer as income into capital gain (i.e. compensation for loss of office) to the advantage of the employer and employee;

(viii) Manipulation of charitable organizations whose affairs are controlled and dominated by its founders thus taking advantage of income tax exemption;

(ix) Buying an article manufactured in Nigeria thereby avoiding import duty on imported articles; and

(x) Avoiding the consumption of the articles with indirect taxes incorporated in their prices.

SELF-ASSESSMENT EXERCISE 2

1. Explain the concept of ‘Tax Evasion’ and ‘Tax Avoidance’.
2. List the dimensions of tax evasion and avoidance known to you?

3.3 Other Problems Militating against Business Taxation in Nigeria

There are other problems militating against business taxation in Nigeria and they include:

(i) **Problem of Assessment:** Where the taxable individual is not in employment, the identification of the persons to be assessed, their address and place of residence so that notices can be served on them possess a major challenge to assessment of taxpayers in Nigeria.

(ii) **Personnel Problem and Low Image of Tax Officials:** This situation arises due to lack of experienced tax personnel to man the various activities of collecting tax in Nigeria and it thus hinders effective tax administration in Nigeria.

(iii) **Inadequate Penalties for Tax Defaulters:** There is low penalty for tax defaulters in Nigeria and as such, tax defaulters do not serve as deterrent to others. There is also the problem of enforceable tax compliance measures by the relevant tax authorities in Nigeria

(iv) **Attitudinal Problem:** Most taxpayers do not know that it is part of their civic duties to pay tax, except a few enlightened individuals, salaried employees whose incomes are subjected to tax at source.

(v) **Cumbersome Process of Payment:** The procedures for paying certain taxes are too cumbersome and do not encourage prompt payment of tax by payers. In some instances, they go scot free by bribing tax officials.

SELF-ASSESSMENT EXERCISE 3

1. Briefly explain some other problems militating against business taxation in Nigeria?

4.0 SUMMARY

The unit has drawn attention to the problems/challenges militating against business taxation in Nigeria. Precisely, the following aspects have been dealt with:

- Challenges of business taxation in Nigeria
- Tax evasion and avoidance and its challenges to equitable tax system
- Other problems militating against business taxation in Nigeria

5.0 TUTOR-MARKED ASSIGNMENT

1. What do you understand by the term ‘Tax Evasion’ and ‘Tax Avoidance’?

2. Briefly explain the problems militating against business taxation in Nigeria?

3. List the dimensions of tax evasion and avoidance known to you?

6.0 REFERENCES/FURTHER READING

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MODULE 2: TAXATION OF SOLE TRADERS

UNIT 1: MEANING OF A TRADE OR PROFESSION

CONTENTS

1.0 INTRODUCTION

The purpose for which a trade or profession is established is enshrined in the articles and memorandum of association of that trade or profession. More specifically, the purpose is contained in the 'objects clause' of entities. The object clause defines the constituents of trade or profession of an entity such as the activities the trade or profession is engaged.

The activities of the trade or profession will definitely result in some forms of income and the income will be subject to income taxation in accordance with the provisions of the Company Income Taxation Act (CITA). However, if such activities of a trade or profession relate to capital items or are specifically exempted by other provision of the Act, such incomes are not liable to company income tax.

The income statement (previously, profit and loss account) of a trade or profession must be established for the purpose of identifying taxable income and allowable expenses in subjecting a sole trader to taxation. An expense will be allowable if it is wholly, reasonably, exclusively and necessarily incurred for the purpose of the trade or profession.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- Know the meaning of Trade or Profession
- Differentiate between a Trade and Profession
- Understand the Types of Income

- Ascertain the Income of a Trade and Profession

3.0 MAIN CONTENT

3.1 Meaning of Trade or Profession

A trade or profession is a business. It is referred to as a business because it its primary motive of existence is based on making profit. A business refers to any trade, profession or vocation but excludes employment.

A trade encompasses every trade, manufacture, adventure or concern in the nature of trade. Trade refers to normal regular routine commercial activity, because it connotes the idea of continuity. Whether or not an activity is a trade in its extended sense remains a mixed question of law and fact. Any person is engaged in a trade if he/she is involved in the buying and selling and/or rendering of services. Thus, regular acts of buying and selling or rendering of services clearly constitute the concept of a trade, as such, the yearly profits or gains emanating from such acts or trade are assessable to tax.

On the other hand, a profession comprises of the idea of an occupation requiring either purely intellectual skill, or manual skill controlled by the intellectual skill of the operator. A profession thus normally refers to intellectual or specialized skill. For instance, doctors, lawyers, accountants, engineers, etc.

A vocation implies "the way a person passes his life". The way a person earns his living thus passes for a vocation. For instance, carpentry, tailoring, etc.

SELF-ASSESSMENT EXERCISE 1

1. In your own view, what do you understand by a trade, profession or vocation?

3.2 Differences between a Trade and Profession

The expressions trade, business, profession, vocation and employment have the same meanings as contained in the Income Tax Acts, but not to the extent of the applications of the provisions of those Acts as to the circumstances in which, on a change in the persons carrying on a trade is to be regarded as discontinued, or as set up and commenced.

The distinction between a trade and profession can be viewed from the following circumstances:

Table 1: Distinction between a Trade and Profession

S/N	TRADE	PROFESSION
1	It encompasses manufacturing, production, adventure or concern in the nature of trade	It requires purely intellectual skills, manual skills
2	It is not controlled by the intellectual skill of the operator	It is controlled by the intellectual skill of the operator

S/N	TRADE	PROFESSION
3	It connotes the idea of continuity and is deemed to be a going concern	It is not deemed to be a going concern
4	It involves buying and selling of goods and services	It does not necessarily involve buying and selling but the provision of professional services
5	A trade must not necessarily be a profession	To be classified as a profession, you must be a professional.

SELF-ASSESSMENT EXERCISE 2

1. What is the Difference between a Trade and Profession?

3.3 Types of Income

Basically, there are two (2) categories of income emanating from a trade, profession, vocation or employment in the field of taxation. These categories as noted earlier are – Earned and Unearned Incomes. **Earned income** simply refers to all such incomes emanating from a trade, business, profession, vocation or employment, carried on or exercised by an individual. Earned income comprises of profits, salaries, wages, bonuses, commission etc.

Earned income can as well be described as any income derived from a trade, business, profession, vocation or employment carried on by a taxable individual with a derivable pension there from, in respect of any previous employment. Income tax is paid under the Pay-As-You-Earn (PAYE) system such that it becomes the responsibility of every employer to deduct income tax at source from the wages and salaries of her employees for onward remittance to the relevant tax authorities by the 10th day of the month following the deduction.

Unearned income refers to income from sources other than those gotten from employment, business or reward for services rendered. Examples of such unearned income include earnings from royalty, trademark, patents right, rental, dividends, gifts, inheritance and bequeathals.

Impliedly, unearned income includes rent, dividends, royalty, discounts, which may be received net of withholding tax. These are also known as investment incomes. Where they are received net of withholding tax, they are referred to as "Franked Investment Income" (FII).

SELF-ASSESSMENT EXERCISE 3

List and explain the categories of income in the field of taxation?

3.4 Recognition of Income From Trade and Profession

This section briefly outlines how incomes of a trade, profession or vocation in Nigeria are recognized. According to the Nigerian Tax Act, the following are the income of a trade, profession or vocation:

a) The profit or loss account must be established for the purpose of identifying taxable income and allowable expenses in subjecting a sole trader to taxation. An expense will be allowable if it is **wholly, reasonably, exclusively and necessarily** incurred for the purpose of the trade or business.

b) Residence is very important in taxation as tax could be imposed only by the state in which the individual is deemed to be resident for that year. In a situation where the individual has more than one place of residence, Personal Income Tax (Amendment) Act, 2011 refers to his 'principal place of residence' as follows:

   i) For an individual with a source of earned income other than employment – that place nearest to his usual place of work on a relevant day – where he holds employment on the first day of January in the year of assessment.

   ii) For an individual with sources of unearned income in Nigeria, that place in which he usually resides – or principal place of residence on the first day of the assessment year.

   iii) Where an individual holds a foreign employment and performs his duties in Nigeria, the individual is regarded as resident in Nigeria.

   iv) In the case of an individual who works in the branch office or operational site of a company, or body corporate, the place at which the branch office or operational site is situate constitute the principal place of residence. In this case, the operational site shall include Oil Terminals, Oil Platforms, Flow Stations, Factories, Quarries, Construction Site with a minimum of 50 workers.

SELF-ASSESSMENT EXERCISE 4

Briefly highlight how the incomes of a trade, profession or vocation as contained in the Nigerian Tax Act is recognized?

4.0 SUMMARY

The unit has drawn attention to the meaning of trade or profession in Nigeria. Precisely, the following aspects have been dealt with:

- The meaning of a Trade or Profession

- Differences between a Trade and Profession
- Types of Income
- Recognition of the Income From Trade and Profession

5.0 TUTOR-MARKED ASSIGNMENT

1. What do you understand by a trade or profession?

2. Differentiate between a Trade and Profession?

3. What are the types of Income?

4. Briefly illustrate the income emanating from a trade or profession as enshrined in the Nigerian Tax Act?

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

Fasoto, F. (2007). *Nigerian taxation.* Lagos: Hosrtosaf Limited

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MODULE 2: TAXATION OF SOLE TRADERS

UNIT 2: COMPUTATION OF ASSESSABLE PROFIT OF A TRADE OR PROFESSION

CONTENTS

1.0 INTRODUCTION

In Nigeria, the taxation of a trade (e.g. sole trader) or profession is covered by the Personal Income Tax Act (PITA). It falls under the personal income tax system of Nigeria. Before 2011, the Personal Income Tax Act Cap .P8 Laws of The Federation of Nigeria (LFN) 2004 governed the administration of Personal Income Tax in Nigeria. The Personal Income Tax (Amendment) Act 2011 was enacted to amend the Personal Income Tax Act Cap . (LFN) 2004 and related matters. Though dated 24th of June, 2011, it was on Tuesday, December 13th, 2011, that the then President of the Federal Republic of Nigeria (Dr. Goodluck Ebele Jonathan), while presenting the 2012 Federal Budget proposal to the joint session of the National Assembly confirmed the signing into law of the Bill enacting The Personal Income Tax (Amendment) Act 2011. In this unit, we hope to expose you to the computations of assessable profit of a trade/profession and that of a sole trader.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- Income tax of a Trade or Profession
- Meaning of assessable profit
- Computation of assessable profit of a Trade or Profession
- Computation of tax liability of a Sole Trader

3.0 MAIN CONTENT

3.1 Income Tax of a Trade or Profession

An **income tax** is a government levy (tax) imposed on a trade or profession, individuals or entities (taxpayers). Such taxes vary with the income or profits (taxable income) of the taxpayer(s). In Nigeria, while taxes imposed on entities, corporations etc are referred to as company income tax; taxes imposed on a trade or profession simply connotes personal income taxes (usually levied on the personal income of trade or profession).

The Personal Income Tax (Amendment) Act 2011 requires that a taxpayer files returns for the preceding year within 30 days of the end of the year (i.e January 31st. – previously 90 days, i.e. March 31st.). Income tax is payable on income from sources within and outside Nigeria, in particular, but not restricted to the following:

- Gains or profit from trade, business, profession or vocation,
- Emolument or remuneration from an employment from both the public and private sectors. Remuneration covers salaries, wages, fees, allowances including compensations, commissions, bonuses, premiums, benefits or other perquisites allowed, given or granted by any person to an employee,
- Dividend, interest or rent,
- Any charge or annuity,
- Gains or profits including any premiums arising from a right granted to any person for the use or occupation of any property,
- Any balancing charge arising where a business person disposed off an asset used for the purpose of trade or business carried on by it at a profit, and
- Any profit, gain or other payments accruing to an individual not falling within items listed above.

Note that the profit of a trade, profession or vocation is liable to tax in Nigeria regardless of the period such a trade, profession or vocation has been carried on. It is also noteworthy however that the income from employment is liable to tax when a person becomes a resident. The assessment of the income is usually done on the preceding year basis.
Remuneration does not include refund of out-of-pocket expenses, medical expenses, and cost of passages to and from Nigeria. It also does not include sums received for up keep of a child; these are all exempted from personal income tax computation.

SELF-ASSESSMENT EXERCISE 1

1. Briefly explain the concept of income tax under a Trade or Profession?

3.2 Meaning of Assessable Profit

Assessable profit is that quantifiable income, earnings, proceeds emanating from a trade or profession. These quantum of income, earnings or proceeds are chargeable to tax under the Personal Income Tax Act (PITA). Assessable profit refers to the accounting profit of trade or profession as adjusted for the purpose of tax (i.e. adjusted profit that will be arrived at before reflecting the effect of any loss relief, balancing charge and or capital allowances).

SELF-ASSESSMENT EXERCISE 2

1. What do you understand by "Assessable Profit" in relation to a Trade or Profession?

3.3 Computation of Assessable Profit of a Trade/Profession

3.3.1 Adjustment of Income Statements

The preparation of a fresh income statement for the purpose of income tax computation may not be necessary since the income statement prepared by the Accountant can serve that purpose, but with some adjustments to make the balances of the taxable profit to conform with the relevant tax laws. The adjustment is necessary as the account was prepared on the basis of financial accounting principles.

The process of adjusting the accounting profit in-line with the provisions of relevant tax laws is referred to as ascertainment of adjusted profit. As mentioned earlier, for the purpose of determining adjusted profit, there shall be a deduction of revenue expenditure which is wholly, exclusively, necessarily and reasonably incurred. Detail of this deduction is explained in the following section.

What is wholly, Reasonably, Exclusively and Necessarily (WREN)?

(i) Wholly – where an individual uses a part of a building privately, as well as for business, the amount paid in any year of assessment will be apportioned on the basis of usage; and the amount attributable to private use will not qualify as an allowable expense in the computation of assessable profit. In effect, the term "wholly" is in reference to the quantum of the money expended for the business. It must be totally for the purpose of business. Thus, an expense is said to be wholly incurred if the entire amount is incurred for the purpose of the business.

(ii) Reasonably – Expenses that are deductible must be reasonable in cost and quantity. This means that such allowable expenses must be incurred for the purpose of generating the income of the business, trade or vocation. Any expense to the contrary should be disallowed. Note that an expense is said to be reasonably incurred based on the amount or size involved.

(iii) Exclusively – the word exclusively is better illustrated with the word "solely". Thus, for expenses to be exclusive, it means that such expenses must have been incurred solely for the purpose of the business.

(iv) Necessarily – all expenses that are reasonable will certainly be necessary for the purpose of producing income in a business. By implication, an expense is said to be necessarily incurred if the business cannot earn an income without incurring the expenses. The two words, “reasonably and necessarily” connote element of compulsion.

3.3.2 Methods for Adjusting Accounting

The following approaches/steps should be taken:

1) Begin with the net profit or loss as shown in the income statement for the period.

2) Add the items listed below to (1) above.
   a) Expenses which have been debited to the income statement which are not allowable as expenses for income tax purpose. A good example is depreciation.

   b) Any income that is accruable to trade, business etc, which has not been credited in the account, and which is subject to income tax. E.g. discount received.

3) Deduct the following from the summation of (1) and (2) above.

   a) Any item which has been credited to the income statement but is exempted from income tax. Example is profit on disposal of fixed assets.

   b) Any item that is allowable as deductible expenses but has not been properly treated in the income statement. Example is any omitted revenue expense0

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3.3.2.1 Simplified Method

ABC ENTERPRISES

Computation of Adjusted Profit for the 2008 tax year

		₦	₦
Net profit as per account of the firm			XX
Add disallowable expenses		XX	XX
Less:	allowable items not treated	XX	
	Income exempted	XX	
			(XX)
Adjusted Profit			**XX**

3.3.2.2 Detailed Method

Method 1

<u>KOKOBILO ENTERPRISES</u>

<u>Computation of adjusted profit for the year ended 31st December 2010</u>

	₦	₦
Net profit as per account		xxx
Add: *Expenses not allowable but have*		
been deducted: Depreciation	xxx	
Loss on disposal of fixed of assets	xxx	
Income Tax	xxx	xxx
Income subject to tax but not treated as such:		
Discount received	xxx	
Comm. Received	xxx	
Recovered b/debt	xxx	
		xxx
Deduct: *Items not taxable under PITA*:		
Profit on disposal of fixed assets	xxx	
Omitted revenue expenses	(xxx)	xxx
Adjusted Profit		xxx

Method 2 – Re-Computing The Accounts

<u>KOKOBILO ENTERPRISES</u>

<u>Computation of adjusted profit for the year ended 31st December 2010</u>

	₦	₦
Sales/Turnover		XX
Less purchases/Direct expenses	XX	
Gross profit/income	XX	
Less operating expenses:		
Selling & administrative	XX	
Salaries & wages	XX	
Discount allowed	XX	
Bad debts	XX	
Transport and travelling	XX	
Telephone & postage	XX	
Rent & Rates	XX	
Other allowable expenses	XX	(XX)
Profit subject to tax assessment		**XX**

SELF-ASSESSMENT EXERCISE 3

1. How are profits determined in relation to a Trade/Profession?

2. What is the implication of expenses being Wholly, Reasonably, Exclusively and Necessarily incurred in relation to Trade/Profession?

3.4 Computation of Tax Liability for Sole Trader

The assessment of income is the second stage in income tax administration. It is concerned with determining the exact amount of income to be paid as tax. The amount of tax to be paid by an individual in any year of assessment is computed following the procedure below:

i. Summation of income of an individual from all sources including any balancing charges;
ii. Deduction of loss relief and capital allowances from (i) above to arrive at total income of an individual;
iii. Deductions of relieves and allowances, like personal allowance, children allowance etc. from the total income to arrive at taxable income;
iv. The tax liability is calculated by applying the personal income tax rates on the taxable income in (iii) above. This procedure is shown in a standard format below:

The taxable or chargeable income, reliefs and allowances are granted against the statutory income. Statutory income here simply refers to the addition of the earned and unearned income. The reliefs and allowances are as follows:

Higher of

a. 1% of gross income **OR**
b. A consolidated relief allowance on income at a flat rate of N200,000;
c. **Plus** 20% of gross income

Tax Exempt Income

The following deductions are tax exempt: National Housing Fund Contribution, National Health Insurance Scheme, Life Assurance Premium, National Pension Scheme and Gratuities

3.5.1 Format For The Computation of Individual's Taxable Income

MAL. ADO

Computation of taxable income for 2012 year of assessment

	₦	₦
Earned Income		
Gross Emolument	X	
Allowances	X	XXX
Less: Exempted Allowances		
National Housing Fund Contribution	X	
National Health Insurance Scheme	X	
Life Assurance Premium	X	
National Pension Scheme	X	
Gratuities	X	XX

Total Income	**XX**

Less: Reliefs:		
Personal Allowances	X	
20% of Gross Income	X	XX
Chargeable Income		**XX**

Annual Tax Due

First N300,000 @ 7%
Next N300,000 @ 11%
Next N500,000 @ 15%
Next N500,000 @ 19%
Next N1,600,000 @ 21@
Balance (Above N3,200,000) @ 24%

Minimum Amount of Personal Income Tax

Where an individual's income is between N10,000.00 and N30,000 respectively as of 1996 and 1998 tax year, he/she is exempted from tax.

However, the applicable rate for minimum tax has increased to 1 per cent with effect from 14th June, 2011.

Personal Income Tax Rate

The taxable income of an individual is assessed to tax at the rate which is published by the government and may be reviewed from time to time. These rates change in line with the tax policy of the government. The table below shows the personal income tax rates for different fiscal years.

EFFECTIVE FROM 1995

Taxable income (N)	**Rate of Tax** (%)
1st 10,000	5
2nd 10,000	10
3rd 10,000	15
4th 10,000	20
Next 20,000	25
Over 60,000	30

EFFECTIVE FROM 1996

Taxable income (N)	**Rate of Tax** (%)
1st 10,000	5
2nd 10,000	10
Next 20,000	15
4Next 20,000	20
Over 60,000	25

EFFECTIVE FROM 1998

Taxable income (N)	**Rate of Tax** (%)
1st 20,000	5
2nd 20,000	10
Next 40,000	15
4Next 40,000	20
Over 120,000	25

EFFECTIVE FROM 2001

Taxable income (N)	**Rate of Tax** (%)
1st 30,000	5
2nd 30,000	10
Next 50,000	15
4Next 50,000	20
Over 160,000	25

EFFECTIVE FROM 14th JUNE 2011

Taxable income (N) Annual	**TaxRate** (%)	**Taxable income** (N) Monthly	**TaxRate** (%)
1st 300,000	7	25,000	7
2nd 300,000	11	25,000	11
Next 500,000	15	41,666	15
Next 500,000	19	41,666	19
Next 1,600,000	21	133,333	21
Above 3,200,000	24	266,666	24

ILLUSTRATION

Below are details from the payslip of Mr. Ade Adedayo for the Month of January, 2017.

TAXABLE			**DEDUCTIONS**	
ITEM	**MONTHLY (N)**		**ITEM**	**MONTHLY (N)**
Basic Salary	131,250		PENSION	22,968.75
Housing Allowance	87,500		PAYE TAX	28,234.84
Transport	87,500		STAFF LOAN	35,000.00
Utility Allowance	8,750		LIFE ASSURANCE (Premium Paid)	17,500.00
Leave Allowance	8,750		NHF CONTRIBUTION	7,656.25
			NATIONAL HEALTH INSURANCE SCHEME	15,312.50
GROSS PAY	**323,750**		**TOTAL DEDUCTIONS**	**126,672.34**
			NET SALARY PAYABLE	**197077.66**

Required:

Compute the Chargeable Income of Mr Ade Adedayo for the month of January and ascertain whether the PAYE Tax of 28,234.84 is actually the right amount of his tax payable for the month.

Solution To Illustration

Important Note on Some Computations in the Payslip:

- Pension Contribution = N22,968.75
  {7.5% of (Basic, Housing and Transport)
- National Housing Fund Contribution = 7,656.25
  {2.5% of (Basic, Housing and Transport)}
- National Health Insurance Scheme = 15,312.50
  {5% of (Basic, Housing and Transport)}

Mr Ade Adedayo
Computation of Taxable Income for the Month of January, 2017

		₦	₦
Earned Income			
Basic Salary		131,250	
Housing Allowance		87,500	
Transport Allowance		87,500	
Utility		8,750	
Leave Allowance		8,750	
Gross Emolument			323,750.00
Less: Exempted Allowances			
National Housing Fund Contribution		7,656.25	
National Health Insurance Scheme		15,312.50	
Life Assurance Premium		17,500.00	
National Pension Scheme		22,968.75	
			63,473.50
Total Income			**260,312.50**
Less: Reliefs:			
Personal Allowances (1/12 x 200,000)	16,666.67		
20% of Gross Income	64,750.00		
			81,416.67
Chargeable Income			**178,895.83**
	First N25,000 at 7%		1,750.00
	Next N25,000 at 11%		2,750.00
	Next N41,666.00 at 15%		6,249.90
	Next N41,666.00 at 19%		7,916.54
	Next N45,563.83 at 21%		9,568.40
PAYE Tax on Taxable Income For January, 2017			**28,234.84**

SELF-ASSESSMENT EXERCISE 4

1. Mal. Ahmad Ibrahim is the sole proprietor of JCB Enterprise, which is a major distributor to leading manufacturing companies in Nigeria for a long time now. The income statement of the enterprise for the accounting year ended 31st December 2015 is as shown below:

	N	N
Gross profit		180,000.00
Profit on sale of generating plant		22,500.00
		202,500.00
Less Operating Expenses:		
Depreciation	25,500.00	
Contribution to approved pension scheme	7,500.00	
Salaries and Wages	3,000.00	
Rent and Rate	4,500.00	
Electricity	2,250.00	
Postage	450.00	
General provision for bad debt	975.00	
Specific provision for bad debt	1,725.00	
Fine for traffic offence	1,800.00	
Estimate income tax	2,550.00	50,250.00
Net-Profit		152,250.00

The following addition information was also made available:

1. It was discovered that the accountant omitted the following expenses in the books of account:

		N
(i)	Motor repair expenses	1,875.00
(ii)	Bad debt on a customer's account	975.00
(iii)	Cost of installation of a new plant	4,125.00
		6975.00

2. The Motor vehicle on which repair was effected is also normally being for domestic purposes of the Director. The extent of such usage has been put at $^1/_3$.

You are required to compute the adjusted profit of Mal. Ahmad Ibrahim' JCB Enterprise, for the year ended 31st December, 2015.

4.0 SUMMARY

The unit has drawn attention to the computation of assessable profit of a trade or profession. Precisely, the following aspects have been dealt with:

- Income taxes in relation to a Trade or Profession
- The meaning of assessable profit
- Computation of assessable profit of a Trade or Profession

5.0 TUTOR-MARKED ASSIGNMENT

1. Explain the concept of income taxes as applicable to a Trade or Profession?

2. What do you understand by “Assessable Profit” in relation to a Trade or Profession?

3. How are profits determined in relation to a Trade/Profession?

4. Chief Otapiapia is an employee of OTEGBIKU UNIVERSITY. His consolidated pay is N934,096 per annum. He is married to 2 wives with a total of seven children. The first 3 children are from the first wife, while the remaining 4 children are from the second wife. Both wives live with Chief Otapiapia. The first son of Chief is a University graduate and works at NNPC Kaduna while the remaining children are undergraduates; 3 at Delta State University, Abraka, 1 at the University of Benin, while the remaining 2 are schooling at ABU, Zaria. Chief Otapiapia has a life assurance policy with NICON insurance Ltd. The sum assured is N250,000 and he pays a premium of N2,500 per month. He also contributes N1,000 monthly to the approved pension scheme under the National Pension Scheme. He also contributes N1,050 monthly for the National Housing Fund Contribution. The following information are also available:
   i. Chief Otota spends N13,000 on his aged parents. Both have no source of income due to old age.
   ii. Chief Otota is entitled to housing allowance of N181,831.00 per annum
   iii. His peculiar allowance is N595,570 per annum
   iv. He is entitled to excess workload of N540,000 per annum

Required: Compute the tax liability of Chief Otota for the relevant year of assessment.

6.0 REFERENCES/FURTHER READING

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MODULE 2 TAXATION OF SOLE TRADERS

UNIT 3: TAXABLE/NON-TAXABLE INCOMES AND ALLOWABLE/NON-ALLOWABLE EXPENSES

CONTENTS

1.0 INTRODUCTION

In order to determine the profits or gains arising from a sole proprietorship business for tax purpose, there is need for the computation of adjusted profit in respect of a defined period. This is done by considering statutory total incomes and deducting all allowable deductions. For an individual who is engaged in an activity to be referred to as a sole proprietor or trader, he must be operating a legal and registered business which is not in contravention of the law in any way.

Again, for a sole trader to be assessed to tax, he must have been in business for, at least, three years from the date of commencement.For the purpose of computing the tax liability of a trade, profession, individuals, expenses are classified as allowable and non-allowable deductions while incomes are classified as taxable and non-taxable incomes.

Accordingly, the Personal Income Tax Act (PITA) provides that before the income of a trade, profession, vocation or individuals could be subjected to tax, certain expenses should be deducted and incomes exempted from tax. These classes of expenses are referred to as allowable deductions. Whereas, other expenses classified as non-allowable deductions are by the provisions of the Act not allowed to be deducted.

On the other hand, there are incomes that are taxable while some are non-taxable. However, this unit will expose readers to taxable/non-taxable incomes and allowable/non-allowable expenses in relation to a trade, profession, vocation or individuals.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- Identify allowable and non-allowable expenses
- Categorize taxable and non-taxable incomes

3.0 MAIN CONTENT

3.1 Allowable and Non-Allowable Expenses

3.1.1 Allowable Expenses

PITA provides that all outgoings and expenses wholly, exclusively, necessarily and reasonably incurred during that period and ultimately borne by the business of individuals in the production of their income are deductible in the process of determining the assessable income or profit to be used for tax purposes.

These deductions include the following:

(a) Interest on loan – any interest on money borrowed and employed as capital in acquiring the income;

(b) Rent & rates - this should be in respect of the land & building occupied for the purpose of an individual's business;

(c) Repairs and maintenance of any asset employed in the business;

(d) Provision for doubtful debts of a specific nature;

(e) Bad debts written off;

(f) Contribution to a pension scheme approved by the Joint Tax Board (JTB);

(g) Legal expenses that are limited to:
   (i) general legal advisory services;
   (ii) retainership fees;
   (iii) renewal of a short lease- that is, lease with tenure of not more than 50 years;
   (iv) any cost of protecting and defending the properties of the business.

(h) Any other expense proved by the board to have been incurred for the purpose of the individual's business.

3.1.2 Non-Allowable Expenses

PITA also provides that the following items shall not be allowed as deductions for the purpose of ascertaining the income of an individual.

(a) Private/personal expenses;

(b) Capital expenditure or withdrawal of capital;

(c) Any loss or expenses recoverable under insurance or contract of indemnity;

(d) Rent and cost of repairs to any premises or part of premises not incurred for the purpose of producing the income;

(e) Taxes on income or profits levied in Nigeria or elsewhere except as provided in section 13 of PITA;

(f) Any unapproved payment to a pension scheme, provident, savings or widows society/orphanages, or any other fund or scheme- except as permitted by paragraphs (f) and (g) of subsection 20 of PITA;

(g) Depreciation of any asset;

(h) Any sum reserved out of profits except there is an expression permission of section 20 of the PITA;

(i) Any provision for doubtful debt of a general nature;

(j) Any payment of management fees except with the approval of the commission;

(k) Legal expenses that include:
    (i) the cost of defending a traffic offence

    (ii) acquisition of new lease – long or short

(l) Donations- however, some donations are allowed under CITA;

(m) Fines and penalties.

SELF-ASSESSMENT EXERCISE 1

1. What are allowable and non-allowable expenses?
2. List some of the allowable and non-allowable expenses known to you?

3.2 Taxable and Non-Taxable Incomes

3.2.1 Taxable Incomes

Taxable income of a trade, profession, business or individual for a tax year is that person's gross income less:

a. Items of income specifically excluded;

b. The amount of deductions allowed; and

c. The amount of personal allowances granted to the taxpayer and dependents

- **Gross Income:** This is the aggregate of economic benefits the taxpayer derives during a tax year. These include:

  (i) Earnings from employment, including benefits received in the form of non-cash property;

  (ii) Income from business, profession, vocation, trade or proprietorship

  (iii) Interest, rents, royalties, and dividends

  (iv) Payments received under a pension, retirement, or annuity arrangement;

  (v) Distributions from a trust or an estate,

  (vi) Gains on the disposition of a property (whether real or personal, tangible or intangible) used in a business or held for investment, but not gains from the sale of property held for personal use unless the amount derived from the sale.

3.2.2 Non-Taxable Incomes

The non-taxable incomes comprised of the following:

a) Any profit on the disposal of an investment

b) Any profit on the disposal of a fixed asset

c) Any reversal with income of a previously disallowed expense e.g. depreciation and general provision for doubtful debt.

SELF-ASSESSMENT EXERCISE 2

1. What are taxable and non-taxable incomes?
2. List some of the taxable and non-taxable incomes expenses known to you?

4.0 SUMMARY

The unit has drawn attention to the allowable/allowable expenses as well as taxable and non-taxable incomes in relation to a trade, profession, vocation or business. Precisely, the following aspects have been dealt with:

- Allowable and non-allowable expenses
- Taxable and non-taxable incomes

5.0 TUTOR-MARKED ASSIGNMENT

1. What are taxable/non-taxable incomes as well as allowable/non-allowable expenses?

2. List some of the taxable and non-taxable incomes known to you?

3. Identify some of the allowable and non-allowable expenses known to you?

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

David, K.E. (2012). *The tax manual: Principles and practice of taxation in Nigeria, (2nd ed.).*

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MODULE 2: TAXATION OF SOLE TRADERS

UNIT 4: DETERMINATION OF BASIS PERIOD FOR ASSESSMENT

1.0 INTRODUCTION

In practice, various governments and corporate entities usually have diverse accounting or fiscal period in which they prepare their accounts and as such, are deemed to pay tax on the income generated during the period to the respective tax authorities operating in that country. What defines the period in which these entities pay tax on income earned is the “Basis Period”.

Basis period is the period for which the taxpayer’s income is being assessed to tax. It is the period in any year of assessment in which income is being earned by an entity. In the case of an individual, the basis for assessing tax is dependent on the source of the income accruing to the individual while for companies; the basis for assessing tax is dependent on the accounting year end.

Accounting year end refers to the period for which the taxpayer or company has declared a profit or loss in its financial statements. It is worthy to note that for an entity’s accounting year to form a basis period in a year of assessment, that accounting year must be a normal accounting year. A normal accounting year is characterized by the following:

- It must be absolutely 12months
- It must begin instantaneously after the end of the prior accounting year. That is, there must be no gap between the accounting years.
- It must be the only accounting year ending in the year of assessment.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- explain what year of assessment means in relation to taxation;
- know the meaning and application of the concept of basis period;
- understand the rules on commencement of business;
- know the rights of election of taxpayers
- illustrate the rules on cessation of business; and
- explain the rules of change of accounting date.

3.0 MAIN CONTENT

3.1 Year of Assessment

Year of assessment denotes the financial year of an entity during which tax is levied. It is the fiscal year, more often than not, a period of one year, during which all income earners must pay tax. Since 1983, it has been 1st of January to 31st of December in the same year.

SELF-ASSESSMENT EXERCISE 1

What do you understand by the term "Year of Assessment"?

3.2 Meaning and application of the concept of basis period

Basis period of a corporate organization or body of persons is the accounting year of the organization or body. It is that period for which the taxpayer's income is being assessed to tax. Note that Preceding Year Basis (PYB) would only be germane if it is an old established business. However, in a scenario where we have a company commencing a new trade, or having a change of her accounting year or in situations of cessation of trade, the Nigerian tax law has made certain provisions. These provisions will be explained as we proceed with the other part of this unit.

SELF-ASSESSMENT EXERCISE 2

In your own view, what does basis period imply for corporate entities and individuals?

3.3 Rules for commencement of new trade

The method for assessing a business that is just commencing is as follows:

1) **First Assessment Year:** The basis period of assessment in the first year of assessment is usually from the actual date the business commenced to 31st December following, that is, to the end of the first assessment year.

2) **Second Assessment Year:** The basis period for the second year is the first twelve (12) months of trading.

3) **Third Assessment Year:** The preceding year basis (PYB) of assessment commences from the third tax year. In a scenario where this cannot be attained, the second tax year basis period will be repeated for the third year.

Illustration 1

Drake Nigeria Plc. commenced business on the 2nd of October 2009 and the directors are considering choosing 31st March or 31st December as year-end. Based on the information provided, appraise the tax implication of choosing either of the dates as year-end.

Suggested Solution

Tax Year	**Basis Period**	
	31st March	31st December
2009	2/10/09 – 31/12/09	2/10/09 – 31/12/09
2010	2/10/09 – 30/09/10	2/10/09 – 30/09/10
2011	2/10/09 – 30/09/10	1/01/10 – 31/12/10

Based on the PYB, for 2011 tax year, the basis period under the March year end would have been 1/4/09 – 31/3/10. Consequently, Drake Nigeria Plc. has not commenced business as at 1st April, 2009. Thus, the basis period for the second is repeated in the third year.

3.3.1 Rights of election

Section 24(d) of the Personal Income Tax Act CAP P8 LFN 2004, makes provisions for right of election by a taxpayer. However, before any taxpayer can exercise this right, such a taxpayer must have given notice in writing to the relevant tax authority within two (2) years after the end of the second tax year to allow him use actual profits for the second and third years.

SELF-ASSESSMENT EXERCISE 3

1. In your own view, what is the implication of basis period for corporate entities and individuals?

2. Chelsea football club commenced business on the 1st of May 2007 and the board of directors are considering choosing 31st October or 31st December as year-end. What is the tax implication of choosing either of the dates as year-end?

3. What are the provisions of the Personal Income Tax Act for provisions for right of election by a taxpayer?

3.4 Rules of Business Cessation

There are cases where organizations may want to liquidate or go out of business. Such scenario is referred to as “cessation of trade or business”. There are rules on cessation of trade. Cessation rule pertains to a situation where a business ceases to operate. When this scenario manifests, the final year (i.e. the year which the business ceases to exist) which is referred to as the ‘ultimate year’ is first ascertained.

In order to determine the penultimate year (the year before the cessation year) for the basis of assessment, the preceding year basis approach is adopted. However, the tax authority could choose the actual basis if it would result in a higher tax than when using preceding year basis.

Ultimate year (final year) is the first day of the year to the last day of the same year in which the organization completely ceased to engage in business. Penultimate year as mentioned earlier is the year immediately before the year in which a business ceases to exist. For the basis of assessment by the relevant tax authority, the basis period that produces the higher assessable profit shall be the choice of the tax authority. Thus, the tax authority may adopt either actual or preceding year basis.
There is also a situation where organizations or businesses have completely ceased to trade; but there might still be further receipts or payments after that date of cessation. Such receipts or payments are classified as “Post-Cessation Transactions”. It is worthy to state that such receipts or payments are to be adjusted for when ascertaining the last accounting or assessable profit of the organization.

SELF-ASSESSMENT EXERCISE 4

1. What do you understand by ultimate and penultimate years?

2. Highlight the rules on cessation of trade known to you?

3.5 Rules of Change of Accounting Date

Section 23(3) of the Personal Income Tax Act Cap P8 LFN 2004, expressly set out the rules governing change of accounting date or accounting year end. The rules governing change of accounting date include:

a) identify the year in which the business fails to make up its accounts to the prior year date. The two years that follow must also be identified.

b) compute the assessment of the first, second and third years using the old accounting date as the basis period.

c) compute the assessments for the three tax years using the new accounting date.

d) the aggregate result obtained using the old accounting date is now compared with the aggregate result obtained using the new accounting date.

e) The relevant tax authority would choose the higher of the two aggregates.

Organizations that change their accounting date/year, must have prepared their accounting year using the new date for a period not less than three years after the departure from the old date. It is worthy to state that there is no legal provision for temporary change of date; thus, organizations who in one accounting year fail to prepare their accounts to the usual/conventional year-end; and immediately revert to the old order after the passage of that year end; the relevant tax authority will however assume that such a departure or change never ensued.

SELF-ASSESSMENT EXERCISE 5

State the rules governing change of accounting dates or year for an organization?

4.0 SUMMARY

The unit has drawn attention to the determination of basis period for assessment in Nigeria. Precisely, the following aspects have been dealt with:

- Year of assessment means in relation to taxation;
- The meaning and application of the concept of basis period;
- The rules on commencement of business;
- The rights of election of taxpayers
- The rules on cessation of business; and
- The rules of change of accounting date.

5.0 TUTOR-MARKED ASSIGNMENT

1. Define the term "Year of Assessment" and what does basis period imply for corporate entities and individuals?

2. Chelsea football club commenced business on the 1st of June 2008 and the board of directors are considering choosing 31st October or 31st December as year-end. What is the tax implication of choosing either of the dates as year-end?

3. Manchester United commenced business on 1 June 2007 as a sole proprietor. He wants to be compliant with tax laws since he has plans to form a limited liability company in future. You are required to determine his basis periods for the years of assessment 2007, 2008, 2009, and 2010.

4. What are the provisions of the Act regarding the right of election by a taxpayer, rules on cessation and change of accounting date?

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

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MODULE 2: TAXATION OF SOLE TRADERS

UNIT 5: CAPITAL ALLOWANCE COMPUTATION

CONTENTS

1.0 INTRODUCTION

In Nigeria, the Company Income Tax Act (CITA) dealt with capital allowances provisions and it is also alike to that of Personal Income Tax Act (PITA) as it relates to individuals. In this regards, an understanding of capital allowance provisions in personal income taxation can be expediently and effectively applied to companies' taxation because the rules of computing capital allowance are the same for both company and personal taxations. In this unit, background knowledge of the concept was provided with the general rules for computing capital allowances in line with the applicable provisions of the Nigerian Tax Act.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know the meaning and purposes of capital allowance
- identify the types of capital allowances
- explain the types of qualifying capital expenditure
- state the conditions for granting capital allowance
- illustrate balancing adjustments on disposal of qualifying capital expenditures
- know the capital allowance rates and restrictions

3.0 MAIN CONTENT

3.1 Meaning and Purposes of Capital Allowance

Capital allowance is an allowance granted to an entity or taxpayer for incurring and using qualifying capital expenditure during a year of assessment for the purpose of deriving its income. It is granted in place of depreciation charges, which are disallowed by the provisions of the Nigerian income tax law in arriving at the assessable income of the entity or taxpayer.

Capital allowances are forms of normalized depreciation granted on certain specified qualifying capital expenditure under the Nigerian tax laws. The granting of capital allowance is designed to encourage taxpayers who engage in other businesses that will develop, modernize and equip their primary businesses. Capital allowance is deducted from the assessable profit of an entity and the amount deductible in any tax year is restricted to $66^{2/3}\%$ of assessable profit. The leftover is then carried forward to subsequent years for the foreseeable future. Capital allowance is not only applicable to entities engaged in agricultural or manufacturing businesses but to all class of businesses.

SELF-ASSESSMENT EXERCISE 1

In your own view what is capital allowance and of what purposes is capital allowance granted?

3.2 Types of Capital Allowances

Basically, there are three (3) types of capital allowances namely initial allowance, annual allowance and investment allowance. However, there is another fourth components of capital allowance which is referred to as balancing charge and balancing allowance. The three types of capital allowances are discussed below:

3.2.1 Initial Allowance

Initial allowance is one of the types of capital allowances which may be claimed once and in the year when the qualifying capital expenditure is first put to use. It can be granted on second hand assets, excluding second hand buildings. Also, it can only be prorated or apportioned if there is an element of private use. Thus the amount of initial allowance can be split between business and private use only.

In respect of qualifying expenditure on plant and machinery for the replacement of old ones, one-off 95% capital allowance in the first year shall be granted. The 5% book value shall be retained until the final disposal of the asset. The aggregate capital allowances granted in respect of any asset shall not exceed 95% of the total cost of the asset as provided by the Nigerian income tax law.

3.4.2 Annual Allowance

This allowance is claimable over the estimated useful life of the qualifying asset on a yearly basis. This is usually computed on the balance of cost after the deduction of the amount of initial allowance claimed on the qualifying capital expenditure or asset. For subsequent years, annual allowance is arrived at by dividing the Tax Written Down Value (TWDV) of the asset by the unexpired life. TWDV is cost minus initial allowance and annual allowance of the asset.

In order to arrive at the annual allowance, it is computed by dividing the difference between the cost of the asset and the initial allowance by the estimate useful life of the asset, provided that an amount of ₦10 retained in the account for tax purposes until the asset is finally disposed. In recent times, some practitioners have argued that the residual value of ₦10 should be deducted and retained in the books in the last year of assessment.

Annual allowance is computed on a straight-line basis. It is not prorated based on the date the asset was acquired but based on the number of months making up the basis period for profit, which is usually the first year the taxpayer commenced business or trade. The formula for arriving at annual allowance is given as:

First Year: $\dfrac{\text{Cost – Initial Allowance (IA)}}{\text{Useful of Life of the Asset}}$

First Year (pro-rated): $\dfrac{\text{Cost –IA}}{\text{Useful of Life of the Asset}} \times \dfrac{\text{No. of months for basis period}}{12}$

Subsequent Year(s): $\dfrac{\text{Tax Written Down Value (TWDV)}}{\text{Unexpired Useful Life of the Asset}}$

Final year(s): $\dfrac{\text{TWDV – 10 x Number of Assets}}{1}$

Illustration 1

Celine commenced trade on May 2010 and acquired a motor vehicle at a cost of N1,000,000. Assuming that the rate of initial allowance is 25% and that of annual allowance is 20%. You are required to compute the capital allowance claimable up to 2012 tax year.

Suggested Solution

	₦
2010 tax year cost ₦1,000,000	
Initial Allowance (I.A) (25%) (250,000)	250,000

Annual Allowance (A.A) (20%) $\frac{(1,000,000 - 250,000)}{5}$

(For 8 months) = $\frac{8}{12}$ x 150,000 = (100,000) 100,000

350000

2011 TWDV(1,000,000-350,000)

Annual Allowance (12 months i.e. 12/8 x N100,000) 150000

2012 TWDV 5,000,000

A.A (12 months) 150,000

3.4.3 Investment Allowance

There is also investment allowance claimable on qualifying expenditure incurred on plant and machinery, tools, equipment, etc. at the rate of 10%. It is usually granted once in the life of an asset and must be in the year the asset was first put into use for the purpose of the business or trade.

The provisions of CITA relating to initial allowance also apply to investment allowance except that an investment allowance is not to be deducted from cost of the assets in arriving at the residue of qualifying expenditure. Also, when a company incurs capital expenditure on electricity, tarred road, investment allowance will be claimable as follows:

i. provision of electricity, water and tarred road will be 100% of amount incurred;
ii. provision of electricity only 50% of the amount incurred;
iii. provision of water only 30% of the amount incurred; and
iv. provision of tarred road only 15% of the amount incurred.

In line with the provision of the Nigerian tax law, investment allowance cannot be claimed, or if already granted, shall be withdrawn if any of the following conditions hold within a period of five years from the date of acquisition of the assets:

(a) any sale or transfer of the asset otherwise than to a person acquiring the asset for a chargeable purpose or for scrap;
(b) any appropriation of the asset to a purpose other than a chargeable purpose;
(c) any sale or transfer or other dealing with the asset being a case where it appears:
    - that the purpose of obtaining tax allowances was the sole or main purpose of the company for incurring the expenditure or for so dealing with the asset; or
    - that the incurring of the expenditure and the asset being so dealt with, were not *bona fide* business transactions, or were artificial or fictitious transactions, and were designed for the purpose of obtaining tax allowances.

Illustration 2

Assuming a qualifying capital expenditure for Jitos Company Plc in the class of plant and machinery is acquired for ₦5,000,000. What is the investment allowance that will be granted by the relevant tax authority to Jitos who acquired the asset?

Suggested Solution

The investment allowance on such plant and machinery is =
(10% x ₦5,000,000) = ₦500,000

SELF-ASSESSMENT EXERCISE 2

1. List and briefly explain the types of capital allowance known to you?

3.3 Types of Qualifying Capital Expenditures

Qualifying capital expenditure means capital expenditure incurred in a basis period. In the Nigerian tax law, qualifying capital expenditure are claimable on the following:

(a) **Buildings expenditures:** These are usually referred to as qualifying building expenditure. They take the form of industrial non-industrial building. Industrial building expenditure include structures or works of a permanent nature (e.g. warehouse, dock, port, jetty, wharf etc) while non-industrial building expenditure include structures of permanent nature other than industrial building (e.g. office complex);

(b) **Plant, machinery, fixtures and fittings**: They are usually referred to as qualifying plant expenditure;

(a) **Public transportation motor vehicles**: They are expenditure incurred on vehicles and fleet of buses not less than three used for public transportation;

(d) **Agricultural plant**: They refer to qualifying agricultural expenditure incurred on plant used in agricultural business ranging from tractors, and other farming equipment;

(b) **Research and development expenditure**: This refer to qualifying research and development expenditures incurred on equipment and facilities, patents license, secret formula, product testing, market testing and other costs not traceable to the existence of any assets;

(c) **Mining:** This refers to qualifying mining expenditure incurred in tandem with a mine, oil well, gas well, quarry or other source of mineral deposit of a wasting nature;

(h) **Ranching and plantation**: This refers to qualifying ranching and plantation expenditure incurred in tandem with a plantation and ranching and they take the form of initial seedlings and labour cost and any construction works or buildings which are likely to be of little help when the plantation is no longer working.

(i) There are also qualifying capital expenditure for housing estate, construction and manufacturing industrial plants.

Note that any expenditure which is an allowable deduction in computing profits of the company's trade or business in accordance with the provision of CITA, shall not be treated as qualifying expenditure.

SELF-ASSESSMENT EXERCISE 3

1. In the Nigerian tax law, qualifying capital expenditure are claimable on certain items. List and briefly explain five (5).

3.4 Conditions for Granting Capital Allowances

The following conditions have to be satisfied in order for a taxpayer to qualify for capital allowances:

(i) The ownership of the asset should not be in dispute;

(ii) The qualifying capital expenditure must be owned by the taxpayer as at the end of the basis period. Thus, an asset obtained via hire-purchase agreement can be subjected to capital allowance claim.

(iii) The capital allowances must be claimed for by the taxpayer apart from where the relevant tax authority is of the view that it is just and rational to grant allowance without a claim.

(iv) The expenditure must be used for the purpose of the trade or business.

(v) The qualifying capital expenditure must be incurred in the basis period.

(vi) The taxpayer who is the claimant must incur qualifying capital expenditure as defined in the tax laws.

(vi) The tax authority will demand a certificate of acceptance for all the qualifying capital expenditures incurred in any year of assessment in excess of ₦500,000. In practice, the certificate of acceptance is usually issued by the Inspectorate Department of the Federal Ministry of Commerce and Industries in Nigeria.

(vii) Where the basis period for any year of assessment is a period less than one year, for instance, when the commencement provisions are being applied, the annual allowance for that assessment year shall be proportionately reduced.

(viii) Unutilized allowances in the year of permanent cessation of a trade or business carried on by an entity shall be available for relief against the remainder of its assessable profits for the preceding year of assessment and so on for other preceding years up to the fifty year before the year of permanent cessation.

(ix) Where a relief is to be given to a company after the assessment has become final and conclusive in respect of any assessment year, the Revenue Service may make such repayment or set-off of the tax, or any part of such tax, paid or charged for that year as may be appropriate, in lieu of making the deduction for the amount of the relief.

(x) The residue of expenditure is the total qualifying expenditure incurred less of any initial and annual allowances granted to date. Note that investment allowance should not be deducted from qualifying expenditure to arrive at the residue.

SELF-ASSESSMENT EXERCISE 4

State five (5) conditions for granting capital allowance?

3.5 Balancing Adjustments on Disposal of Qualifying Capital Expenditures

Balancing charge or adjustments is one of the elements of balancing adjustment, which is gotten when an asset is disposed of. Practically, it may occur where the sales proceeds exceed the tax written down value at the time of disposal. It is also regarded as an additional taxable income chargeable to tax. Consequently, the maximum amount taxable should not exceed the total capital allowance that will be claimed on the asset before the disposal of such asset.

Balancing allowance arises where proceed from sale on disposal of qualifying capital expenditure is less than the tax written down value of the asset. In this manner, it may be seen as an extra annual allowance as it decreases tax liability for the taxpayer. A balancing allowance can only be made if immediately prior to the disposal of the asset, the owner puts the asset in use by the trade or business for the purpose of which the qualifying expenditure was incurred.

Illustration 3

Given that an asset with a tax written down value of ₦487,500 is sold for ₦600,000. Compute the balancing charge.

Suggested Solution

	₦
TWDV	487,500
Sales proceeds	600,000
Balancing charge	112,500

Illustration 4

Jefferson Nigeria Limited commenced a retail trade business on 1 October 2007 and makes up accounts to 30 September of every year. The following qualifying capital expenditure on plant and machinery were incurred:

Date	Amount
	₦
1/01/07	260,000
1/11/07	267,500
1/4/08	362,500

Required:
Calculate capital allowances for the relevant years of assessment

Suggested Solution

Jefferson Nigeria Limited
Computation of capital allowances for the relevant years of assessment

The annual allowance (A.A) for the first year of assessment will be as follows:
Basis period for capital allowance purposes is the period
1/10/07 to 31/12/07

	₦	
Total qualifying expenditure during that period	527,500	
Less Initial Allowance (I.A.) at 50%	263,750	
Balance of cost after initial allowance	263,750	
Investment Allowance is also due, since the item is capital in nature (i.e. plant and machinery):		₦
Investment Allowance at 10% of ₦527,500		52,750
Annual allowance:		
For a full year at 25% of ₦263,750		65,938
But restricted to 3/12 x ₦65,938, in view of number of months in the basis period being less than twelve.	16,485	
Residue of expenditure c/f to the second year of assessment	247,265	

SELF-ASSESSMENT EXERCISE 5

1. Differentiate between balancing charge or adjustment and balancing allowance?

3.6 Capital Allowance Rates and Restriction

3.6.1 Capital Allowance Rates

The following are the capital allowances rates as applicable in Nigeria.

Qualifying Expenditure	Initial Rate(%)	Annual Rate(%)
Non-Industrial Building	15	10
Industrial Building	15	10
Mining	95	Nil
Plant: Agricultural Production	95	Nil
Other Plant and Machinery	50	25
Furniture and fittings	25	20
Motor vehicle, others	50	25
Public transportation	95	Nil
Plantation equipment	95	Nil
Housing Estate	50	25
Ranching and Plantation expenditure	30	50
Research and Development expenditure	95	Nil

Note that a company engaged in gas utilization (downstream operations) shall be granted accelerated capital allowances after the tax-free period of three years, as follows:

(i) an annual allowance of 90% with 10% retention for investment in plant and machinery;

(ii) an extra investment allowance of 15% which shall not reduce the value of the asset.

3.6.2 Restrictions on Capital Allowance Claimable

The 1985 Financial (Miscellaneous Taxation Provisions) Act in Nigeria established the restrictions or limits of an amount of capital allowance claimable in the year of assessment. This amount is limited or restricted to $66^{2/}3$% of assessable profit for non-manufacturing and non-agricultural companies.

SELF-ASSESSMENT EXERCISE 6

1. Articulate the capital allowance rates on the basis of Initial and Annual Rates?

2. State the restrictions on capital allowance claimable?

5.0 SUMMARY

This unit provides an introduction to the concept of capital allowance. More specifically, the following issues were covered:

- The meaning and purposes of capital allowance
- The conditions for granting capital allowance
- Qualifying capital expenditure
- The types of capital allowances

- The capital allowance rates and restrictions

6.0 TUTOR-MARKED ASSIGNMENT

1. What is capital allowance and of what purposes are they granted?
2. State at least five (5) conditions for granting capital allowance?
3. List and briefly explain five (5) qualifying capital expenditure claimable.
4. Henry Nigeria Plc. commenced a business on 1 October 2008 and makes up accounts to 30 September of every year. The following qualifying capital expenditure on plant and machinery were incurred: **Date**
   Amount

	₦
1/01/08	5,200,000
1/11/08	5,350,000
1/04/09	7,250,000

Required: Calculate capital allowances for the relevant years of assessment

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MODULE 2: TAXATION OF SOLE TRADERS

UNIT 6: LOSS RELIEF

CONTENTS

1.0 INTRODUCTION

Practically, for one to arrive at the chargeable income of taxpayers, reliefs and allowances, where granted, are matched with their statutory total income. Statutory total income here refers to the addition of both the earned and unearned incomes of an individual or that of corporate entities in Nigeria.

Reliefs and allowances are meant to reduce the tax burden on the taxpayers so as to enable them recoup losses incurred in a particular year of assessment from subsequent year's profits. However, in contrast to what is obtained in personal income tax, there is no current year loss relief available to corporate entities. That which is available to them are the reliefs carried forward. In this unit therefore, the meaning of loss relief, types of reliefs and their treatments as well as treatments of loses under commencement and cessation of business shall be covered.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know the meaning of loss relief
- understand types of loss reliefs and their treatments
- treat losses under commencement and cessation of trade
- know the limitations and priority of relief

3.0 MAIN CONTENT

3.2 Loss Relief

In the Nigerian income tax law, loss relief is a provision that allow taxpayers to recover or get back losses incurred in a particular year of assessment from subsequent year's profit. The purpose of this is to ensure that trade, vocation, professions or individuals do not pay taxes on their capital. Reliefs also help trades, vocations, professions or individuals to have cash available for the efficient and effective operation of their businesses and to become profitable in the subsequent year in which the losses were recouped, likewise corporate entities.

Basically, the provisions of the relevant tax laws on loss reliefs include:

(i) The amount of the loss to be allowed should be that which the Revenue Service is satisfied as having been incurred by the business or trade during a preceding year of assessment. It is worthy to note that current year relief is not available for losses incurred by companies;

(ii) In no circumstance shall the amount to be relieved exceed the total amount of the loss;

(iii) Relief can only be made against profits from the same trade or business in which the loss was incurred;

(iv) Losses can be carried forward for a maximum of four (4) years following that in which they were incurred. Losses incurred by any company engaged in agricultural trade or business can be carried forward with no time limit; and

(v) The loss available for relief should be computed on the same basis as that of assessable profit for a year of assessment.

SELF-ASSESSMENT EXERCISE 1

1. Explain in details, loss relief and the provisions of the relevant tax laws on loss reliefs?

3.2 Types of Loss Reliefs and their Treatments

In accordance with the Nigerian income tax laws, the following are the underlying principles and types of loss reliefs for a business or trade:

- Effective Loss Relief,
- Current Year Loss Relief; and
- Carry Forward Loss Relief.

3.2.1 Effective Loss Relief

As stated earlier on, there are certain underlying principles for relieving losses in accordance with the Nigerian tax law. They include effective loss relief, current year loss relief and carry forward loss relief. The other two are discussed in subsequent part of this unit.

The effective loss relief principles holds that where a loss is taken into cognizance in the determination of assessable profit in any year of assessment, such loss is deemed to be effectively relieved to the extent of the profit available.

3.2.2 Current Year Loss Relief

The current year loss relief principle allows losses to be relieved against prior year profit. The current year loss would be relieved from all sources of income accruing to the taxpayer. Note that current year loss relief is available only to individuals that apply in writing to the relevant tax authority within 12months after the year of assessment in which the loss was incurred.

3.2.3 Carry Forward Loss Relief

The carry forward loss relief principle allows losses to be carried forward to subsequent years and relieved only from the profit of the same source in which the loss was incurred. This means that any portion of current year's loss that is not fully relieved would be carried forward. Companies and individual taxpayers are allowed to use carry forward loss relief without any writing to the relevant tax authority.

There are loss relief for individuals and that of companies. First, individuals are permissible by the Nigerian tax law to use both current year and carry forward loss relief methods based on the following fundamental conventions:

- Losses are relieved on current year or actual year basis. The implication is that a loss incurred in a year let's say 30th November 2015 would be relieved in 2015 tax year. In principle, the loss incurred in 2015 is being relieved against the profit of the financial year ending in 2014 which is assessed to tax in 2015 tax year on preceding year basis;

- Losses incurred by an individual can be relieved from income from all other sources accruing to the individual in that year of assessment;

- Where a loss is not completely relieved on current year, the unrelieved portion becomes a carry forward and can only be relieved subsequently from the same source the loss was incurred;

- Loss incurred from property letting business or trade is not allowed to be relieved on current year basis; and

- Individuals other than those engaged in agriculture business can carry forward loss up to four (4) years of assessment. Any unrelieved portion after the fourth year becomes lapsed.

For personal income tax, there are personal allowance, disabled person allowance, wife allowance, children allowance, dependent relative allowance, life assurance allowance, donations to research and development companies, equity participation in research and development company and general charges. Although with the amendment of PITA in 2011, practitioners have argued that the introduction of the consolidated relief allowance repealed the above allowances regarding personal income tax. However, it is pertinent to note that since the Personal Income Tax (Amendment) Act did not expressly or specifically address the above issue, by being silent on the matter, other practitioners have also argued that the 2011 amendment to PITA did not repeal the personal allowance, disabled person allowance, children allowance, dependent relative allowance etc.

(a) Personal Allowance

This is granted to every taxpayer who earns income irrespective of his/her age. The allowance is calculated on earned income and is granted to both residents and non-residents. Beginning from 1990 tax year, the following stood out:

(i) between 1990 and 1997, the allowance was 2,000 plus 15% of earned income.
(ii) between 1992 and 1997, the allowance increased to 3,000 plus 15% of earned income.
(iii) with effect from 1998 to date, the allowance is 5,000 plus 20% of earned income.

(b) Disable Person Allowance

Disabled person allowance is an allowance granted to a taxpayer who is incapacitated with special equipment and services of an attendant in the course of his paid occupation. Such allowance is in addition to his/her personal allowance. Prior to 1998 tax year, disabled person allowance was the lower of 2,000 or 10% of income earned but with effect from 1998, it was further increased to higher of 3,000 and 20% of earned income.

(c) Wife Allowance

This is an allowance given to every married man up to 1991 assessment year. However, with effect from 1992, it was abolished as a result of discrimination amongst women.

(d) Children Allowance

Children allowance is granted to any taxpayer who on the first day of the preceding year maintained a natural offspring or an adopted child. There are several conditions for claiming children allowances and they include:

(i) the number of children shall not exceed four (4);
(ii) the child shall be maintained by the individual in the preceding year of assessment;
(iii) the child shall be less than 16years of age on the first day of the preceding year;

(iv) if the child is more than 16years of age, the allowance can still be granted, if the child is still receiving full time instruction in a recognized educational institution or was under indenture (i.e. bond or contract) in a trade or profession;
(v) no deduction shall be granted in respect of a married child whatever his/her age may be;
(vi) no extra allowance shall be granted to a husband and his wife in respect of the same set of children;
(vii) where the cost of maintaining a child is shared between two or more persons, the tax authority reserves the right to apportion the allowance between those persons; and
(viii) a widow who re-marries, can still claim the full allowance in respect of the children of the deceased husband, up to a maximum of four.

With respect to the above, the permissible allowances are as follows:

- Before 1987 tax year, it was ₦250 per child for each year.
- Between 1987 and 1991, it was ₦400 per child for each year.
- Between 1992 and 1994 tax year, it increased to ₦500 per child for each year;
- In 1995, it was ₦1,000 per child for each year;
- Between 1996 and 1997, it increased to ₦1,500 per child for each year.; and
- With effect from 1998 to date, it increased to ₦2,500 per child for each year.

(e) Dependent Relative Allowance

For dependent relative allowance, it shall be granted under the following condition(s):
(i) the relative must be the widowed mother of the individual's spouse or he must be a close relative of the individual or his spouse who is incapacitated by old age or infirmity and thus incapable of self-maintenance;
(ii) the income of the dependant in the preceding tax year must not be more than the amount of the allowance;
(iii) where two or more persons maintain a relative, the amount of allowance shall be apportioned between them in promotion to the sum incurred; and
(iv) a husband and his wife can claim dependant relative allowance where each maintains separate relatives.

It is worthy to mention that the amount of allowance claimable for dependant relative is equal to:

- Before 1987 tax year - ₦400 per year;
- Between 1987 and 1994 tax year - ₦600 per year;
- Between 1995 and 1997 – ₦1,000 per year; and
- From 1998 to date – ₦2,000 per dependant for maximum of two dependants.

(f) Life Assurance Allowance

Life assurance allowance is granted in respect of life assurance premium paid by an individual during the preceding year of assessment for himself or for his spouse. The amount that can be claimed is subject to the following:

(i) Up to 1991 tax year, it is the lower of premium paid, 205% of net statutory total income, 10% of capital sum assured and overriding limit of ₦2,000;

(ii) Between 1992 and 1995, it was the lower of 10% of total income, premium paid and overriding limit of₦5,000; and

(iii) With effect from 1996, the allowance is the actual amount of premium paid.

Note that the above allowances include any contribution made to an approved pension, provident or other retirement benefit schemes or funds.

(g) Donations to Research and Development Companies

Donations to research and development companies with effect from January 1st 1987 are allowed relief. The amount claimable is the lower of:

- Actual amount of donation; and
- 10% of the taxpayer's chargeable income.

(h) Equity Participation in Research and Development Company

Equity participation in research and development with effect from 1987 is allowed to be claimed as relief, the amount of equity holding in a company floated exclusively for research purposes OR 25% of total income whichever is lower. Where such amount cannot be fully relieved in a year, the unrelieved amount can be carried over to subsequent years until such amount is fully relieved.

There are several conditions before granting relief to taxpayer in respect of equity participation in research and development. They include:

- The company must be a Nigerian company incorporated on or after January 1st 1987;
- The main objective of the company must be to carry out the business of research and development; and
- Research projects must commence within two months after the incorporation of the company.

(i) General Charges

General charges are charges that do not relate to any income but allowed as deductions in arriving at the chargeable income of an individual taxpayer.

The charges comprise of the following:

(i) Professional subscription (e.g. ICAN, ANAN);

(ii) Mortgage loan interest i.e. annual interest on loan for an owner-occupier residential house; and

(iii) Alimony payment made by a husband to his divorced wife. The amount is ₦300 and is unaffected by the abolition of wife allowance.

SELF-ASSESSMENT EXERCISE 2

1. State the various provisions for loss relief for individuals and companies?

2. What are the underlying principles for relieving losses incurred by a business or trade?

3. Briefly explain: personal allowance, disabled person allowance, wife allowance, children allowance dependent relative allowance, life assurance allowance, donations to research and development companies, equity participation in research and development company and general charges.

3.3 Treatments of Losses under Commencement/Cessation of Business

Illustration I: Effective Loss Relief

XYZ commenced business on May 1st 2009 and prepares it accounts for September every year. During the year ended 30/9/2009, there was a loss of ₦400,000 while the results for the year ended 30/9/2010, revealed a profit of ₦500,000. Compute the loss relief.

Suggested Solution

XYZ

Computation of Loss Relief (using the Effective Loss Relief)

2009 tax year: 1/5/09 to 31/12/09 {(₦400,000) + 3/12*₦500,000}

Profit available	₦125,000
Loss	(₦400,000)
Loss c/f	(₦275,000)

2010 tax year: 1/5/09 to 30/4/10{(₦275,000) + 4/12*₦500,000}

Profit available	₦166,667
Loss b/f	(₦257,000)
Loss c/f	(₦90,333)

2011 tax year: 1/10/09 to 30/09

Profit	₦500,000
Loss b/f	(₦90,333)
	₦ 409,667

It is worthy to mention that there is restriction to actual loss and available profit as well. For restriction to actual loss, it implies that the aggregate deduction from assessable profit with respect to any loss shall not be more than the actual loss incurred.

Illustration 2: Restriction to Actual Loss

XYZ commenced business on May 1st 2009 and the result of its operations were for the year ended 30/04/2010, revealed a loss of ₦400,000, while the results for the year ended 30/04/2011, showed a profit of ₦300,000. Compute the restriction to actual loss.

Suggested Solution

XYZ
Computation of Loss Relief (Restriction to Actual Loss)

2009 tax year:	1/5/09 to 31/12/09	8/12 * (₦400,000)	
	Loss c/f		(₦266,667)
2010 tax year:	1/5/09 to 30/4/10		(₦400,000)
	Loss b/f		(₦266,667)
	Total Loss		(₦666,667)
	Restricted to actual loss c/f		(₦400,000)
2011 tax year:	1/05/10 to 30/04/11		₦300,000
	Unrelieved loss b/f		(₦400,000)
	Unrelieved loss c/f		(₦ 100,00)

For restriction to available profit, the principle demands that the aggregate deductions from assessable profit in a particular year of assessment with respect to any loss shall not be more than the profit available.

For instance, using the above illustration, the assessable profit available for 2011 tax year is ₦300,000 while the unrelieved loss brought forward is ₦400,000. The implication with respect to restriction to available profit is that the taxpayer can only relieve ₦300,000 in 2011 tax year and the balance of ₦100,000 carry forward to 2012 tax year.

SELF-ASSESSMENT EXERCISE 3

In your own view, what do you understand by effective loss relief and restriction to actual loss?

3.4 Limitation and Priority of Relief

In the Nigerian tax law, where commencement rule applies, losses accumulated may be greater than the actual loss incurred but it must be observed that losses cannot be relieved for an amount that is greater than the actual amount of loss.

In addition to the above, reliefs in respect of an earlier loss has a priority over a current year's loss. Usually, relief is given before the relief for capital allowance is taken into consideration.

Illustration 1

Emmanuella has the following financial records:

Year ended 31 December 2008 ₦1,250,000
Year ended 31 December 2009 ₦1,500,000 (loss)
Year ended 31 December 2010 ₦2,000,000

Required: Compute the assessable income stating how the loss would be relieved.

Suggested Solution

Emmanuella
Computation of Assessable Income

YOA	**Basis Period**		**Assessable Income**	
2009	1/1/08-31/12/08	=	1,250,000	₦
	Less: Current loss relief		(1,500,000)	
	Unrelieved loss c/f		(250,000)	Nil
2010	1/1/09 – 31/12/09	=	1,500,000(loss) Nil	
2011	1/1/10 – 31/12/10	=	2,000,000	
	Less: Unrelieved loss b/f		(250,000)	1,750,000
				1,750,000

SELF-ASSESSMENT EXERCISE 4

What do you understand by limitation and priority of relief?

5.0 SUMMARY

The unit highlighted loss relief as it pertains to a trade, profession, vocation or business in accordance with the Nigerian tax law. More specifically, the following areas were covered:

- The meaning of loss relief
- Types of loss reliefs and their treatments
- Treatment of losses under commencement and cessation of trade
- The limitations and priority of relief

6.0 TUTOR-MARKED ASSIGNMENT

1. What do you understand by loss of office and loss relief?

2. State the provisions for loss relief for individuals and companies?

3. What is the basic condition that must be fulfilled before current year's loss relief can be made available to individuals?

4. Highlight the underpinnings of the principle of effective loss relief.

7.0 REFERENCES/FURTHER READING

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MODULE 3 TAXATION OF PARTNERSHIP

UNIT 1: DETERMINATION OF COMPUTATION OF TAXABLE AND NON-TAXABLE INCOME OF A PARTNER

CONTENTS

1.0 INTRODUCTION

Under the Personal Income Tax Act 1993 (as amended), the income accruing from a partnership cannot be subjected to taxation, rather, it is the individuals making up the partnership that can be separately subjected to taxation. There are certain incomes that are taxable while there are some that are not taxable in a partnership business. The tax laws provide that such non-taxable incomes should be deducted before arriving at the chargeable income in a partnership. However, this unit explored the determination of computation of taxable and non-taxable income of a partner. The treatment of taxation in relationship to partnership is likened to that of a sole-trader.

It is worthy to note that the sources of partnership income comprised of salary paid to the partner, interest on capital and leave passages as agreed between the partners and the share of profit or loss at the agreed profit and loss ratio.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know the meaning of a partnership
- identify the types of partnership
- understand some core issues in partnership

- know the taxable and non-taxable incomes of a partner
- compute the taxable & non-taxable incomes of a partner

3.0 MAIN CONTENT

3.1 Meaning of a Partnership

Partnership was first enacted in the year 1890 by the Partnership Act However, the Act regulating limited partnership was first enacted in 1907. According to the Partnership Act, it is defined as the relation which subsists between persons carrying on a business in common with a view to profit. The activities and processes involved in a partnership are contained in the Partnership Agreement. It is worthy to note that there are cases where there is the absence of partnership agreement. In accounting, when there is the absence of partnership agreement, profits and losses are shared equally and a partner who contributed capital beyond the agreed amount will be paid 5% interest on the excess amount contributed to the partnership.

SELF-ASSESSMENT EXERCISE 1

1. What do you understand by a partnership?

3.2 Types of Partnership

Basically, partnership can be categorized into two namely: Active and Dormant or Sleeping Partners. A partner is said to be active if such partner engages his/herself in the day-to-day activities of the partnership but have his/her capital contributed in the partnership. On the other hand, a sleeping or dormant partner is one who does not partake in the day-to-day activities of the partnership but have his/her capital contributed in the partnership and shares from the losses or profits of such partnership.

SELF-ASSESSMENT EXERCISE 2

1. Differentiate between a Dormant and Active Partners

3.3 Some Core Issues in Partnership

3.3.1 Loss Relief

Partnership income is determined in similar way as that of a sole proprietor. Consequently, remuneration, interest on capital and cost of passages are allowed in the partnership account and taxed in the hands of the recipients in the same manner. The partnership income is arrived at after allowable deductions is apportioned to each of the partners in accordance with the agreed ratio.

In a circumstance where a partner incurs a loss as a result of the loss incurred by the partnership, such a loss is available for relief. Thus, loss relief is a way of assisting or alleviating a partner from harm of crashing out of business. More importantly, note that the commencement rule is applicable to a situation where a new partner is admitted into a partnership while the cessation rule is applicable in situations where a partner resigns or retires or in the case of death of a partner.

3.3.2 Amalgamation of a Partnership

Amalgamation of a partnership occurs when other partners are incorporated into the partnership business. In circumstances of amalgamation of two or more partners, there wouldn't be the need of applying the commencement or cessation rules. However, the qualifying capital expenditure is transferred to the new partner and is deemed to have been transferred at its tax written down value, thus there would be no computation of balancing adjustment (only annual allowance is claimable by such partner).

Where two or more partnerships amalgamate or merge to form a new partnership:

1. Determine the assessable profit of the different partnerships prior to the merger and amalgamation
2. Determine the share of profit of each of the partners in their profit and loss sharing ratio for the period he was a part of the old partnership i.e. up to the time of merger
3. Determine the share of capital allowance of each partner in the agreed profit and loss sharing ratio for the period he was a part of the old partnership i.e. up to the time of merger
4. Determine the partnership income of each of the partners by deducting the share of capital allowance from the share of profit
5. Compute the income derived from the merger or amalgamation based on No. 4
6. Add together, for a particular tax year, if the merger took place during a financial year, the partnership incomes for No. 4 and 5. Where the merger took place at the beginning of a new year, No. 6 will not be necessary.

3.3.3 Conversion of a Partnership

There are circumstances that may lead to the conversion of a partnership into a limited liability company. However, when this occurs, the cessation rule is applicable and the old partnership is deemed to have ceased business. In the same vein, the commencement rule is applicable to the new business. However, all the qualifying capital expenditure transferred are deemed transferred at the agreed values and there would be computation of balancing adjustment. In addition, while computing capital allowances on the assets transferred, initial allowance is not allowed and the capital allowance claimable would take into account, the duration of time the asset has been with the previous partners.

Illustration 1

Fred and Frederick (F&F) have been in partnership for many years now. The principal office of F&F is at Asaba in Delta State of Nigeria. Fred normally resides in Ugbowo, Edo State whereas Frederick resides in Asaba. Accounts are made up to 31 August every year.

Required: Determine the relevant tax authority in relation to the partnership stating the duties of the relevant tax authority in accordance with the relevant Nigerian tax law.

Suggested Solution

The relevant tax authority in relation to the partnership is the Delta State Board of Internal Revenue since the principal place of the partnership business is at Asaba in Delta State. It is the duty of the Delta State Board of Internal Revenue to request for a certified copy of the partnership deed or agreement. It is also the duty of the Board to determine the partnership income or loss and its apportionment between the partners in any year of assessment. The Board, having determined the partnership income or loss, supplies the other tax authority, the Edo State Board of Internal Revenue with the information regarding the income of the partner who is resident in Delta State.

Illustration 2

Amos, Atos and Akpos are in partnership and agreed to share profits or losses in the ratio of 2:2:3 respectively. During the year ended 31st December 2014, their books showed adjusted loss of N105,000 after accounting for:

	Amos	Atos	Akpos
	N	N	N
Salaries	35,000	40,000	75,000
Interest on Capital	6,000	8,000	6,000
Bonus	3,000	2,000	5,000
Depreciation	56,800		

Additional information:

1. Amos received N25,000 as gratuity from his former employment
2. Amos is married with five (5) children and maintained two dependant relatives on which he expended N5,000 yearly
3. Amos has a life assurance policy on himself attracting capital sum of N80,000 but pays yearly premium of N900
4. Atos is unmarried while Akpos has two children, aged nine and eleven years respectively.

Suggested Solution

(i) Computation of Assessable Income of each Partner

	Amos	**Atos**	**Akpos**	**Total**
	N	**N**	**N**	**N**
Salaries	35,000	40,000	75,000	150,000
Interest on capital	6,000	8,000	6,000	20,000
Bonus	3,000	2,000	5,000	10,000
Total Amount	44,000	50,000	86,000	180,000
Share of adjusted profit	(13,772)	(13,772)	(20,657)	(48,200)
Assessable Income of each partner	**30,229**	**36,229**	**65,343**	**131,800**

(ii) Computation of Amos's Income Tax Liability for 2014 Assessment Year

	N	N
Assessable/Earned Income		30,229
Less relief		
Personal allowance (N2,500 +20% x 30,229)	8,545	
Children allowance (N1,250 x 4)	5,000	
Dependant relative allowance (N1,000 x 2)	2,000	
Life assurance	800	16,345
Total Income		**13,783**

Note:

(a) The minimum tax payable = 0.5% x 13,783 68.92

(b) Annual income of N15,000 and below is exempted from tax but a minimum tax of 0.05% is charged on total income with effect from 1st January 1999

(c) Amos's gratuity of N25,000 is exempted from tax

Workings

(i) Computation of Adjusted Loss

	N
Loss per account	105,000
Less: Depreciation	56,800
	48,200

(ii) Share of Adjusted Loss

Amos 2/7 x 48,200	13,772
Atos 2/7 x 48,200	13,772
Akpos 2/7 x 48,200	13,772

3.3.4 Resignation and Admission of a Partner

This situation arises where a partner resigns, retires or dies. In this regard, such partner is deemed to have ceased business. Consequently, the cessation rule will become applicable to the partner who has resigned while the commencement rule will be applicable to the partner who has been admitted into the partnership business.

The resignation and admission of a partner will be treated in details in subsequent part of this module.

SELF-ASSESSMENT EXERCISE 3

1. What are the rules applicable to conversions and amalgamation of a partnership?

3.4 Taxable and Non-Taxable Incomes of a Partner

3.4.1 Taxable Incomes

Taxable income of a partner is similar to that of a trade, profession, business or individual. Taxable income of a partner for a tax year is that partner's gross income less:

a. Items of income specifically excluded;
b. The amount of deductions allowed; and
c. The amount of personal allowances granted to the partner

- **Gross Income:** This is the aggregate of economic benefits the partner derives during a tax year. These include:
  - (i) Benefits received in the form of non-cash property;
  - (ii) Income from the partnership
  - (iii) Interest, rents, etc.
  - (vi) Gains on the disposition of a property (whether real or personal, tangible or intangible) used in a partnership or held for investment, but not gains from the sale of property held for personal use unless the amount derived from the sale.

3.4.2 Non-Taxable Incomes

The non-taxable incomes comprised of the following:

a) Any profit on the disposal of an investment
b) Any profit on the disposal of a fixed asset
c) Any reversal with income of a previously disallowed expense e.g. depreciation and general provision for doubtful debt.

SELF-ASSESSMENT EXERCISE 4

1. What are taxable and non-taxable incomes of a partnership?
2. List some of the taxable and non-taxable incomes of a partnership?

3.5 Computation of Taxable and Non-Taxable Incomes of a Partner

Assessable profit is that quantifiable income, earnings, proceeds emanating from a trade or profession. These quantum of income, earnings or proceeds are chargeable to tax under the Personal Income Tax Act (PITA). Assessable profit refers to the accounting profit of trade or profession as adjusted for the purpose of tax (i.e. adjusted profit that will be arrived at before reflecting the effect of any loss relief, balancing charge and or capital allowances). As earlier one stated, the taxation of partnership is similar to that of a trade or profession. However, the student may refer to Module 2, Unit 1 "Computation of Assessable Profit of a Trade or Profession".

4.0 SUMMARY

The unit highlighted the computation of taxable and non-taxable income of a partner. More specifically, the following areas were covered:

- The meaning of a partnership
- The types of partnership
- Some basic concepts in partnership

- The taxable and non-taxable incomes of a partner
- Computation of taxable & non-taxable incomes of a partner

5.0 TUTOR-MARKED ASSIGNMENT

1. What are taxable and non-taxable incomes of a partnership?

2. List some of the taxable and non-taxable incomes of a partnership?

3. What are the rules applicable to conversions and amalgamation of a partnership?

4. Faith, Favour and Fidelia who are in partnership have agreed to share profits and losses in the ratio of 2:2:3 respectively. During the year ended 31^{st} December 2014, their books showed adjusted loss of N210,000 after accounting for the following:

	Faith	Favour	Fidelia
	N	N	N
Salaries	70,000	80,000	150,000
Interest on Capital	12,000	16,000	12,000
Bonus	6,000	4,000	10,000
Depreciation	113,600		

Additional information:

1. Faith received N50,000 as gratuity from his former employment
2. Faith is married with five (5) children and maintained two dependant relatives on which he expended N10,000 yearly
3. Faith has a life assurance policy on himself attracting capital sum of N160,000 but pays yearly premium of N1,800
4. Favour is unmarried while Fidelia has two children, aged nine and eleven years respectively.

Required:

(a) Compute each partners assessable income

(b) Compute Faith's income tax, for the relevant year of assessment

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

ICAN Study Pack (2009). *Advanced taxation for Professional Examination II.* Ibadan: VI Publishing Limited

Ologhodo, C.J. (2007). *Taxation principles and practices in Nigeria: A practical approach.* Jos: University Press Limited

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MODULE 3: TAXATION OF PARTNERSHIP

UNIT 2: IDENTIFICATION AND COMPUTATION OF ALLOWABLE AND NON-ALLOWABLE EXPENSES OF PARTNERSHIP

CONTENTS

1.0 INTRODUCTION

As earlier on stated in unit 1 of this module, the Personal Income Tax Act 1993 (as amended) do not subject to taxation, the income accruing form a partnership but rather the individual making up the partnerships are subjected to taxation individually. As part of the provisions of this Act, certain expenses are allowable while there are some that are not allowable in a partnership business.

The tax laws provide that such allowable expenses should be deducted before arriving at the chargeable income in a partnership and the non-allowable expenses must be added back before arriving at the chargeable income of a partnership. Consequently, this unit dealt with allowable and non-allowable expenses of a partnership.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know the allowable and non-allowable expenses of a partner
- compute the allowable and non-allowable expenses of a partner

3.0 MAIN CONTENT

3.1 Allowable and Non-Allowable Expenses

3.1.1 Allowable Expenses

PITA provides that all outgoings and expenses wholly, exclusively, necessarily and reasonably incurred during that period and ultimately borne by the business of individuals in the production of their income are deductible in the process of determining the assessable income or profit to be used for tax purposes.

These deductions include the following:

(a) Interest on loan – any interest on money borrowed and employed as capital in acquiring the income;

(b) Rent and rates - this should be in respect of the land & building occupied for the purpose of an individual's business;

(c) Repairs and maintenance of any asset employed in the business;

(d) Provision for doubtful debts of a specific nature;

(e) Bad debts written off;

(f) Contribution to a pension scheme approved by the Joint Tax Board (JTB);

(g) Legal expenses that are limited to:
    (i) general legal advisory services;

    (ii) retainership fees;

    (iii) renewal of a short lease- that is, lease with tenure of not more than 50 years;
    (iv) any cost of protecting and defending the properties of the business.

(h) Any other expense proved by the board to have been incurred for the purpose of the individual's business.

3.1.2 Non-Allowable Expenses

PITA also provides that the following items shall not be allowed as deductions for the purpose of ascertaining the income of an individual.

(a) Private/personal expenses;

(b) Capital expenditure or withdrawal of capital;

(c) Any loss or expenses recoverable under insurance or contract of indemnity;

(d) Rent and cost of repairs to any premises or part of premises not incurred for the purpose of producing the income;

(e) Taxes on income or profits levied in Nigeria or elsewhere except as provided in section 13 of PITA;

(f) Any unapproved payment to a pension scheme, provident, savings or widows society/orphanages, or any other fund or scheme- except as permitted by paragraphs (f) and (g) of subsection 20 of PITA;

(g) Depreciation of any asset;

(h) Any sum reserved out of profits except there is an expression permission of section 20 of the PITA;

(i) Any provision for doubtful debt of a general nature;

(j) Any payment of management fees except with the approval of the commission;

(k) Legal expenses that include:
  (i) the cost of defending a traffic offence
  (ii) acquisition of new lease – long or short

(l) Donations- however, some donations are allowed under CITA;

(m) Fines and penalties.

SELF-ASSESSMENT EXERCISE 1

1. What are allowable and non-allowable expenses?

2. List some of the allowable and non-allowable expenses known to you?

3.2 Computation of Allowable and Non-Allowable Expenses of a Partner

Assessable profit is that quantifiable income, earnings, proceeds emanating from a trade or profession. These quantum of income, earnings or proceeds are chargeable to tax under the Personal Income Tax Act (PITA). Assessable profit refers to the accounting profit of trade or profession as adjusted for the purpose of tax (i.e. adjusted profit that will be arrived at before reflecting the effect of any loss relief, balancing charge and or capital allowances). As earlier one stated, the taxation of partnership is similar to that of a trade or profession. However, the student may refer to Module 2, Unit 1 “Computation of Assessable Profit of a Trade or Profession”.

4.0 SUMMARY

The unit highlighted the computation of allowable and non-allowable expenses of a partner. More specifically, the following areas were covered:

- The allowable and non-allowable expenses of a partner
- Computation of allowable and non-allowable expenses of a partner

5.0 TUTOR-MARKED ASSIGNMENT

1. What are allowable and non-allowable expenses of a partnership?

2. List some of the allowable and non-allowable expenses of a partnership?

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

ICAN Study Pack (2009). *Advanced taxation for Professional Examination II.* Ibadan: VI Publishing Limited

Ologhodo, C.J. (2007). *Taxation principles and practices in Nigeria: A practical approach.* Jos: University Press Limited

Soyode, L. & Kajola, S.O. (2006). *Taxation principles and practice in Nigeria.* Ibadan: Silicon Publishing Company

MODULE 3: TAXATION OF PARTNERSHIP

UNIT 3: COMPUTATION OF ASSESSABLE AND CHARGEABLE PROFIT OF PARTNERSHIP

CONTENTS

1.0 INTRODUCTION

The computation of assessable profit of a partnership is reinforced by certain rules known as the commencement and cessation of business of the partnership. It should be noted that the commencement of business of a partnership may manifest in twofold: where all the partners commence business at the same time and where one partner commences and is joined later by another person. However, the computation of assessable profit of a partnership in these two situations listed above demand different treatments.

Furthermore, there are cases where the partnership may cease to exist; this also demands different treatments. This module covered all these issues as regards the computation of assessable profit of partnership in relation to commencement and cessation of partnership as well as treatment of capital allowance of a partnership.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know how to compute assessable profit in relation to commencement and cessation of a partnership
- understand the treatment of capital allowance of a partnership
- format for computing the chargeable profit for partners

3.0 MAIN CONTENT

3.1 Computation of Assessable Profit in relation to Commencement and Cessation of a Partnership

3.1.1 Format for Computing Assessable Profit of a Partnership

	N	N
Net Profit/(Loss)		XX
Add:		
Non-allowable expenses	XX	
Taxable income not reported	XX	XX
Deduct:		
Non-taxable incomes	XX	
Allowable expenses not reported	XX	(XX)
Adjusted/Assessable Profit		**XXX**

3.1.2 Commencement of Business

The commencement of business of a partnership may manifest in twofold. First, where all the partners commence business at the same time and second, where one partner commences business and is joined later by another partner. It should be remembered that since a member of a partnership is treated as an individual taxpayer, all the rules regarding commencement of individual taxpayers do apply to members of the partnership wherever necessary.

Illustration 1: Where all partners commence business at the same time

Buhari and Osinbanjo met at the Abuja in 2000 and decided to form a partnership known as B&O. They have been in partnership since then and shared profits and losses equally. The adjusted profit of the partnership for the year ended 31/12/2010 was ₦1,000,000. Capital Allowance was also N250,000.

Required: What will be the chargeable income of each partner?

Suggested Solution

Computation of Chargeable Profit of the Partnership

	₦
Adjusted Profit for tax purposes	1,000,000
Deduct: Capital allowance claimable	250,000
Chargeable Income	750,000

Share of Chargeable Income:
Bowale (50%) 7,500,000

Ali (50%) 7,500,000 15,000,000

3.1.3 Cessation of Business

There are cases where a partnership may cease to exist. When the partnership ceases to exist, the cessation rule as it applies to individual taxpayers should be applied to members of the partnership wherever necessary.

SELF-ASSESSMENT EXERCISE 1

3.2 Treatment of Capital Allowance of a Partnership

In a partnership, capital allowances are computed and granted against the income of the partners just in the same way as any taxpayer (e.g. company or individual). Capital allowance is not allocated to partners as in the case of a tax credit.

SELF-ASSESSMENT EXERCISE 2

1. How is capital allowance treated in a partnership?

3.3 Format for Computing the Chargeable Profit for Partners

In order to compute the chargeable profit for the individual partners, the below format can be used:

Format for computing the chargeable profit of Partners

	Total	**X**	**Y**	**Z**
	N	**N**	**N**	**N**
Assessable profit	X			
Share of Profit	(X)	X	X	X
Capital Allowance	X			
Share of Capital Allowance	(X)	(X)	(X)	(X)
Income from Partnership		**X**	**X**	**X**
Other Earned Income		X	X	X
Total Earned Income		X	X	X
Unearned Income		X	X	X
Statutory Total Income		**X**	**X**	**X**
Deduct: Personal Allowance		**(X)**	**(X)**	**(X)**
Children Allowance		(X)	(X)	(X)
Dependant Relative Allowance		(X)	(X)	(X)
Life Assurance Policy Allowance		(X)	(X)	(X)
Chargeable Income		**X**	**X**	**X**

4.0 SUMMARY

The unit highlighted the computation of assessable profit in relation to cessation and commencement of business of a partnership. More specifically, the following areas were covered:

- Computation of assessable profit in relation to commencement and cessation of a partnership
- Treatment of capital allowance of a partnership
- Format for commuting the chargeable profit for partners

5.0 TUTOR-MARKED ASSIGNMENT

1. How is capital allowance treated in a partnership?
2. Briefly describe how the chargeable and assessable profits computed in a partnership business?

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

ICAN Study Pack (2009). *Advanced taxation for Professional Examination II.* Ibadan: VI Publishing Limited

Ologhodo, C.J. (2007). *Taxation principles and practices in Nigeria: A practical approach.* Jos: University Press Limited

Soyode, L. & Kajola, S.O. (2006). *Taxation principles and practice in Nigeria.* Ibadan: Silicon Publishing Company

MODULE 3: TAXATION OF PARTNERSHIP

UNIT 4: DETERMINATION AND TREATMENT OF TAX UNDER ADMISSION AND RESIGNATION OF A PARTNER

CONTENTS

1.0 INTRODUCTION

The resignation and admission of a partnership arises where a partner resigns, retires or dies. In this regard, such partner is deemed to have ceased business. Consequently, the cessation rule will become applicable to the partner who has resigned.

The commencement rule will be applicable to the partner who has been admitted into the partnership business. This unit dealt with the determination and treatment of tax under admission and resignation of a partner.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know the tax treatment where a new partner is admitted
- understand the tax treatment where a partner resigns or retires
- compute the tax liability under admission and resignation of a partner

3.0 MAIN CONTENT

3.1 Tax treatment where a new partner is admitted

Where a new partner is admitted:

1. Determine the assessable profit of the partnership

2. Determine the share of profit of each of the partners in their profit and loss sharing ratio from the time he joined the partnership

3. Determine the share of capital allowances of each partners in the agreed profit and loss sharing ratio from the time he joined the partnership

4. Determine the partnership income of each of the partners by deducting the share of capital allowance from the share of profit

5. Determine the basis period for assessable profit under the commencement rule for the partner who has been newly admitted

6. Determine the assessable profit for the relevant tax years under the commencement rule, using the partnership income for the relevant periods computed in No. 4

7. Determine the basis of assessing the partner under the commencement rule.

SELF-ASSESSMENT EXERCISE 1

1. What is the taxation treatment in situation where a new partner is admitted into the partnership?

3.2 Tax treatment where a partner resigns or retires

Where a partner resigns or retires:

1. Determine the assessable profit of the partnership

2. Determine the share of profit of each of the partners in their profit and loss sharing ratio for the period he was a part of the partnership i.e. up to the time of retirement, resignation or demise

3. Determine the share of capital allowance of each partner in the agreed profit and loss sharing ratio for the period he was a part of the partnership i.e. up to the time of retirement, resignation or demise

4. Determine the partnership income of each of the partners by deducting the share of capital allowance from the share of profit

5. Determine the basis period for assessable profit under the cessation rule for the partner who has resigned, retired or demised

6. Determine the assessable profit for the relevant tax years under the cessation rule using the partnership income for the relevant periods computed in No. 4

7. Determine the basis of assessing the partner under the cessation rule.

SELF-ASSESSMENT EXERCISE 2

1. What is the taxation treatment in situation where a partner retires or resigns?

3.3 Computation of tax liability under admission and resignation of a partner

Adrian and Adriana have been in partnership for years trading under the business name A&A, sharing profits in the ratios 3:2. On 1st May 2014, Lucy was admitted with one-sixth share of the profit with further understanding that the ratio between Adrian and Adriana was not be disturbed. For the year ended 30th April, 2015, the following statement of profit or loss was submitted:

		N	N
Gross profit			215,175
Salaries and wages:	Staff	37,500	
	Adrian	18,750	
	Adriana	15,000	
	Lucy	12,500	
Interest on capital		15,000	
Current Account:	Adrian	3,750	
	Adriana	5,000	
Rents and insurance		1,125	
Electricity bill		1,800	
Motor expenses		3,000	
Repairs and renewals		800	
Legal fees		625	
Sundry expenses		375	
Audit and Accountancy fee		2,500	
Leave allowances		6,250	
Depreciation		8,750	
Bad debts		1,250	
Entertainment expenses		3,750	
Telephone charge		1,400	
Postages		1,050	140,175
Net Profit			**75,000**

All the partners are married with four and two children respectively. All other prescribed personal reliefs are claimed equally with the exception of Life Insurance Premium as follows:

	N
Adrian	6,250 per annum
Adriana	205 per month
Lucy	26.875 per week

All the policies are personal life and are secured for varying capital sum at deaths.

Additional information:

(i) Interest on capital: Adrian: N7,500; Adriana: N5,000; Lucy: N2,500

(ii) The legal fee were incurred on drawings up of the new partnership agreement on the admission of Lucy

(iii) The leave allowances include the N1,750 each paid to the partners on their respective annual vocation

(iv) Depreciation includes charges in respect of Adrian and Adriana personal cars in respect of which the tax authority has conceded 70% relief. The written down value for both tax and book purposes on the 1st May 2014 were N20,000 and N18,750 respectively. The depreciation charge for the year had been calculated at the rate of 12.5%

(v) Entertainment was in respect of the maintenance of a hut rented in Calabar Resort for the relaxation of staff. For the year in consideration, there is no evidence that anyone other than the three partners and members of their families made use of the hut.

Required: (a) Compute the adjusted profit; and
(b) Calculate the tax payable by each of the partners

Suggested Solution

Computation of Adjusted Profit

			N	**N**
Net profit				75,000
Add back:				
Salaries:	Adrian	18,750		
	Adriana	15,000		
	Lucy	12,500		46,250
Current Account:	Adrian	3,750		
	Adriana	5,000		8,750
Interest on Capital	Adrian	7,500		
	Adriana	5,000		
	Lucy	2,500		15,000
Depreciation				8,750
Legal fee				625
Cost of passages or leave allowance:	Adrian:	1,250		
	Adriana:	1,250		
	Lucy:	1,250		3,750
Motor expenses (30% of 3,000) disallowed				900
Adjusted or Assessable Profit				**159,025**

Computation of Tax Payable for 2013 Year of Assessment

		Total	**Adrian**	**Adriana**	**Lucy**
Adjusted profit	159,025		½	1/3	1/6
Salary		(46,250)	18,750	15,000	12,500
Interest on capital		(15,000)	7,500	5,000	2,500
Cost of passages		(3,750)	1,250	1,250	1,250
Computed Income		94,025			
Less: Capital allowance					
25% x N20,000 x 70%	3,500				
Net Computed Income	90,525				

Share of Profit	(90,525)	45,263	30,175	15,087
Partnership Income	-	72,763	51,425	31,338
Deduct Reliefs				
Personal allowance				
2,500+20% of earned income		(17,053)	(12,785)	(8,768)
Children allowance		(5,000)	(3,750)	(2,500)
Dependent relative		(2,000)	(2,000)	(2,000)
Life assurance premium		(6,250)	(2,460)	(1,398)
Taxable Income		**42,460**	**30,430**	**16,673**
Tax Payable:				
1st 15,000 5%		750	750	750
Next 15,000 10%		1,500	1,500	167.25
Next 25,000 15%		1,869	64.5	-
		4,119	**2,315**	**917.25**

Workings

(a) Determination of sharing ratios

If Lucy has taken 1/6, it means 1 – 1/6 which = 5/6 will be for Adrian and Adriana and since the old profit sharing ratio between them must not be disturbed, their new profit sharing ratio upon the admission of Lucy into the new partnership will be: Adrian 3/5 x 5/6 = ½ and Adriana 2/5 x 5/6 = 1/3

(b) Treatment of Capital Allowance

It can either be deducted from the computed income of the partnership and the net computed income shared between the partners or the capital allowance can be shared straight between the partners and deducted from their respective incomes. Whichever alternative adopted will result to the following:

			Adrian	**AdrianaLucy**	
Computed Income	94,025		45,013	31,342	15,671
Capital allowance	3,500				
	(3,500)	(1,750)	(1,167)	(584)	
Partners Share or Profit	45,263	30,175	15,087		

4.0 SUMMARY

The unit highlighted the determination and treatment of tax under admission and resignation of a partner. More specifically, the following areas were covered:

- The tax treatment where a new partner is admitted
- The tax treatment where a partner resigns or retires
- Computation of tax liability under admission and resignation of a partner

5.0 TUTOR-MARKED ASSIGNMENT

1. Briefly illustrate the taxation treatment in situation where a new partner is admitted, retires or resigns in partnership?

2. Blessed, Blessing, Blissful have been in partnership for many years and providing specialized engineering services to the oil sector in Nigeria. Accounts are made up to 31st December, each year. The following are the adjusted profits:

Year ended 31st December 2005	N144,000
Year ended 31st December 2006	N165,000
Year ended 31st December 2007	N240,000
Year ended 31st December 2008	N220,000

Additional Information:

(i) Partners are to share profits in the ratio 1:2:1

(ii) Salaries are drawn in this order:
- Blessed N36,000
- Blessing N24,000
- Blissful N18,000

(iii) Interest on capital is 6% per annum

(iv) The capital accounts of each partner is:
- Blessed N15,000
- Blessing N30,000
- Blissful N21,000

(v) On 31st May 2005, Blessed retired and Brenda was admitted on 1st June of same year on a salary of N18,000. He brought in a capital of N21,000 and was to have the sharing ratio which Blessed used to enjoy

Required:

(a) Compute each partner's income from the partnership for 2007 year of assessment

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

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MODULE 4: TAXATION OF LIMITED LIABILITY COMPANIES

UNIT 1: INTRODUCTION TO COMPANY INCOME TAX

CONTENTS

1.0 INTRODUCTION

The term company refers to a corporation, firm or business established for the sole purpose of maximizing the wealth of the owners of resources. This company can take the form of a group or individual entity established by the laws of a country. There are several types of companies known to law and they take the form of Public Limited Companies (Plc.), Companies Limited by Guarantee, Unlimited Liability Company.

There are other forms of companies that fall under the category of partnership. However, this unit focused on introduction to Company Income Tax (CIT) which is a form of corporate entity established by the provision of laws in Nigeria – Corporate Affairs Commission (CAC) and Companies and Allied Matters Act (CAMA).

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- provide an understanding of the types of company

- basis for charging company income tax and imposition of company tax in Nigeria
- know taxable and non-taxable incomes
- identify allowable and non-allowable expenses

3.0 MAIN CONTENT

3.1 Identification of the Types of Company

As earlier on stated in the preceding part of this unit, a company refers a corporation, firm or business established for the sole purpose of maximizing the wealth of the owners of resources. Company can manifest in the form of a group or individual entity established by the laws of a country. In Nigeria, a company can be identified based on whether it is a public of private entity.

Public companies are those that can be found in the governmental sector. These sets of companies are owned and managed by the government of a country. On the other hand, private companies whether limited, unlimited or limited by guarantee are entities owned by shareholders (who are the owners of the wealth) and managed by agents (who are known as the management of the entity). In Nigeria, private companies are established by statues such as the CAC and CAMA. However, this chapter focused on these sets of companies – Private Company and the tax provisions in the country as regards private companies are provided for by the Company Income Tax Act (CITA).

It is worthy to note that there are resident and non-resident companies. These companies (resident and non-resident) are liable to pay tax especially when such income derived by the company is liable to tax under the provisions of the Companies Income Tax Act (CITA). Company income tax is paid for by all companies operating in Nigeria except those exclusively exempted under CITA. A resident company is that which is incorporated under the Companies and Allied Matters Act (CAMA) 1990 as amended while a non-resident company is that which is established by or under any law in force in any given territory or country outside Nigeria. It thus implies that non-resident companies are those not incorporated under CAMA. It is worthy to note that for resident companies, the total profits in any given year of assessment are assessable to Nigeria tax regardless of whether or not all the profits originated from, or were brought into or received in Nigeria.

Withholding tax of 10% is deductible from dividends, interests or royalties due to non-resident companies arising in Nigeria. The legal basis for assessing resident companies to tax is the CITA, CAP C21 LFN 2004, which is administered by the Federal Inland Revenue Service (FIRS) via different large tax offices and integrated tax offices.

SELF-ASSESSMENT EXERCISE 1

1. In your own view, what is a company and how would you categorize the types of companies?

3.2 Basis for Charging Company Income Tax and Imposition of Company Tax in Nigeria

3.2.1 Basis for Charging Company Income Tax in Nigeria

The basis for charging company income tax in Nigeria includes the following considerations:

(i) The comprehensive (global) profits of resident companies regardless of whether or not they were brought into or were received in Nigeria are liable to tax. Dividend income to a resident company is treated as Franked Investment Income (FII) on which no income tax is payable.

(ii) The quota of the profits of non-resident companies derived from such companies' operations in Nigeria is liable to tax.

(iii) Dividends, interest or royalties due to non-resident companies are assessed at 10% (withholding tax rate) on the gross amount due and only the net is payable to the respective companies.

3.2.2 Imposition of Company Tax in Nigeria

Company Income Tax is governed by the Company Income Tax Act (CITA). However, there are certain provisions of the Act that expressly state how taxes are imposed on companies. Section 8 of CITA imposed tax at a specific rate on the profits of any company accruing in, derived from, brought into or received in Nigeria. At the moment, the tax rate for companies in Nigeria is 30%. Taxes are imposed on companies in respect of:

(i) any trade or business;

(ii) rent or any premium emanating from a right granted to any other person for use or occupation of any property. The treatment of rental income for company income tax is similar to that of personal income tax;

(iii) dividends, interests, royalties, discounts, charges or annuities;

(iv) any source of annual profits or gains not falling within the preceding categories;

(v) any amount deemed to be income or profit under a provision of the Act, or with respect to any benefit arising from a pension or provident fund or scheme, of the Personal Income Tax Act;

(vi) fees, dues and allowance (wherever paid) for services rendered. Any company entering into any agreement (whether verbal or documented) in respect of any service in this regard is required by CITA to make full disclosure in writing to the Revenue Service (FIRS) of the terms of such agreement; and

(vii) any amount of profits or gains arising from acquisition and disposal of short-term money instruments like Federal Government Securities, Treasury Bills, Treasury Certificates, Debentures or Treasury Bonds.

SELF-ASSESSMENT EXERCISE 2

1. What are the basis for charging income tax as it relates to resident and non-resident companies?

2. Presently, tax rate for companies in Nigeria is 30%. List the conditions for imposing tax on companies in Nigeria?

3.3 Taxable and Non-Taxable Incomes

3.3.1 Taxable Incomes

Taxable income of corporation for a tax year is the gross income of the corporation less
a) items of income specifically excluded; and
b) the amount of deductions allowed

It is worthy to note that gross income is the aggregate of economic benefits the taxpayer derives during a tax year.

3.3.2 Non-Taxable Incomes

There are adequate provisions of the law on incomes that are non-taxable. For instance, the provisions of the tax laws in terms of Nigerian dividends received by companies other than Nigerian companies is such that:
(i) no tax shall be charged on it for that year in respect of any dividend received by it from a Nigerian company at any time during a year of assessment;
(ii) where any dividend is paid out of profits on which no tax is payable due to no total profits or total profits which are less than the amount of dividend which is paid, whether the recipient of the dividend is a Nigerian company or not, the company paying the dividend shall be charged to tax at the rate prescribed in this Act of section 40 as if such dividend is the total profits of the company for the year of assessment which relates to accounts out of which the dividend is declared;
(iii) nothing in the tax laws act shall confer on such company or on the company paying the dividend, a right to payment of tax paid by reason of the provision of the act.

On a general basis, the following are the incomes exempted from tax:
(a) incomes of any company being a statutory or registered friendly society, in so far as such incomes are not derived from a trade or business carried on by such society;
(b) the incomes of any company being a co-operative society registered under any enactment or law relating to co-operative societies, not being incomes from any trade or business carried on by that company other than co-operative activities solely carried out with its members or from any share or other interest possessed by that company in a trade or business in Nigeria carried on by some other persons or authority;
(c) incomes of any company engaged in ecclesiastical, charitable or education activities of a public character in so far such profits are not derived from a trade or business carried on by such company;
(d) incomes of any company formed for the purpose of promoting sporting activities where such profits are wholly expendable for such purpose, subject to such conditions the Board may prescribe;

(e) incomes of any company being a trade union registered under the Trade Unions Act in so far as such profits are not derived from a trade or business carried on by such trade union;

(f) dividend distributed by Unit Trust.

(g) incomes of any company being a body corporate established by or under any Local Government Law or Edict in force in any State in Nigeria;

(h) incomes of anybody corporate being a purchasing authority established by an enactment and empowered to acquire any commodity for export from Nigeria from the purchase and sale (whether for the purposes of export or otherwise) of that commodity;

(i) incomes of any company or any corporation established by the law of a State for the purpose of fostering the economic development of that State, not being profits derived from any trade or business carried on by that corporation or from any share or other interest possessed by that corporation in a trade or business in Nigeria carried on by some other person or authority;

(j) any incomes of a company other than a Nigerian company which, but for this paragraph, would be chargeable to tax by reason solely of their being brought into or received in Nigeria;

(k) dividend, interest, rent, or royalty derived by a company from a country outside Nigeria and brought into Nigeria through Government approved channels. For the purpose of this subsection, "Government approved channels", means the Central Bank of Nigeria, any bank or other corporate body appointed by the Minister as authorized dealer under the Foreign Exchange (Monitoring and Miscellaneous) Act or any enactment replacing that Act;

(l) the interest on deposit accounts of a foreign non-resident company: provided that the deposits into the account are transfers wholly of foreign currencies to Nigeria on or after 1st January 1990 through Government approved channels;

(m) the interest on foreign currency domiciliary account in Nigeria accruing on or after 1st January 1990.

(n) dividend received from small companies in the manufacturing sector in the first five years of their operation;

(o) dividend received from investments in wholly export oriented businesses;

(p) incomes of any Nigerian company in respect of goods exported from Nigeria provided that the proceeds from such export are repatriated to Nigeria and are used exclusively for the purchase of raw materials, plant, equipment and spare parts;

(q) incomes of a company whose supplies are exclusively inputs to the manufacturing of products for export provided that the exporter shall give a certificate of purchase of the inputs of the exportable goods to the seller of the supplies power to exempt.

(r) incomes of a company established within an export processing zone or free trade zone, provided that 100 percent production of such company is for export otherwise tax shall accrue proportionately on the profits of the company.

The Nigerian tax law provides that when a deduction has been allowed to a company under the provisions of section 24 or 25 of the Company Income Tax Act (CITA) in respect of any liability of, or any expense incurred by that company and such liability is waived or released or such expense is refunded to the company, I whole or in part, then the amount of that liability or expense which is waived, released or refunded, as the case may be, shall be deemed to be profits of the company on the day on which such waiver, release or refund was made or given.

There are certain provisions that accord the President to exempt incomes tax. The following are the provisions of law that give the President power to exempt incomes from tax:

(a) any company or class of companies from all or any of the provisions of this Act; or
(b) from tax of all or any profits of any company or class of companies from any source, on any ground which appears to it sufficient.
(c) the Income Tax Exemption (Interest on Nigerian Public Loans) Notice;
(d) the Income Tax (Exemption) (Nigerian Broadcasting Corporation) Order;
(e) the Railway Loan (International Bank) (Exemption of Interest) Notice.

SELF-ASSESSMENT EXERCISE 3

1. There are certain provisions that accord the President to exempt incomes from tax. State the conditions known to you?
2. Briefly illustrate the power to exempt incomes from tax as contained in the Company Income Tax Act (CITA)?

3.4 Allowable and Non-Allowable Expenses

3.4.1 Allowable Expenses

Allowable expenditures are those permissible expenditures or deductions that have been provided for by the relevant tax laws in Nigeria for companies and individuals in order to reduce their tax burden, thereby creating what is often referred to as *"tax shield"*. Tax shield simply refers to reduction in income taxes as a result of deductions of allowable expenditures from the income of individuals or companies. For instance, interest on tax shield is tax-deductible which makes it possible for debts to give rise to tax shield for companies.

Allowable deductions are expenses or expenditures incurred by a company wholly, exclusively, necessarily and reasonably in the creation of profits. This means that any expenditure incurred to meet the above conditions is deemed allowable in arriving at the chargeable profits of the company. This may not be the case where such expenditures are specifically forbidden under any provision of relevant tax laws.

The tax laws in Nigeria provides for allowable deductions provided that they are incurred for the purpose of acquiring the profits being subject to tax. Thus, the following are deemed to be allowable deductions for tax purpose in Nigeria:

(i) interest on borrowed money and capital employed;
(ii) rental sum and premiums with respect to land or buildings used for the purpose of acquiring profits.
(iii) Repairs and renewal costs relating to the premises, plants, fixtures, furniture's etc utilized in the business.

(iv) Bad and doubtful debts to the extent that they are respectively estimated to the satisfaction of the Revenue Service to have become bad or doubtful of collection.

(v) Contributions to approved pension, provident or other retirement benefits fund, society or scheme;

(vi) In the case of the Nigerian Railway Corporation, such deductions as are permissible under the provisions of the Authorized Deductions such as the Nigerian Railway Corporation rules, 1959.

(vii) Any expenses incurred during the year in respect of:

  (a) salaries, wages or other remuneration disbursed to employees;

  (b) cost to the company of any benefit or allowance provided for the senior staff and executives which shall not exceed the limit of the amount prescribed by the collective agreement between the company and the employees and approved by the Federal Ministry of Employment, Labour and Productivity and the productivity, prices and income/revenue service as the case may be; and

  (c) the expenses provided to the satisfaction of the Revenue Service to have been incurred by the entity on Research and Development for the period including the amount of levy paid by it to the National Science and Technology Fund (NSTF).

(viii) Amount of reserve made out of profits for research development subject to a ceiling (i.e. maximum value) of 10% of the total profits of the company before any deduction is made.

(ix) Companies and other organizations engaged in research and development activities for commercialization shall be allowed 20% investment credit on their qualifying expenditure for that purpose.

There are specific items that are tax permissible which are emphasized by the tax law. These specific items that are tax permissible or allowable are highlighted below:

(A) **Donations:** CITA for instance specifies among other things, the conditions to be satisfied before any donation can be permissible. Thus, donations that do not satisfy these conditions are not tax permissible or allowable. These conditions include:

  (i) Donations must be made out of profits of the entity. Therefore if an entity makes a loss, whatever donations paid during that year should not be treated as allowable deductions.

  (ii) Donations should not be expenditure of a capital nature.

  (iii) Donations must be made to any of the approved bodies e.g. Boys Brigade, Boys Scouts, Girls Guides of Nigeria, Red Cross etc.

  (iv) For any year of assessment, the maximum amount allowable is limited to 10% of the total profits of the company before deducting the donations.

It is worthy to note that donations (whether revenue or capital in nature) made in respect of University and other Tertiary or Research institutions for research/developmental purposes, or as an endowment out of profits of the period of an entity, shall not exceed an amount which is equal to 15% of the total profits or 25%

of the tax payable in the year of the donation, whichever is higher. Donations to anybody or institution whose name is not included on the list in the fifth schedule shall not be treated as an allowable deduction.

The Fifth Schedule

Funds, bodies and institutions in Nigeria to which donations may be made under the Act include:

(a) **Youths/Philanthropic Organizations:** These youths/philanthropic organizations include:
- Boys Brigade of Nigeria
- Boys Scouts of Nigeria
- Girls Guides of Nigeria
- Nigerian Red Cross
- National Youth Council of Nigeria
- Nigerian Youth Trust

(b) **Religious Bodies:** The religious bodies that donations can be made to include the following:;
- Christian Council of Nigeria
- Islamic Education Trust

(c) **Medical:** Any hospital owned by the federal or state government, university teaching hospital or any hospital which is carried on by a society or association otherwise than for the purpose of profits or gains, to the individual members of that society or association.

(d) **Educational:** The following are the donations exempted from tax to educational activities:
- Institute of Medical Laboratory Technology
- National library
- National Braille library of Nigeria
- Van Leer Nigerian Educational Trust
- The Institute of Chartered Accountants of Nigeria Building Fund
- Nigerian Accounting Standards Revenue Service
- Paterson Zochonis Nigeria Technical Education Trust Fund
- Educational Cooperative Society
- Any educational institution affiliated under any law with any University in Nigeria or established under any law in Nigeria and any other educational institution recognized by any government in Nigeria.
- A public fund established and maintained exclusively for providing money for the acquisition, construction, maintenance or equipping a building used or to be used as a school/college by the federal or state government or by a public authority or society, association which is carried on otherwise than for the purpose of profit or gain to the individual members of that society or association.

(e) **Relief Funds**: The following are tax allowable with respect to relief funds:
- Southern African Relief Fund
- National Commission for Rehabilitation

- A public fund established and maintained for providing fund for the construction or maintenance of a public memorial relating to the civil war in Nigeria which ended on 15 January, 1970
- Any public fund established by the federal, or state government in aid of or for the relief of drought or any other natural disaster in any part of the federation or state e.g. Ecological Fund.

(f) **Research:** The following are tax allowable with respect of research:

- Nigerian Institute of Trypanosomiasis Research
- National Science and Technology Fund
- Nigerian Institute for Oil Palm Research
- Nigerian Institute for International Affairs
- National Council for Medical Research
- Cocoa Research Institute of Nigeria
- National Science and Technology Development Agency.

(g) **Welfare:** The following are tax allowable with respect of welfare in the country:

- Musical Society of Nigeria
- Rotary International (Polio-plus programme)
- Training Centres and Residential Schools for the Blind in Nigeria
- Associations or Societies for the Blind in Nigeria
- Society for the Blind
- Nigerian National Advisory Council for the Blind
- Nigerian Society for the Deaf and Dumb
- National Sports Commission and its State Associations
- A public institution or public fund comprising of the Armed Forces Comfort Fund, Navy or Air Force established or maintained for the comfort, recreation or welfare of its members.

(h) **Foundation/Endowment Fund:** The following are tax allowable with respect to foundation/endowment funds in Nigeria:

- University College Hospital Endowment Fund
- Afprint Foundation Limited
- KewalframChanrai Foundation Limited.

(i) **Others:** There are other funds or activities not classified in any of the above but they are tax allowable such as the Nigerian Museum and Nigerian Conservation Fund.

(j) **Research and Development:** The allowable amounts relating to research and developments manifest in two folds in the Nigerian tax law. The two folds (sections) of the Nigerian tax law that dealt with research and development can be summarized as:

- Actual expenditure on research and development are allowable deductions in accordance with the provisions of the Act.
- Reserve made out of profits for research and development expenditure are allowable deductions from profit subject to a fixed maximum.

It is worthy to mention here that the Nigerian tax law provides 20% investment tax credit on the qualifying expenditure of companies and other organizations engaged in research and development activities for commercialization once the expenditure are incurred for that purpose.

(B) **Rental Charges:** Rental charges in respect of residential accommodation occupied by employees of the entity are allowable up to a ceiling of 100% of the basic salary of employees.

(C) **Property Holding Companies:** The allowable deductions for property holding companies are limited to:

- expenses attributable to the maintenance of the property concerned; and
- directors remuneration up to ₦10,000 per annum per director payable to a ceiling of three directors in any one company.

(D) **Repairs and Renewals:** The usual items under this heading are those expenses incurred in maintaining the earnings capacity of the assets of the entity. In line with the above, the keeping of such assets in good working condition is very important for the entity to acquire profits; as such, costs connected with such exercise must, by reasonable expectation be allowable deductions.

(E) **Bad and Doubtful Debts:** The striking issues to observe with respect to the treatment of bad and doubtful debts for the purpose of tax include:

- They must relate to debts incurred in the ordinary course of the business
- They must be identifiable to specific debts. This means that general reserves against bad and doubtful debts are not allowable deductions
- Reserves no longer required are taxable if previously allowed.
- Debts previously written off, allowed in tax computation, and later received are taxable as income for the year in which recoveries are made
- Necessary evidence must be provided at the request of the revenue service to prove that the debts have become bad or estimated to be doubtful of recovery.

Illustration 1

The bad/doubtful debts account of XYZ Ltd for the period 2016 revealed the following:

	₦		₦
Trade debts written of	6,000	Reserves b/f:	
Reserves c/f:		Specific	20,000
Specific	24,000	General	12,000
General	10,000	Charged to P/L a/c	8,000
	40,000		40,000

Required: Show how the sum of N8,000 charged to P/L a/c was arrived at; and what is the implication of this amount for tax purpose?

Suggested Solution

In the profit or loss account of XYZ, the sum of ₦8,000 will be shown as the charge for bad and doubtful debts for the year. How this sum was arrived at can be reproduced in a statement form as below:

	₦
Trade debts written off	6,000
Add: Increase in specific provision ₦(24,000 – 20,000)	4,000
	10,000
Less: Reduction in general provision ₦(12,000 – 10,000)	2,000
Charged to profit or loss account	8,000

On the basis of the above, it becomes obvious that:

(i) the increase in the provision of bad and doubtful debts will be allowable as the amount involved is in respect of specific debts.

(ii) The general provision would have previously been allowed when created. Thus, the accounting profit will be reduced by the amount of the reduction in the general provision, resulting in a lower taxable profit than the accounting profit.

Thus, if a specific reserve for bad debt increases or decreases, no adjustment is needed to be made to the accounting profit; but in case of general reserve, appropriate adjustments will need to be made.

3.4.2 Non-Allowable Expenses

Apart from the class of expenditures referred to as allowable expenditures, we also have another class of expenditure called disallowable expenditures or reductions, which again, is applicable to both companies and individuals. Disallowable expenditures or reductions are those unacceptable expenditures or deductions that may have been provided for, or deducted from the income or revenue of companies or individuals as reflected in their financial statements or accounts. All such expenditures, when added back tend to increase the taxable income of taxpayers, thus increasing the amount of tax revenue of the government. They are also used as tools of government to shield against tax evasion and avoidance.

There are certain expenditures that are not permissible or not allowable for the purpose of tax. Accordingly, these expenditures are added back to the accounting profit during the course of determining the assessable profit of the entity. By the provisions of the relevant tax law in Nigeria, the following are the items or expenditures that must be disallowed:

(a) Capital repaid or withdrawn and any expenditure of a capital nature;

(b) Any sum recoverable under an insurance contract or indemnity;

(c) Taxes on income or profits levied in Nigeria or elsewhere. In case of tax levied outside Nigeria on profits which are also chargeable to tax in Nigeria and double taxation relief is not available, such tax will be an allowable deductions;

(d) Payments to unapproved pension, provident, savings or widows and orphans society, funds or schemes or development or education funds;

(e) Depreciation of any asset (capital allowance are granted instead);

(f) All appropriations for profits; namely, dividends; general provision for bad/doubtful debts; write off of preliminary/formation expenses and expenses on issue/redemption of shares and other securities;

(g) Any expense of any description incurred within or outside Nigeria for the purpose of earning management fee unless prior approval of an agreement giving rise to such management fee has been obtained from the Minister;

(h) Any expense whatsoever incurred within or outside Nigeria as management fee under any agreement entered into except to the extent as the Minister may allow; and

(i) Any expense of any description incurred outside Nigeria for and on behalf of any company except of a nature and to the extent as the Revenue Reserve may consider allowable.

Illustration 2

Faith Clinic Nigeria Limited has been in business for some time now. The following information has been extracted from the company's records for the year ended 31st December 2015.

	₦'000
Turnover	920,000
Direct Costs	(510,000)
	410,000
Other Income	90,000
	500,000
Admin and Other Expenses	(270,000)
	230,000
Bad Debt Provision	(85,000)
Profit Before Tax	145,000
Taxation	(25,000)
Profit After Tax	120,000
Transfer to Reserve	(100,000)
Retained Profit	20,000

Additional Information: ₦

(a) **Other income includes the following:**

Profit on sale of non-current assets	2,500,000
Dividend (Net)	3,000,000
Interest on foreign placement	14,000,000

(b) **Administrative expenses include the following:**

Depreciation	175,000,000
Directors remuneration	22,000,000
Audit fees	5,500,000
Other operating expenses	70,500,000

(c) **Other operating expenses include the following:**
Total rent for the period is ₦20,000,000. The amount relating to residential accommodation was ₦12,5000,000. The total basic salary of the staff involved amounted to ₦9,500,000.

(d) **Donations for the period include the following:**

Afprint Foundation Limited	2,500,000
Islamic Disaster Fund	3,000,000
Islamic Education Trust Fund	1,500,000
Better-Life Foundation	4,000,000

(e) **Misappropriated Funds include the following:**

By senior management	23,700,000
Preliminary expenses written off to income statement	7,300,000

Marketing expenses amounted to ₦15,000,000; ₦4,000,000 of which was incurred on promotional gift items; ₦8,000,000 on corporate adverts and the balance was used to facilitate operations at the port.

(f) Bad Debt Provision Account

	₦'000		₦'000
Bad debt written off	80,000	Provisions b/f:	
Staff debt written off	7,000	Specific debt	30,000
Provision c/f		General debt	40,000
Specific debt	20,000	Recovered debt	12,000
General debt	60,000	P/L	85,000
	167,000		167,000

(g) Capital Allowance(s)

	₦'000
Unabsorbed capital allowance c/f	183,000
Initial allowance	170,000
Annual allowance	135,000
Investment	42,000
Balance allowance	22,000
Balancing charge	18,500

The following information are relevant:

(i) Unrelieved loss brought forward amounted to ₦46,500,000

(ii) The authorized share capital of Faith Clinic Nigeria Limited is ₦1,000,000,000 at ₦1 per share. 650million shares have been issued and fully paid.

(iii) The shareholder's fund at the end of the year was ₦550,000,000

(iv) 75% of the foreign interest earned was repatriated through First Bank Nigeria Plc.

Required: Compute the tax liability payable by the firm for 2016 tax year.

Suggested Solution

Faith Clinic Nigeria Limited
Computation of Tax Liability

	₦'000	₦'000
Profit before tax		145,000
Add Back		
Depreciation	175,000	
Staff Rent (N12,500 – 9,000)	3,000	
Donations: Islamic Disaster Fund	3,000	
Better Life Foundation	4,000	
Misappropriated Fund	23,700	
Preliminary expenses	7,300	
Marketing expenses (15,000 – 12,000)	3,000	
Bad debt provision	27,000	223,000
		391,000
Deduct		
Profit on sale of non-current assets	2,500	
Dividend	3,000	
Interest	10,500	(16,000)
Assessable profit		375,000
Add balancing charge		18,500

		393,500
Less: Unrelieved loss b/f	46,500	
Relieved loss	(46,500)	(46,500)
	NIL	347,000
Less: Capital Allowance	552,000	
Restricted to 2/3 of assessable profit	(250,000)	(250,000)
Total Profit		97,000

Tax Liability Payable

	₦'000	₦'000
Income tax @ 30%	29,100	
Tax on dividend (30% x ₦100,000)	30,000	30,000
Minimum tax	3,899	
Education tax (2% x ₦375,000)	7,500	7,500
Tax liability payable		37,500

Workings 1: Bad Debt

	DR	CR
	₦'000	₦'000
General provisions c/f	60,000	
Staff debt written off	7,000	
General provisions b/f		40,000
Profit or loss	27,000	
	67,000	67,000

Workings 2: Minimum Tax

1. Based on Turnover of ₦500,000 – The highest of:

i.	Turnover of ₦500,000 @ 0.2%	=	1,250
ii.	Paid-up capital ₦650,000,000 @ 0.25%	=	1,625,000
iii.	Gross profit ₦410,000,000 @ 0.5%	=	2,050,000
iv.	Net Asset ₦550,000,000 @ 0.5%	=	2,750,000

2. Excess Turnover Tax

(₦920,000,000 – ₦500,000) x 0.125%	=	1,149,375
The highest base of 1 above	=	2,750,000
Minimum Tax		**3,899,375**

SELF-ASSESSMENT EXERCISE 4

1. There are certain provisions of the Nigerian tax laws on specific items that are tax allowable. List some of these specific items that are tax allowable?

2. There are certain provisions of the Nigerian tax laws expenditures that are not tax allowable. List them?

4.0 SUMMARY

This unit highlighted issues company income tax by exploring allowable/disallowable expenditures and taxable and non-taxable incomes for the purpose of tax and the determination of profits. The following issues were actually covered:

- Identification of the types of company

- Basis for charging company income tax and imposition of company tax in Nigeria
- Taxable and non-taxable incomes
- Allowable and non-allowable expenses

5.0 TUTOR-MARKED ASSIGNMENT

Identify at least 5 each of the allowable and disallowable expenditures when computing or determining the taxable profit of entities in Nigeria.

6.0 REFERENCES/FURTHER READING

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MODULE 4: TAXATION OF LIMITED LIABILITY COMPANIES

UNIT 2: DETERMINATION OF BASIS PERIOD FOR ASSESSMENT

CONTENTS

1.0 INTRODUCTION

In our discussion on bases period in previous units, we started by defining basis period as the period for which the taxpayers income is being assessed for tax purpose. However, we did not talk much about the various forms of basis period which could either be classified as:

1. normal basis period, and
2. abnormal basis periods.

Normal basis period occurs when organizations or taxpayers make tax payment for 12 months. In such periods, there is hardly any period that overlaps with another. Conversely, under the abnormal basis period, we see situations where two basis periods overlap or sometimes one would find gaps in between basis periods. Situations like these (abnormal basis period) makes it very difficult in arriving at the assessable profit of a company.

Overlapping of basis periods occurs mostly under the commencement rule and, oftentimes, under the change of accounting date when expenditure can be incurred in a period which is used as the basis for two years of assessment. Where two basis periods overlap, the period common to both shall be deemed to fall in the basis period ending at the earlier date. There are specific rules and procedures applied in determining the assessable profit of the business. These, we have discussed in unit one of this module.

2.0 OBJECTIVES

The aims and objectives of this unit are to:

- determine the basis period for companies;

- evaluate on-going or subsisting businesses;
- ascertain rules for new trade
- ascertain rules for change of date of fiscal year
- illustrate in practical terms, tax issues under business cessation

3.0 MAIN CONTENT

3.1 Determination of Basis Period for Companies

The broad rules for the determination of basis period for companies are contained in Section 29 of the Company Income Tax Act (CITA), 2013. As stated earlier in unit one of this module, income tax year which is referred to as assessment year is the government's or corporate entity's financial year which usually runs from January 1, to December 31 of every year. Previously, it was usually 1st April to 31st March following, up to 31 March 1980.

Assessable profit is defined in CITA as the accounting profit of an entity as adjusted for the purpose of tax (i.e. adjusted profit that will be arrived at before reflecting the effect of any loss relief, balancing charge and or capital allowances). The determination of basis period for companies is dependent on whether:

i) the company is an on-going or subsisting business;
ii) the company is a new trade;
iii) the company had changes in its accounting year; and
iv) the company ceases to trade or engage in business.

The above conditions upon which the basis period for companies is computed or assessable is further discussed in subsequent parts of this module.

SELF-ASSESSMENT EXERCISE 1

What are the conditions that determines the basis period for companies in Nigeria?

3.2 On-Going or Subsisting Business

For an on-going or subsisting business, the preceding year basis (PYB) is used in computing the assessable profit. Preceding year basis is the basis in which the income of a taxpayer or entity in the immediate prior accounting year is being assessed to tax in the present accounting year or year of assessment. The implication is that for on-going or subsisting businesses, the twelve months accounting period ending in the previous year forms the basis of assessment (Preceding Year Basis).

SELF-ASSESSMENT EXERCISE 2

In your own view, what is preceding year basis and what is its implication for an on-going or subsisting business?

3.3 Rules for New Trade

Section 29, Part IV, No. 3 of CITA covered issues on new trade or business. According to the provisions of the Act, assessable profits of any company from any trade or business for the year of assessment in which it commenced trade or business shall be ascertained in accordance with the certain provisions. Note that these provisions also covers situations where companies other than Nigerian companies, for the year of assessment in which it commenced, carry on trade or business in Nigeria for at least, two years following their respective years of assessment (which years are in this S.29 respectively referred to as “the first year”, “the second year”, and “the third year”). These provisions are:

a) for the first year, the assessable profits shall be only the profits of that year;
b) for the second year, the assessable profits shall, unless such notice as hereinafter mentioned is given, the amount of the profits of one year from the date of the commencement of the trade or business as determined by the purposes of paragraph (a) of S.29 of the Act;
c) for the third year, the assessable profit shall, unless such notice as hereinafter mentioned is given, be computed in accordance with subsection (1) of S.29 of the Act;
d) a company shall be entitled, on giving notice in writing to the Board within two years after the end of the second year, to require that the assessable profits both for the second and the third year (but not for one or other only of those years) shall be the profits of the respective years of assessment.
    i) Provided that the organization may, by notice in writing given to the Board within twelve months after the end of the third year, revoke the notice, and in such case, the assessable profits both for the second year and the third year shall be computed as if the notice of the relevant tax authority (in which case, the FIRS) had never been given:
    ii) Provided that if the basis period for the second or third year is the period of nine months from 1 April to 31 December, 1980; the profits of that basis period shall be grossed up as if they were the profits of twelve months;
e) Where such notice as aforesaid has been given or revoked, such additional assessments or such reductions of assessment or repayments of tax shall be made as may be necessary to give effect to paragraph (d) of S.29 of the Act:
    i) Provided that if the company fails to agree with the Board as to the amount of any reduction of an assessment or repayment of tax, the Board shall give notice to the company of refusal to admit such reduction or repayment.

It is worthy to note that for the fourth and subsequent years, the preceding year basis rule will be applied for determination of assessable profit of the entity. Also, taxpayer have right of election to have the assessments for the second and third years based on the actual result for those years. The right of election and applicable time frames are similar for both personal and companies taxation.

Illustration 1

Livestock Limited established Ella Lakes in 1991 for the purpose of commercial livestock production in the country. Ella Lakes commenced business on 1 January 1992. Its accounting date was 31 December each year while its adjusted profits for the first ten years were given as:

Trading Periods	Adjusted Profits or Losses (₦)
Year ended 31/12/92	(100,000.00)
Year ended 31/12/93	30,000.00
Year ended 31/12/94	25,000.00
Year ended 31/12/95	20,000.00
Year ended 31/12/96	15,000.00
Year ended 31/12/97	35,000.00
Year ended 31/12/98	50,000.00
Year ended 31/12/99	(40,000.00)
Year ended 31/12/00	35,000.00
Year ended 31/12/01	30,000.00

Required: Calculate the assessable profits for the relevant years

Suggested Solution

Year of Assessment		Basis Period Assessable	Assessable Profits
1992	01/01/92 – 31/12/92 – Actual		
	Loss for year ended 31/12/92	(100,000)	Nil
	Loss c/f to 1993	(100,000)	
1993	1st 12mnths 01/01/92-31/12/92	(100,000)	
	Loss b/f from 1992	(100,000)	
	Loss c/f to 1994 restricted to actual loss sustained	(100,000)	Nil
1994	PYB – 01/01/93-31/12/93		
	Profit for year ended 31/12/93	30,000	
	Loss b/f to 1993	(100,000)	
	Loss c/f to 1995	(70,000)	Nil
1995	PYB – 01/01/94-31/12/94		
	Profit for year ended 31/12/94	25,000	
	Loss b/f to 1994	(70,000)	
	Loss c/f to 1996	(45,000)	Nil
1996	PYB		
	Profit for year ended 31/12/95	20,000	
	Loss b/f to 1995	(45,000)	
	Loss c/f to 1997	(25,000)	Nil
1997	PYB		
	Profit for year ended 31/12/96	15,000	
	Loss b/f to 1996	(25,000)	
	Profit for year ended 31/12/1998	(10,000)	Nil
1998	PYB		
	Profit for year ended 31/12/97	35,000	
	Loss b/f to 1997	(10,000)	25,000
1999	PYB		

Profit for year ended 31/12/98	50,000	50,000

2000	PYB		
	Loss for year ended 31/12/99	(40,000)	
	Loss b/f to 2001	(40,000)	Nil
2001	PYB		
	Profit for year ended 31/12/00	35,000	
	Loss b/f to 2000		(40,000)
	Loss c/f to 2002	(5,000)	Nil
2002	PYB		
	Profit for year ended 31/12/01		30,000
	Loss b/f to 2001	(5,000)	25,000

Comment(s): Since Ella Lakes is engaged in large scale production in the country, it qualifies to be regarded as Agro-Allied Company and losses incurred by an Agro-Allied company can be carried forward indefinitely, that is not restricted to four (4) years.

SELF-ASSESSMENT EXERCISE 3

1. In your own view, what is preceding year basis and what is the implication for on-going or subsisting business?

2. Mr. Nicholas established Mrs. Nicholas in 2000 for the purpose of commercial farming. Mrs. Nicholas commenced business on 1 January, 2001. Its accounting date was 31 December each year while its adjusted profits for the first ten years were given as:

Trading Periods	**Adjusted Profits or Losses ₦**
Year ended 31/12/2001	(110,000.00)
Year ended 31/12/2002	40,000
Year ended 31/12/2003	35,000
Year ended 31/12/2004	30,000
Year ended 31/12/2005	25,000
Year ended 31/12/2006	45,000
Year ended 31/12/2007	60,000
Year ended 31/12/2008	(50,000)
Year ended 31/12/2009	45,000
Year ended 31/12/2010	40,000

Required: Calculate the assessable profits for the relevant years.

3.4 Rules for Change of Date of Fiscal Year

In a given circumstance, one could observe that a company may opt to change the date of her fiscal year for one reason or the other. When there is a change in the date of the fiscal year for a company, the Revenue has power to compute as it deems fit the assessable profits for:

i) the year of assessment in which the change ensued;

ii) the two years of assessment following;

iii) the 3 years identified (i.e. the year of assessment the change ensued and the two years of assessment following), the profits of the entity is assessed based on preceding year basis using the old accounting date;

iv) the same 3years of assessment identified in i-iii, while in addition, compute assessable profit on a preceding year basis using the new accounting year end

Given the above, the tax authority shall:

v) compute the aggregate assessable profit for three years based on the old and new accounting dates; and

vi) assess the entity's profit to tax based on the accounting year end that produces the higher aggregate assessable profits.

The implication of the above is that when there is a change of date of fiscal year of a company, the assessable profits for tax purpose will be computed on the basis of the old and new accounting date for the three relevant years and the tax authority will decide on the alternative that produce the higher assessable profits. It is worthy of note that the preceding year rule is rigorously observed throughout the computations.

Illustration 2

Freestyle Plc. had for many years prepared accounts to 31st December. However, in its Annual General Meeting (AGM) in 2008, the Board of Directors agreed to prepare the next accounts to end on 30th April 1010. Find below, the relevant adjusted profits:

	₦'000
12 months to December 31, 2007	264,000
12 months to December 31, 2008	352,000
16 months to April 30, 2010	495,800
12 months to April 30, 2011	211,200

Required: Calculate the assessable profit of Freestyle Plc. for the relevant years of assessment.

Suggested Solution

Freestyle Plc.
Computation of Assessable Profits for all Relevant Years

a. Computation Based on Old Accounting Date

YOA	**Basis Period**	**Assessable Profit**
		₦'000
2009	1/1/08-31/12/08	352,000
2010	1/1/09 – 31/12/09	371,850
	12/16 x 495,800	
2011	1/1/10-31/12/10	264,750
	4/16 x 495,800 + 8/12 x 211,200	

		988,600

b. **Computation Based on New Accounting Date**

YOA	**Basis Period**	**Assessable Profit**
		₦'000
2009	1/5/07-30/4/08	
	8/12/ x 264,000 + 4/12 x 352,000	293,333
2010	1/5/08 – 30/4/09	
	8/12 x 352,000 + 4/16 x 495,000	358,417
2011	1/5/09-30/4/10	
	12/16 x 495,800	371,850
		1,023,600

SELF-ASSESSMENT EXERCISE 4

1. When there is a change of date of fiscal year, the tax authority has power to compute tax as it deems fit on the assessable profit. Highlight those situations that warrant this?

2. Julius Berger is a construction company incorporated in Nigeria with affiliates worldwide. It has been operating in Nigeria for many years and prepares it accounts to 31 December of every year. the controlling company for all the affiliates worldwide which has its registered office in the United Kingdom had also been preparing its accounts to 31 December of every year, until 1993, when it decided in its AGM that all affiliated companies worldwide must submit copies of their audited financial statements two months before 31 December of every year, beginning from 1993. There are two alternative Julius Berger is considering:
   a) June 1994; or
   b) September 1994

As a student of taxation, your advice was sought for so as to ascertain the financial year-end that would minimize the assessable profits on which tax is payable for those periods and the following information were provided:

	₦
Net profit per accounts for 12months ended 21 Dec. 1992	200,000
Net profit per accounts for 12months ended 31 Dec. 1993	500,000
Net profit per accounts for 12 months ended 31 Dec. 1994	600,000
Net profit per accounts for 1 months ended 31 Dec. 1995	700,000

Other information in respect of the accounts for the year ended 31st December are as follows:

	1992	**1993**	**1994**	**1995**
	₦	₦	₦	₦
Depreciation charged	20,000	50,000	55,000	70,000
Loss on Sales of Assets			(5,000)	

Required: Advise the management of Julius Berger with supporting computations on the new accounting year-end which they should adopt.

3.5 Rules for Business Cessation

In reality, some organizations are deemed to liquidate or may cease to continue in business. When this situation occurs, it is referred to as cessation of trade or business. In business cessation, the computations of tax are dependent on the ultimate year. By Ultimate year, we simply mean the year in which the business ceased to exist. Close to this is the penultimate year which refers to the assessment year before the year of cessation of trade or business.

Some of the issues on business cessation have been dealt with in prior units of this module. However, we shall focus on other issues as regards business cessation as well as computations in tandem with business cessation.

Issues on business cessation or cessation of trade/business were clearly treated in the Companies Income Tax Act (CITA), Part IV, No. 4 2013. According to the provisions of CITA, where a company permanently ceases to carry on a trade or business (or in the case where a company other than a Nigerian company, permanently ceases to carry on a trade or business in Nigeria), its assessable profits therefrom shall be:

- as regard the year of assessment in which the cessation occurs, the amount of the profits of that year;
- as regards the year of assessment, preceding that in which the cessation occurs, the amount of the profits as computed in accordance with the foregoing subjection, or the amount of that profits of such year, whichever is the greater;
- provided that where the profits of such year is for a period of nine months from 1st April to 31st December, 1980, the profits shall be grossed up as if they were the profits of twelve months; and
- treated in such a way that the company shall not be deemed to have derived assessable profits from such trade or business for the year of assessment following that in which the cessation took effect.

Illustration 3

Afri Print Nigeria Limited has been in business of book production for several years in Nigeria. The company ceased trade as it could not procure raw materials in commercial quantity to continue production of quality books, reams of paper, and so on. The results of its last years of operation are given below:

	N'000
Year ended 31st December 2007	28,000
Year ended 31st December 2008	31,000
Period ended 30th June 2009	16,800

The following transactions occurred after the date of cessation:

- On 15th July 2009, the company's solicitor recovered N17.5 million debt from a customer previously considered as irrecoverable. The solicitor is entitled to 5% of any amount received.

- On September 5 2009, the company's vehicle that was stolen by hoodlums in 2008 was recovered by the Nigerian Police and disposed for N610,000

- One of the creditors accepted N2.5 million of his outstanding balance of N4 million as full and final settlement of debt.

Required: Calculate the assessable profit for all the relevant years.

Suggested Solutions

Afri Print Nigeria Limited
Computation of Assessable Profits for all Relevant Years

YOA	Basis Period		Assessable Profit N'000
2008	The higher of:		
	PYB 1/1/07 – 31/12/07	28,000	
	AYB 1/1/08 – 31/1/08	31,000	31,000
2009	1/1/09 – 30/6/08		34,925

Workings:
Adjustments for Post Cessation Transactions

YOA	Basis Period		₦'000	Assessable Profit ₦'000
2009	Assessable Profit			16,800
	Add:	Debt received	17,500	
		Debt Waived	1,500	19,000
				35,800
	Less:	Legal expenses (5% x 17,500)		(875)
				34,925

4.0 SUMMARY

The unit has dealt with the determination of basis period for assessment. Precisely, the following aspects have been dealt with in this unit:

- The basis period for companies;
- On-going or subsisting business;
- Rules for new trade
- Rules for change of date of fiscal year
- Rules for business cessation

5.0 TUTOR-MARKED ASSIGNMENT

1. What are the conditions that determine the basis period for companies in Nigeria and what is the implication for on-going or subsisting business?
2. Crunches commenced a fast food trade on 1st July 2002 and make up accounts to 31st December of every year. The company changed its accounting year in

2006 to 30th September. As a result of certain financial crisis militating against the operations of Crunches, the company ceased trade on February 28th 2010. The result of the company's operations are summarized below:

	N'000
Period to 31st December 2002	62,000
Year ended 31st December 2003	164,500
Year ended 31st December 2004	188,000
Year ended 31st December 2005	235,000
Period to 30th September 2006	297,600
Year ended 30th September 2007	317,400
Year ended 30th September 2008	282,000
Year ended 30th September 2009	169,200
Period to 28th February 2010	94,000

Required: Ascertain the assessable profits while taking into cognizance, the relevant provision in the tax law for assessing companies to tax.

7.0 REFERENCES/FURTHER READING

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MODULE 4: TAXATION OF LIMITED LIABILITY COMPANIES

UNIT 3: CAPITAL ALLOWANCE COMPUTATION

CONTENTS

1.0 INTRODUCTION

In Nigeria, the Company Income Tax Act (CITA) dealt with capital allowances provisions and it is also alike to that of Personal Income Tax Act (PITA) as it relates to individuals. In this regards, an understanding of capital allowance provisions in personal income taxation can be expediently and effectively applied to companies' taxation because the rules of computing capital allowance are the same for both company and personal taxations. In this unit, background knowledge of the concept was provided with the general rules for computing capital allowances in line with the applicable provisions of the Nigerian Tax Act.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- identify the types of capital allowances
- explain the types of qualifying capital expenditure
- state the conditions for granting capital allowance
- illustrate balancing adjustments on disposal of qualifying capital expenditures

3.0 MAIN CONTENT

3.1 Types of Capital Allowances

Basically, there are three (3) types of capital allowances namely initial allowance, annual allowance and investment allowance. However, there is another fourth components of capital allowance which is referred to as balancing charge and balancing allowance. The three types of capital allowances are discussed below:

3.1.1 Initial Allowance

Initial allowance is one of the types of capital allowances which may be claimed once and in the year when the qualifying capital expenditure is first put to use. It can be granted on second hand assets, excluding second hand buildings. Also, it can only be prorated or apportioned if there is an element of private use. Thus the amount of initial allowance can be split between business and private use only.

In respect of qualifying expenditure on plant and machinery for the replacement of old ones, one-off 95% capital allowance in the first year shall be granted. The 5% book value shall be retained until the final disposal of the asset. The aggregate capital allowances granted in respect of any asset shall not exceed 95% of the total cost of the asset as provided by the Nigerian income tax law.

3.1.2 Annual Allowance

This allowance is claimable over the estimated useful life of the qualifying asset on a yearly basis. This is usually computed on the balance of cost after the deduction of the amount of initial allowance claimed on the qualifying capital expenditure or asset. For subsequent years, annual allowance is arrived at by dividing the Tax Written Down Value (TWDV) of the asset by the unexpired life. TWDV is cost minus initial allowance and annual allowance of the asset.

In order to arrive at the annual allowance, it is computed by dividing the difference between the cost of the asset and the initial allowance by the estimate useful life of the asset, provided that an amount of ₦10 retained in the account for tax purposes until the asset is finally disposed. In recent times, some practitioners have argued that the residual value of ₦10 should be deducted and retained in the books in the last year of assessment.

Annual allowance is computed on a straight-line basis. It is not prorated based on the date the asset was acquired but based on the number of months making up the basis period for profit, which is usually the first year the taxpayer commenced business or trade. The formula for arriving at annual allowance is given as:

First Year: $\dfrac{\text{Cost – Initial Allowance (IA)}}{\text{Useful of Life of the Asset}}$

First Year (pro-rated): $\dfrac{\text{Cost –IA}}{\text{Useful of Life of the Asset}} \times \dfrac{\text{No. of months for basis period}}{12}$

Subsequent Year(s): $\dfrac{\text{Tax Written Down Value (TWDV)}}{\text{Unexpired Useful Life of the Asset}}$

Final year(s): $\frac{\text{TWDV} - 10 \times \text{Number of Assets}}{1}$

Illustration 1

Great Enterprise commenced trade on May 2010 and acquired a motor vehicle at a cost of N1,000,000. Assuming that the rate of initial allowance is 25% and that of annual allowance is 20%. You are required to compute the capital allowance claimable up to 2012 tax year.

Suggested Solution

		₦
2010 tax year cost ₦1,000,000		
Initial Allowance (I.A) (25%) (250,000)		250,000
Annual Allowance (A.A) (20%) $\frac{1,000,000 - 250,000}{5}$		
(For 8 months) $= \frac{8}{12} \times 150,000$		
$= (100,000)$		100,000
		350000
2011	TWDV(1,000,000-350,000)	
	Annual Allowance (12 months i.e. 12/8 x N100,000)	150000
2012	TWDV	5,000,000
	A.A (12 months)	150,000

3.1.3 Investment Allowance

There is also investment allowance claimable on qualifying expenditure incurred on plant and machinery, tools, equipment, etc. at the rate of 10%. It is usually granted once in the life of an asset and must be in the year the asset was first put into use for the purpose of the business or trade.

The provisions of CITA relating to initial allowance also apply to investment allowance except that an investment allowance is not to be deducted from cost of the assets in arriving at the residue of qualifying expenditure. Also, when a company incurs capital expenditure on electricity, tarred road, investment allowance will be claimable as follows:

v. provision of electricity, water and tarred road will be 100% of amount incurred;
vi. provision of electricity only 50% of the amount incurred;
vii. provision of water only 30% of the amount incurred; and
viii. provision of tarred road only 15% of the amount incurred.

In line with the provision of the Nigerian tax law, investment allowance cannot be claimed, or if already granted, shall be withdrawn if any of the following conditions hold within a period of five years from the date of acquisition of the assets:

(a) any sale or transfer of the asset otherwise than to a person acquiring the asset for a chargeable purpose or for scrap;

(b) any appropriation of the asset to a purpose other than a chargeable purpose;

(c) any sale or transfer or other dealing with the asset being a case where it appears:
   - that the purpose of obtaining tax allowances was the sole or main purpose of the company for incurring the expenditure or for so dealing with the asset; or
   - that the incurring of the expenditure and the asset being so dealt with, were not *bona fide* business transactions, or were artificial or fictitious transactions, and were designed for the purpose of obtaining tax allowances.

Illustration 2

Assuming a qualifying capital expenditure for Jitos Company Plc in the class of plant and machinery is acquired for ₦5,000,000. What is the investment allowance that will be granted by the relevant tax authority to Jitos who acquired the asset?

Suggested Solution

The investment allowance on such plant and machinery is	=	
(10% x ₦5,000,000)	=	₦500,000

SELF-ASSESSMENT EXERCISE 1

1. List and briefly explain the types of capital allowance known to you?

3.2 Types of Qualifying Capital Expenditures

Qualifying capital expenditure means capital expenditure incurred in a basis period. In the Nigerian tax law, qualifying capital expenditure are claimable on the following:

(a) **Buildings expenditures:** These are usually referred to as qualifying building expenditure. They take the form of industrial non-industrial building. Industrial building expenditure include structures or works of a permanent nature (e.g. warehouse, dock, port, jetty, wharf etc) while non-industrial building expenditure include structures of permanent nature other than industrial building (e.g. office complex);

(b) **Plant, machinery, fixtures and fittings**: They are usually referred to as qualifying plant expenditure;

(d) **Public transportation motor vehicles**: They are expenditure incurred on vehicles and fleet of buses not less than three used for public transportation;

(d) **Agricultural plant**: They refer to qualifying agricultural expenditure incurred on plant used in agricultural business ranging from tractors, and other farming equipment;

(e) **Research and development expenditure**: This refer to qualifying research and development expenditures incurred on equipment and facilities, patents license, secret formula, product testing, market testing and other costs not traceable to the existence of any assets;

(f) **Mining:** This refers to qualifying mining expenditure incurred in tandem with a mine, oil well, gas well, quarry or other source of mineral deposit of a wasting nature;

(h) **Ranching and plantation**: This refers to qualifying ranching and plantation expenditure incurred in tandem with a plantation and ranching and they take the form of initial seedlings and labour cost and any construction works or buildings which are likely to be of little help when the plantation is no longer working.

(i) There are also qualifying capital expenditure for housing estate, construction and manufacturing industrial plants.

Note that any expenditure which is an allowable deduction in computing profits of the company's trade or business in accordance with the provision of CITA, shall not be treated as qualifying expenditure.

SELF-ASSESSMENT EXERCISE 2

1. In the Nigerian tax law, qualifying capital expenditure are claimable on certain items. List and briefly explain five (5).

3.3 Conditions for Granting Capital Allowances

The following conditions have to be satisfied in order for a taxpayer to qualify for capital allowances:

(i) The ownership of the asset should not be in dispute;

(ii) The qualifying capital expenditure must be owned by the taxpayer as at the end of the basis period. Thus, an asset obtained via hire-purchase agreement can be subjected to capital allowance claim.

(iii) The capital allowances must be claimed for by the taxpayer apart from where the relevant tax authority is of the view that it is just and rational to grant allowance without a claim.

(iv) The expenditure must be used for the purpose of the trade or business.

(v) The qualifying capital expenditure must be incurred in the basis period.

(vi) The taxpayer who is the claimant must incur qualifying capital expenditure as defined in the tax laws.

(vi) The tax authority will demand a certificate of acceptance for all the qualifying capital expenditures incurred in any year of assessment in excess of ₦500,000. In practice, the certificate of acceptance is usually issued by the Inspectorate Department of the Federal Ministry of Commerce and Industries in Nigeria.

(vii) Where the basis period for any year of assessment is a period less than one year, for instance, when the commencement provisions are being applied, the annual allowance for that assessment year shall be proportionately reduced.

(viii) Unutilized allowances in the year of permanent cessation of a trade or business carried on by an entity shall be available for relief against the remainder of its assessable profits for the preceding year of assessment and so on for other preceding years up to the fifty year before the year of permanent cessation.

(ix) Where a relief is to be given to a company after the assessment has become final and conclusive in respect of any assessment year, the Revenue Service may make such repayment or set-off of the tax, or any part of such tax, paid or charged for that year as may be appropriate, in lieu of making the deduction for the amount of the relief.

(x) The residue of expenditure is the total qualifying expenditure incurred less of any initial and annual allowances granted to date. Note that investment allowance should not be deducted from qualifying expenditure to arrive at the residue.

SELF-ASSESSMENT EXERCISE 3

State five (5) conditions for granting capital allowance?

3.4 Balancing Adjustments on Disposal of Qualifying Capital Expenditures

Balancing charge or adjustments is one of the elements of balancing adjustment, which is gotten when an asset is disposed of. Practically, it may occur where the sales proceeds exceed the tax written down value at the time of disposal. It is also regarded as an additional taxable income chargeable to tax. Furthermore, the maximum amount taxable should not exceed the total capital allowance that will be claimed on the asset before the disposal of such asset.

Balancing allowance arises where proceed from sale on disposal of qualifying capital expenditure is less than the tax written down value of the asset. In this manner, it may be seen as an extra annual allowance as it decreases tax liability for the taxpayer. A balancing allowance can only be made if immediately prior to the disposal of the asset, the owner puts the asset in use by the trade or business for the purpose of which the qualifying expenditure was incurred.

The 1985 Financial (Miscellaneous Taxation Provisions) Act in Nigeria established the restrictions or limits of an amount of capital allowance claimable in the year of assessment. This amount is limited or restricted to $66^{2/}3\%$ of assessable profit for non-manufacturing and non-agricultural companies.

Illustration 3

Given that an asset with a tax written down value of ₦487,500 is sold for ₦600,000. Compute the balancing charge.

Suggested Solution

	₦	
TWDV	487,500	
Sales proceeds	600,000	
Balancing charge		112,500

Illustration 4

Jefferson Nigeria Limited commenced a retail trade business on 1 October 2007 and makes up accounts to 30 September of every year. The following qualifying capital expenditure on plant and machinery were incurred:

Date	Amount
	₦
1/01/07	260,000
1/11/07	267,500
1/4/08	362,500

Required:
Calculate capital allowances for the relevant years of assessment
Suggested Solution

Jefferson Nigeria Limited
Computation of capital allowances for the relevant years of assessment

The annual allowance for the first year of assessment will be as follows:
Basis period for capital allowance purposes is the period
1/10/07 to 31/12/07

	₦
Total qualifying expenditure during that period	527,500
Less Initial Allowance (I.A.) at 50%	263,750
Balance of cost after initial allowance	263,750
Investment Allowance is also due, since the item is capital in nature (i.e. plant and machinery):	₦
Investment Allowance at 10% of ₦527,500	52,750
Annual allowance:	
For a full year at 25% of ₦263,750	65,938

But restricted to 3/12 x ₦65,938, in view of number of months in the basis period being less than twelve.	16,485
Residue of expenditure c/f to the second year of assessment	247,265

SELF-ASSESSMENT EXERCISE 4

1. Differentiate between balancing charge or adjustment and balancing allowance?
2. State the restrictions on capital allowance claimable?

4.0 SUMMARY

This unit explored capital allowance computation as regards companies in Nigeria. More specifically, the following issues were covered:

- Types of capital allowances
- Types of qualifying capital expenditure
- Conditions for granting capital allowance
- Balancing adjustments on disposal of qualifying capital expenditure

6.0 TUTOR-MARKED ASSIGNMENT

1. What is capital allowance and of what purposes are they granted?
2. State at least five (5) conditions for granting capital allowance?
3. List and briefly explain five (5) qualifying capital expenditure claimable.
4. Henry Nigeria Plc. commenced a business on 1 October 2008 and makes up accounts to 30 September of every year. The following qualifying capital expenditure on plant and machinery were incurred:

Date	**Amount**
	₦
1/01/08	5,200,000
1/11/08	5,350,000
1/04/09	7,250,000

Required: Calculate capital allowances for the relevant years of assessment

7.0 REFERENCES/FURTHER READING

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MODULE 4: TAXATION OF LIMITED LIABILITY COMPANIES

UNIT 4: LOSS RELIEF

CONTENTS

1.0 INTRODUCTION

Practically, for one to arrive at the chargeable income of taxpayers, reliefs and allowances, where granted, are matched with their statutory total income. Statutory total income here refers to the addition of both the earned and unearned incomes of an individual or that of corporate entities in Nigeria.

Reliefs and allowances are meant to reduce the tax burden on the taxpayers so as to enable them recoup losses incurred in a particular year of assessment from subsequent year's profits. However, in contrast to what is obtained in personal income tax, there is no current year loss relief available to corporate entities. That which is available to them are the reliefs carried forward.

The Nigerian tax law permits companies to only use carry forward loss relief method based on the following fundamental conventions:

- Losses are relieved on preceding year basis. For instance, loss incurred in the financial year ended 30th November 2015 would be relieved in 2016 tax year;
- Losses can only be relieved from the same source which the loss was incurred; and
- Companies other than insurance companies can carry forward losses indefinitely. That is to say, insurance companies can only carry forward losses up to four (4) years of assessment after the year the loss was incurred and any unrelieved portion becomes elapsed.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- understand types of loss reliefs and their treatments
- treat losses under commencement and cessation of trade

3.0 MAIN CONTENT

3.1 Types of Loss Reliefs and their Treatments

In accordance with the Nigerian income tax laws, the following are the underlying principles and types of loss reliefs for a business or trade:

- Effective Loss Relief,
- Current Year Loss Relief; and
- Carry Forward Loss Relief.

3.1.1 Effective Loss Relief

As stated earlier on, there are certain underlying principles for relieving losses in accordance with the Nigerian tax law. They include effective loss relief, current year loss relief and carry forward loss relief. The effective loss relief principles holds that where a loss is taken into cognizance in the determination of assessable profit in any year of assessment, such loss is deemed to be effectively relieved to the extent of the profit available.

3.1.2 Current Year Loss Relief

The current year loss relief principle allows losses to be relieved against prior year profit. The current year loss would be relieved from all sources of income accruing to the taxpayer. Note that current year loss relief is available only to individuals that apply in writing to the relevant tax authority within 12months after the year of assessment in which the loss was incurred.

3.1.3 Carry Forward Loss Relief

The carry forward loss relief principle allows losses to be carried forward to subsequent years and relieved only from the profit of the same source in which the loss was incurred. This means that any portion of current year's loss that is not fully relieved would be carried forward. Companies and individual taxpayers are allowed to use carry forward loss relief without any writing to the relevant tax authority.

There are loss relief for individuals and that of companies. First, individuals are permissible by the Nigerian tax law to use both current year and carry forward loss relief methods based on the following fundamental conventions:

- Losses are relieved on current year or actual year basis. The implication is that a loss incurred in a year let's say 30th November 2015 would be relieved in 2015 tax year. In principle, the loss incurred in 2015 is being relieved against the profit of the financial year ending in 2014 which is assessed to tax in 2015 tax year on preceding year basis;

- Losses incurred by an individual can be relieved from income from all other sources accruing to the individual in that year of assessment;

- Where a loss is not completely relieved on current year, the unrelieved portion becomes a carry forward and can only be relieved subsequently from the same source the loss was incurred;

- Loss incurred from property letting business or trade is not allowed to be relieved on current year basis; and

- Individuals other than those engaged in agriculture business can carry forward loss up to four (4) years of assessment. Any unrelieved portion after the fourth year becomes lapsed.

SELF-ASSESSMENT EXERCISE 2

1. State the various provisions for loss relief for companies?
2. What are the underlying principles for relieving losses incurred by a company?

3.2 Treatments of Losses under Commencement/Cessation of Company

Illustration I: Effective Loss Relief

XYZ commenced business on May 1st 2009 and prepares it accounts for September every year. During the year ended 30/9/2009, there was a loss of ₦400,000 while the results for the year ended 30/9/2010, revealed a profit of ₦500,000. Compute the loss relief.

Suggested Solution

XYZ
Computation of Loss Relief (using the Effective Loss Relief)

2009 tax year: 1/5/09 to 31/12/09 {(₦400,000) + 3/12*₦500,000}

	Profit available	₦125,000
	Loss	(₦400,000)
	Loss c/f	(₦275,000)

2010 tax year: 1/5/09 to 30/4/10{(₦275,000) + 4/12*₦500,000}

	Profit available	₦166,667
	Loss b/f	(₦257,000)
	Loss c/f	(₦90,333)

2011 tax year: 1/10/09 to 30/09

Profit	₦500,000
Loss b/f	(₦90,333)
	₦ 409,667

It is worthy to mention that there is restriction to actual loss and available profit as well. For restriction to actual loss, it implies that the aggregate deduction from assessable profit with respect to any loss shall not be more than the actual loss incurred.

Illustration 2: Restriction to Actual Loss

XYZ commenced business on May 1st 2009 and the result of its operations were for the year ended 30/04/2010, revealed a loss of ₦400,000, while the results for the year ended 30/04/2011, showed a profit of ₦300,000. Compute the restriction to actual loss.

Suggested Solution

XYZ
Computation of Loss Relief (Restriction to Actual Loss)

2009 tax year:	1/5/09 to 31/12/09	8/12 *	(₦400,000)
	Loss c/f		(₦266,667)
2010 tax year:	1/5/09 to 30/4/10		(₦400,000)
	Loss b/f		(₦266,667)
	Total Loss		(₦666,667)
	Restricted to actual loss c/f		(₦400,000)
2011 tax year:	1/05/10 to 30/04/11		₦300,000
	Unrelieved loss b/f		(₦400,000)
	Unrelieved loss c/f		(₦ 100,00)

For restriction to available profit, the principle demands that the aggregate deductions from assessable profit in a particular year of assessment with respect to any loss shall not be more than the profit available.

For instance, using the above illustration, the assessable profit available for 2011 tax year is ₦300,000 while the unrelieved loss brought forward is ₦400,000. The implication with respect to restriction to available profit is that the taxpayer can only relieve ₦300,000 in 2011 tax year and the balance of ₦100,000 carry forward to 2012 tax year.

SELF-ASSESSMENT EXERCISE 2

In your own view, what do you understand by effective loss relief and restriction to actual loss?

Illustration 1

Ali Boy has the following financial records:
Year ended 31 December 2008 ₦1,250,000
Year ended 31 December 2009 ₦1,500,000 (loss)
Year ended 31 December 2010 ₦2,000,000

Required:
Compute the assessable income stating how the loss would be relieved.

Suggested Solution

Ali Boy
Computation of Assessable Income

YOA	**Basis Period**		**Assessable Income**	
2009	1/1/08-31/12/08	=	1,250,000	₦
	Less: Current loss relief		(1,500,000)	
	Unrelieved loss c/f		(250,000)	Nil
2010	1/1/09 – 31/12/09	=	1,500,000(loss)	Nil
2011	1/1/10 – 31/12/10	=	2,000,000	
	Less: Unrelieved loss b/f		(250,000)	1,750,000
				1,750,000

4.0 SUMMARY

The unit highlighted loss relief as it pertains companies in accordance with the Nigerian tax law. More specifically, the following areas were covered:

- Types of loss reliefs and their treatments
- Treatment of losses under commencement and cessation of trade

5.0 TUTOR-MARKED ASSIGNMENT

1. State the provisions for loss relief for companies?
2. What is the basic condition that must be fulfilled before current year's loss relief can be made available to companies?

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

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MODULE 5: TAXATION OF SPECIALIZED BUSINESSES

UNIT 1: TAXATION PROVISIONS AND COMPUTATION FOR REAL ESTATE, TRUST AND SETTLEMENT BUSINESSES IN NIGERIA

CONTENTS

1.0 INTRODUCTION

There are numerous accounting and tax issues emanating from estate administration, trust and settlements and they comprise of capital gain tax, income tax and capital transfer tax (now repealed) computations. The preparation of such trust, estate and settlement accounts in relation to the incomes are needed for the beneficiaries, trustees as well as other interested parties (e.g. relevant tax authorities) about the transactions and the current state of affairs of the trust, estate and settlement.

It is worthy to note that the assessable income of a trust, executor or a beneficiary of a settlement or trust for any taxpayer is deemed to be the income of that person on preceding year basis, derived from business, profession or vocation. However, this unit dealt with the taxation provisions and computation for real estate, trust and settlement businesses in Nigeria.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- understand the conceptual issues in estate, trust and settlement businesses
- know the format of computed income under real estate, trust and settlement businesses in Nigeria

- identify special deductions under real estate, trust and settlement business in Nigeria
- illustrate the apportionment of computed income under real estate, trust and settlement businesses in Nigeria
- know the special provisions as to settlement of unmarried children
- ascertain the basis of assessment

3.0 MAIN CONTENT

3.1 Conceptual Issues in Estate, Trust and Settlement Businesses

The following are some of the conceptual issues under estate, trust and settlement businesses:

(i) **Administration:** This refers to the dealing with the estate of a deceased person, that is, collecting assets, paying the debts and distributing any surplus among the persons entitled to.

(ii) **Administrative Period:** This is the period between the date of death and the date of the executor is able to set up a trust or distribute the residue of the estate – any undistributed residue remain in trust and is in the same position as any other trust estate e.g. one established by deed.

(iii) **Administrator:** This is a person appointed by the course to administer the estate of an intestate or of testator where an executor has not been appointed or if appointed, does not act.

(iv) **Estate:** This refers to the property of the deceased person or the aggregate of the things possessed by a person. That is, money, goods and property of any kind.

(v) **Executor:** This is a representative appointed by the will or codicil of a deceased person to administer his estate after his death. When a person dies, his estate passes into the possession of his personal representatives, executors or administrators.

(vi) **Intestate:** This is when a person dies and leaves no valid will or leaves a will but has not disposed off all his property by the will, is said to have died intestate.

(vii) **Settlement:** This is an agreement whereby a sum of money is set aside to make provision for another person. Settlement also is every device by which the employment of an estate under the said deed or will may be had by persons in succession.

(viii) **Testator:** This is the person making a will.

(ix) **Trust:** This is a disposition of property whereby the title thereto is vested in one or more trustees who are required from eth terms of the deposition to apply the benefits arising out of the property for the advantage of the beneficiaries.

(x) **Beneficiaries:** These are types of persons that may benefit from the income of an estate. Examples of beneficiaries include:

- **Legatee:** This is an individual to whom a legacy is bequeathed, that is a person receiving a specific bequest form the estate
- **Annuitant:** An individual receiving an annuity that may be charged on the income of the estate, on income and capital or on a particular asset.

(xi) **Trustee:** This is an individual to whom is given the administration of a trust, an individual who holds property on trust for another. A trustee may also be a beneficiary.

(xii) **Connected Persons:** This refers to a person that is related to an individual. Such connected persons may include husband, wife, children, brother, sister, ancestor, linear descendant, uncle, aunt, nephew, or niece or a person who is the trustee of settlement of any person who is connected with the settlor.

(xiii) **Settlor:** This is in relation to a settlement and they include any person by whom the settlement was made or entered into directly or indirectly, and in particular includes any person who has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement.

SELF-ASSESSMENT EXERCISE 1

1. Define the following terms in relation to estate, trust and settlements:
   (a) Administration
   (b) Administrative Period
   (c) Administrator
   (d) Estate
   (e) Executor
   (f) Intestate
   (g) Settlement
   (h) Testator
   (i) Trust
   (j) Beneficiaries
   (k) Trustee
   (l) Connected Persons
   (m) Settlor

3.2 Format of Computed Income Determination under Real Estate, Trust and Settlement Businesses in Nigeria

The following format(s) applied to the computed income determination under real estate, trust and settlement businesses in Nigeria.

Format 1: Computed Income Determination

XYZ Trust or Settlement
Computed Income for the year ended December 31 2015

	₦	₦
Income		
Earned	X	
Unearned	X	X
Deduct:		
Authorized Expenses	X	
Annuity of Fixed Amount	X	
Trustees or Executors Remuneration	X	(X)
Computed Income		**X**
Less: Discretionary Payment		(X)
Net Computed Income (available for share)		**X**

Amount Due to Each Beneficiary

	O	**P**	**Q**	**R**
Annuity of Fixed Amount	X	X	X	X
Share of computed income	X	X	X	X
Discretionary payments	X	X	X	X
	XX	XX	X	XX

Format 2: Computed Income Determination

XYZ Trust or Settlement
Computed Income for the year ended December 31 2015

	₦	₦
Earned Income		
Trading Profit	X	X
Sundry Income	X	
Unearned Income:		
- Dividends	X	
- Rent	X	
- Royalty	X	X
Less: Authorized Expenses		XX
Annuity of Fixed Amount	X	
Trustee or Executors Remunerations	X	XX
Less Capital Allowance		(XX)
Total Income of Trust Taxable		**XX**
Tax Liability Computed		X

Less withholding taxes (XX)

Distributable Income **XX**

Illustration

Ahmed lived in Kano State for many years and died in 2002 due to insurgency in the area. He was survived by a widow and three children: two sons and a daughter. Ahmed left a will appointing Abdukareem as his executor to administer his estate. Abdukareem obtained the necessary power under the will and has since 2002 been administering the estate.

The executor's account showed the following income and expenses during the year ended 31 December 2005:

		₦
Income:		
-	Rent income relieved from properties	375,000
-	Dividends paid by Dangote Plc. (Gross)	187,500
Expenses:		
-	Rates and grounds rents	42,500
-	Commission on rent collected	18,750
-	Repairs and upkeep of properties	46,250
-	Wages of staff	30,000
-	Professional fees (to the executor)	20,000

Under the will, Abdukareem has discretion to make an ex-gratia payment in case of need to any of the beneficiaries but should not exceed ₦75,000 in any one year. During the year ended 31st December 2005, Abdulkareem paid ₦30,000 to the twin sons in equal amounts in this regards. The beneficiaries' share of the estate is determined by the will to be:

Wife: 2; Son No.: 3; Son No.: 3; and Daughter: 2

Required: Compute the amounts which the beneficiaries would include in their respective income tax returns of 2006 year of assessment in respect of the income for the state?

Suggested Solution

Estate of Ahmed

Computation of Income for year ended 31 December 2005

	Total Amount				
Income	**N**	**N**	**N**	**N**	**N**
Gross rent		375,000			
Less: Rates/Rent	4,250				
Commission	18,750				
Repairs	46,250	69,250			
		305,750			
Dividends (gross)		187,500			
		493,250	Wife	Son1	Son2
Daughter					
Less: other expenses					
Wages	30,000				
Fees	20,000	50,000			

443,250

Less: Executor's discretionary payment	30,000		15,000	15,000	
Amount available for Distribution in the ratio	375,000	75,000	112,500	112,500	75,000
		75,000	127500	127500	75,000

Note that withholding tax of 15 percent on the dividend amounting to ₦29,375 will be distributed by the beneficiaries in the ratio of 2:3:3:2.

SELF-ASSESSMENT EXERCISE 2

Mr. Kemmy died in 2003 and left all his properties in trust for his two children. The following information was made available to you in 2005 for the purposes of preparing 2004 income tax computation and tax payable by the trustees and the children: Paul and Peter.

	N
Profit year-ended 31/12/2004	75,000
Capital allowances	5,000
Rent acquired (gross)	20,000
Bank interest	4,000

Remuneration of the trustees has been fixed at N9,000 per annum. The sum of N3,000 and N4,000 was paid towards the children's university education. Expenses incurred by the Trustees in administering the estate amount to N3,250 were paid. The trust created an annuity of N3,900 in favour of Motherless Babies Home.

The children are to share equally two-thirds of the net income every year. The trustee has no power to make discretionary payments.

Required: Compute income tax payable by the trustee and the beneficiaries respectively for 2004 year of assessment while assuming that the beneficiaries have no other income.

3.3 Special Deductions under Real Estate, Trust and Settlement Business in Nigeria

The following shall be deducted from the ascertained income under real estate, trust and settlement business in Nigeria:

(i) Any expenses of the trustee or executor relative to the settlement, trust or estate which is authorized by the terms of the deed of settlement or trust or of the will as the case may be

(ii) Any annuity of fixed annual amount paid out of the income of the settlement, trust or estate in accordance with the provisions of the deed or will.

It should be noted that where the income includes any gain or profit from a trade, business or vocation or a rent or premium, there shall be added or deducted as the case may require any sum which would have been added or deducted for the next following year of assessment under the provisions of the tax law if the income from those sources had been the assessable income of an individual for that year of assessment under the provision of the Nigerian tax law.

SELF-ASSESSMENT EXERCISE 3

1. State the special deductions under trust, estate and settlement?

3.4 Apportionment of Computed Income under Real Estate, Trust and Settlement Businesses in Nigeria

According to the Personal Income Tax Act, the computed income of a year of settlement, trust or restate shall be apportioned for the settlement in the following ways:

(a) Where:
   (i) the terms of the deed of settlement or trust or of a will provide that the whole income of the settlement, trust or estate after deduction of any authorized expense or annuity of fixed amount is to be divided in specific proportions among the beneficiaries entitled thereto, from time to time, or
   (ii) by operation of the law or an intestacy, the income of an individual is to be divided in the manner referred to in the PITA, the income of each beneficiary of any year from the settlement, trust or estate shall be his similarly apportioned share of the computed income.

(b) Where:
   (i) A trustee or executor has discretion to make any payment (other than a payment on account) to a beneficiary out of the income of a settlement, trust or estate in such amount as he sees if from time to time, then the amount of the payment to a beneficiary made in the cause of a year shall be treated as income of that year which is assessable to tax in the hands of that beneficiary; and
   (ii) Out of the remainder of the computed income after deducting the aggregate amount of all the payments during any year, there shall be apportioned to each beneficiary who has any specified proportion interest in the income of the settlement, trust or estate, so much thereof as is obtained by applying the proportion to that remainder, provided that if the aggregate amount exceeds the computed income, the amount of each payment to be treated as income in the hands of a beneficiary under this Act shall be reduced proportionally so that the aggregate of the amount as so reduced does not exceed the computed income.

(c) Any remainder of the computed income of a settlement, trust or estate of any year after deducting all amount apportioned to beneficiaries or treated as income in the hands of beneficiary under the provision of this Act shall be apportioned to the trustee or executor for assessment in his name as trustee of the settlement or trust or as executor of the estate.

SELF-ASSESSMENT EXERCISE 4

1. Briefly state the apportionment of computed income under real estate, trust and settlement businesses in Nigeria?

3.5 Special Provisions as to Settlement of Unmarried Children

Income paid for the benefit of a child of the settlor in a year of assessment shall be treated for the purpose of this Act as the income of the settlor and not the income of any other person if at the time of payment the child was an infant and unmarried. Exceptions to the above are:

(a) Where for any year of assessment, the aggregate amount of the income paid to or for the benefit of that child does not exceed five hundred naira only (N500)

(b) This shall not apply in relation to income arising under a settlement in a year preceding a year of assessment if the settler is not in Nigeria at any time during that year of assessment, or is not in Nigeria for a period or periods amounting to 183 days or more in any 12 months period commencing in the calendar year and ending either in the same year or the following year

SELF-ASSESSMENT EXERCISE 5

1. What are the special provisions in relation to settlement of unmarried children?

3.6 Basis of Assessment

The assessment of income from settlements, trusts and estates is governed by the provisions of PITA as follows:

(a) **Individual Receiving a Fixed Annuity:** Any individual in receipt of an annuity of fixed annual amount paid out of the income of a settlement, trust or an estate shall be assessable to tax on the full amount of the annuity. The income is assessed on preceding year basis and is included in his income tax assessment.

(b) **Beneficiary, Trustee or Executor:** Part of the computed income received by the beneficiary, trustee, executor or annuitant for a year of assessment shall be assessed on preceding year basis.

Note that:

(a) The income of a beneficiary is included in his income tax assessment in the same way as income from other sources accruing to him

(b) The income of a trustee or executor is not included in any assessment on him as an individual, but is assessed separately in his name as trustee or executor.

He cannot therefore as a trustee or executor claim personal relief so that it won't amount to double taxation relief. Note that a double taxation relief shall be available to any settlement, trust or estate whose income includes any income which has suffered tax in Nigeria or elsewhere. The relief shall be computed in accordance with the provisions of PITA and in accordance with the rules for apportioning the computed income of the year in proportion to the respective shares.

Where there is no computed income that is, where the income of the settlement, trust or estate is exhausted by expenses, annuities and other deductions, the relief or repayment shall be given or made to the trustee or executor for the discount of the settlement, trust or estate.

Where aggregate apportionment exceeds computed income

If the aggregate amount apportioned exceeds the computed income, the amount of payments made to all beneficiaries are proportionally reduced so that the total amounts equal the computed income.

SELF-ASSESSMENT EXERCISE 6

1. What is the basis of assessment for:
   a. individual receiving a fixed annuity
   b. beneficiary, trustee or executor

4.0 SUMMARY

The unit highlighted real estate, trust and settlement businesses in Nigeria More specifically, the following areas were covered:

- Conceptual issues in estate, trust and settlement businesses
- Format of computed income under real estate, trust and settlement businesses in Nigeria
- Special deductions under real estate, trust and settlement business in Nigeria
- Apportionment of computed income under real estate, trust and settlement businesses in Nigeria
- Special provisions as to settlement of unmarried children
- Basis of Assessment

5.0 TUTOR-MARKED ASSIGNMENT

1. With respect to taxation of income from a settlement, trust or estate, define the following:
   (a) Estate, Intestate and testator
   (b) Executor and testator
   (c) Trust and trustee
   (d) Connected persons

2. Mr. Kemmy died in 2003 and left all his properties in trust for his two children. The following information was made available to you in 2005 for the purposes of preparing 2004 income tax computation and tax payable by the trustees and the children: Paul and Peter.

	N
Profit year-ended 31/12/2004	75,000
Capital allowances	5,000

Rent acquired (gross)	20,000
Bank interest	4,000

Remuneration of the trustees has been fixed at N9,000 per annum. The sum of N3,000 and N4,000 was paid towards the children's university education. Expenses incurred by the Trustees in administering the estate amount to N3,250 were paid. The trust created an annuity of N3,900 in favour of Motherless Babies Home.

The children are to share equally two-thirds of the net income every year. The trustee has no power to make discretionary payments.

Required: Compute income tax payable by the trustee and the beneficiaries respectively for 2004 year of assessment while assuming that the beneficiaries have no other income.

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

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MODULE 5: TAXATION OF SPECIALIZED BUSINESSES

UNIT 2: TAX PROVISIONS AND COMPUTATION FOR TRANSPORTATION/TELECOMMUNICATION BUSINESSES

CONTENTS

1.0 INTRODUCTION

The taxation of transportation and telecommunication businesses will arise on the preceding year basis at 30% of taxable profit. All the basic rules as discussed under the taxation of companies are applicable to transportation and telecommunication businesses in Nigeria. This covered allowable and non-allowable expenses and taxable and non-taxable incomes. This business is categorized as 'Taxation of Special Business' due to the peculiar nature of their income and expenditure and the impact on tax payable.

Special businesses comprise of Insurance business, air transport, shipping and telecommunication businesses and unit trust schemes. However, this unit focused on the tax provisions and computation for two special businesses in Nigeria: Transportation and Telecommunication.

The Nigerian tax law provides for special method for ascertaining that part of global income that is actually carried out in Nigeria for the purpose of taxation. Companies under this category comprised of those that are engaged in shipping or air transportation, those that carries on the business of transmission of messages by cable or by any form of wireless, apparatus; and insurance companies.

It is worthy to note that the Vessel or Aircraft of a company that carries on the business of transport by sea or air calls at any Nigerian seaport or airport, its profit or loss that is deemed to be derived from Nigeria is the full profit or loss arising from the carriage of passengers mails, livestock, or goods shipped or loaded into an aircraft in Nigeria.

On the other hand, where a company other than a Nigerian company carries on the business of transmission of message (telecommunication) by cable or by any form of wireless apparatus, shall be assessable to tax as though it operates Ship or Aircraft, and therefore the provision of CIT as regards Ship or Aircraft apply to cable undertaking as regard the computation of its profit deemed to be derived from Nigeria as though the transmission of message to places outside were equivalent to the shipping or loading of passengers, mails, livestock or goods in Nigeria.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- understand how the tax liability of transportation and telecommunication businesses are computed
- identify the steps involved in tax computation under transportation and telecommunication businesses
- determine the gross adjusted profit ratio
- compute the total profits and income tax liability of transportation and telecommunication business

3.0 MAIN CONTENT

3.1 Tax Liability of Transportation and Telecommunication Business

For the purpose of taxation under transportation and telecommunication businesses, the tax liability will generally arise on the profit in the normal way for any other company. This is achieved by taking the net profit or loss and then adding or deducting items as discussed under the taxation of companies. What makes them special is the fact that the businesses may apply to the Federal Inland Revenue Service to be subjected to tax using two ratios.

Note that a taxpayer is only able to exercise this option where it can be proved that the tax authority of the country where the company is normally resident computes and assess tax on basis that it is not materially different from that of Nigeria. For any company that wants to take advantage under this provision, a formal application to be assessed on the basis of the two ratios should be made not later than six years from the year of assessment concerned.

SELF-ASSESSMENT EXERCISE 1

1. Briefly describe how the tax liability for transportation and telecommunication businesses are computed?

3.2 Steps Involved in Tax Computation under Transportation and Telecommunication Businesses

The tax computation is achieved as follows with respect to transportation and telecommunication businesses in Nigeria:

Step 1: Identify the global income of the company

Step 2: Identify the Nigerian income is the income derived from the carriage of goods and passengers into a ship or aircraft from Nigeria.

Step 3: Determine the Global Adjusted Profit of the company

Step 4: Compute the Adjusted Profit Ratio as follows:

$$\text{Adjusted Profit Ratio: } \frac{\text{Global Adjusted Profit} \times 100}{\text{Global Income}}$$

Step 5: Identify the Global Depreciation charged in the account

Step 6: Compute the Depreciation Ratio as follows:

$$\text{Depreciation Ratio: } \frac{\text{Global Depreciation} \times 100}{\text{Global Income}}$$

Step 7: Compute the Nigerian Adjusted Profit as follows:
Nigerian Adjusted Profit: Adjusted Profit Ratio x Nigerian Income

Step 8: Compute the capital allowance for the Nigerian operations as follows:
Capital Allowance = Depreciation Ratio x Nigerian Income

It must be noted that sometimes, the examiner may devise another basis for capital allowance computation. Where this occurs, the basis devised must be used.

For example, the examiner may require the student to assume that capital allowance to be claimed shall be 125% of the depreciation charged in the accounts. In the event that the basis of capital allowance is given, there will be no need to compute step 8 of this format.

Step 9: Compute the Taxable Profit for Nigerian Income tax purpose by deducting step 8 from step 7

SELF-ASSESSMENT EXERCISE 2

1. How is the taxable profit for Nigerian income tax computed for transportation and telecommunication business?

3.3 Gross Adjusted Profit Ratio

It is the ratio that the adjusted profit or loss before depreciation allowance bears to the total sum receivable in respect of carriage of passenger, mails, livestock or goods.

SELF-ASSESSMENT EXERCISE 3

1. What do you understand by Gross Adjusted Profit Ratio?

3.4 Computation of Total Profits and Income Tax Liability

The global income statement of Arik Airline, a foreign airline, operates in Nigeria for the year ended 31st December, 2015 shows the following:

		N'000	N'000
Transportation income			
-	income from passengers, cargo and mails		
	Outside Nigeria sales	1,550,000	
	Nigerian sales	50,000	1,600,000
Less:	Transportation expenses		
	- salaries and other expenses	1,150,000	
	- depreciation	160,000	
	- other disallowed expenses	90,000	1,400,000
Net Transportation Profit		200,000	
Other income			
	- income from properties (net)	12,500	
	- income from maintenance (net)	25,000	
	- income from duty-free shops (net)	25,000	
	- income from catering (net)	37,500	100,000
Net Profit			243,750

Required: Determine the tax payable in Nigeria

Suggested Solution

Arik Airline
Computation of Tax Liability

(a) Calculation of Adjusted Profit on the Transportation Business

	N'000
Net transportation profit as per account	200,000
Add depreciation	160,000
Disallowed expenses	90,000
	450,000

(b) Computation of Statutory Ratios:

(i) Adjusted profit ratio:

$$\frac{N450{,}000 \times 100\%}{N1{,}600{,}000} = 28.125\%$$

(ii) Depreciation ratio:

$$\frac{N160{,}000 \times 100\%}{N1{,}600{,}000} = 10\%$$

(iii) Calculation of tax payable:

Nigeria sales as above	50,000
Total Assessable Profit 28.125% of N100,000	28,125
Less: Depreciation allowance 10% of N100,000	10,000

Total Profit	18,125
Tax at 30%	5,438

Note: The depreciation allowance is in lieu of the capital allowance claimable by Arik Airline under the tax law. It is very fundamental to note that the above formula will apply on two conditions:

- if the FBIR is satisfied that the tax authority of the foreign country concerned computes and assesses the profits of companies operating ships and aircrafts on substantially similar basis as in Nigeria; and
- that the foreign tax authority certifies both the adjusted profit and depreciation relief ratios to the FBIR.

4.0 SUMMARY

The unit highlighted the tax provisions and computation for transportation and telecommunications businesses in Nigeria. More specifically, the following areas were covered:

- The tax liability of transportation and telecommunication businesses
- The steps involved in tax computation under transportation and telecommunication businesses
- Gross adjusted profit ratio
- Computation of assessable profit and income tax liability of transportation and telecommunication businesses

5.0 TUTOR-MARKED ASSIGNMENT

1. Briefly describe how the tax liability for transportation and telecommunication businesses are computed?

2. How is the taxable profit for Nigerian income tax computed for transportation and telecommunication business?

3. Delta Airline Limited is a foreign company registered in South Africa. It is involved in the carriage of passengers, mails, livestock into and out of Nigeria. You are given the following financial information for the year ended December 31, 2015

		N'000
Income from passenger's flight on other routes		25,137,500
Income from cargo loaded into aircraft on other routes		25,680,000
Income from passengers' flight from Nigeria		6,400,150
Income from cargo loaded into aircraft from Nigeria		5,875,080
		63,092,730
	N'000	
Deduct: Depreciation	82,250	
Staff salaries	1,191,055	
General provision	25,300	
Other expenses	18,225	(1,316,830)
Net Profit		61,775,900

Additional information:

(a) Capital allowance were agreed with the relevant tax authority at 120% of depreciation charged
(b) Other expenses include disallowable expenses of N7.500

Required:

(a) Compute the total profits of Delta Airline Limited for Nigerian Income Tax purposes
(b) Calculate the Income Tax Liability for the relevant assessment year, assuming tax rate of 30%

6.0 REFERENCES/FURTHER READING

Association of Accountancy Bodies in West Africa (ABWA) (2009). *Study pack for preparing tax computations and returns*. Abuja: ABWA Publishers Limited

ICAN Study Pack (2009). *Advanced taxation for Professional Examination II.* Ibadan: VI Publishing Limited

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MODULE 5: TAXATION OF SPECIALIZED BUSINESSES

UNIT 3: CRITERIA TO BE ELIGIBLE FOR SMALL COMPANY RELIEF

CONTENTS

1.0 INTRODUCTION

This unit takes a cursory look at the relief for small companies, business or trade in Nigeria. The purpose of this relief is simply to encourage full participation of these companies, business or trade (given their size) in the economic prosperity of the country. For examination purposes, students are usually expected to know when questions on small business are being set.

The simplest way of knowing this is that information on turnover would be included in the information provided. This unit explored among other issues, the meaning and computation of tax relief for small companies.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- know the meaning of small companies
- compute the tax relief for small companies
- understand the minimum tax for small companies
- identify relevant exemptions from minimum tax

3.0 MAIN CONTENT

3.1 Meaning of Small Companies

A small company, business or trade is one whose turnover does not surpass ₦1,000,000 (one million naira) for each year. A company, business or trade that falls under this category is referred to as a small company, business or trade and the applicable tax rate is 20% on the taxable profit instead of the rate of 30% for normal businesses.

The tax relief for small companies or business or trade is applicable for the first five years of the business or trade. It is also applicable to companies engaged wholly in export. It must be noted that relief for small companies are not applicable to companies formed to acquire the whole or part of an existing business.

SELF-ASSESSMENT EXERCISE 1

In your own opinion, what do you understand by small company or trade or business?

3.2 Computation(s) of Relief for Small Companies

In order to compute reliefs for small companies, trade or business, one must watch out for the information provided. Once the information provided includes information on turnover for different years such that no year's turnover exceeded ₦1,000,000, it becomes very clear that there would be the need for the computations of relief for small companies where possible.

Illustration 1

Eddyson Nigeria Limited has been in trade for some time now. However, the information relates to the company from which the tax payable is to be computed:

Year	Turnover	Adjusted Profit	Capital Allowance
	₦	₦	₦
2010	225,000	228,450	150,000
2011	325,000	284,500	175,000
2012	475,000	390,000	275,000

Required: Compute the tax liability for the relevant tax years

Suggested Solution

Eddsyson Nigeria Limited
Computation of Tax Liability for the Relevant Tax Years

	₦	₦
2011 Tax Year		
Assessable Profit		228,450
Capital Allowance	150,000	
Relieved (2/3 of 228,450)	(150,000)	(150,000)
Capital Allowance c/f	NIL	
Taxable Profit		78,450
Tax at 20%		**15,690**

	₦	₦
2012 Tax Year		
Assessable Profit		284,500
Capital Allowance	175,000	
Relieved (2/3 of 228,450)	(175,000)	(175,000)
Capital Allowance c/f	NIL	
Taxable Profit		109,500
Tax at 20%		**21,900**

	₦	₦
2013 Tax Year		
Assessable Profit		390,000
Capital Allowance	275,000	
Relieved (2/3 of 228,450)	(260,000)	(260,000)
Capital Allowance c/f	NIL	
Taxable Profit		130,000
Tax at 20%		**26,000**

Remark(s):
The most fundamental issue to note is the turnover for each of the years which is not more than ₦1million and hence the company is classified as a small company, trade or business.

On this note, the applicable tax rate is 20%. However, note that the turnover values are not needed in the computation of the tax liabilities.

SELF-ASSESSMENT EXERCISE 2

XYZ Limited has been in trade for some time now. However, the information relates to the company from which the tax payable is to be computed:

Year	**Turnover**	**Adjusted Profit**	**Capital Allowance**
	₦	₦	₦
2013	352,000	328,000	250,500
2014	452,000	384,000	275,200
2015	551,000	490,500	275,400

Required: Compute the tax liability for the relevant tax years

3.3 Minimum Tax for Small Companies

Minimum tax for small companies, trade or business is payable either where there is no chargeable profit or the chargeable profit results in no tax payable or the tax payable is less than the minimum tax. Minimum tax is computed as follows:

(a) Where the Turnover does not exceed ₦500,000, the minimum tax is the highest of:
   (i) 0.5% of Gross Profit
   (ii) 0.5% of Net Assets
   (iii) 0.25% of Paid Up Share Capital
   (iv) 0.25% of Turnover not exceeding ₦500,000

(b) Where the Turnover exceeds ₦500,000, the minimum tax is the sum of:
   (i) the highest in (a) above plus
   (ii) 0.125% of Turnover in excess of ₦500,000

Important Note

The first step in the computation of minimum tax is to ascertain the turnover of the company, trade or business. For instance, if the turnover of the company, trade or business is ₦240,000, the computation of the minimum tax would be based on step (a) above. However, where the turnover is above ₦1million, then step(a) is computed using a maximum and step (b) is computed using the difference between (a) and (b).

SELF-ASSESSMENT EXERCISE 3

What is the basis for computing minimum tax for small companies?

3.4 Exemption from Minimum Tax

Minimum tax computation is not applicable to the following company, trade or businesses:

(a) a company carrying on agricultural trade or business;
(b) a company with at least 25% imported equity capital; and
(c) a company within its first four calendar years of commencement of trade.

Illustration 1

Charles Darwin Limited has provided the following information from which you are expected to compute the tax payable:

	₦	
Adjusted Profit	1,837,950	
Capital allowance for the year	890,000	
Capital allowance brought forward	172,500	
Paid up share capital		50,000,000
Net Assets employed	37,500,000	
Turnover for the year	42,000,000	
Gross Profit for the year	19,100,000	

Suggested Solution

Charles Darwin
Computation of Tax Payable for the Relevant Tax Year

	₦	₦
Adjusted Profit		1,837,950
Capital Allowance for the year	890,000	
Capital Allowance brought forward	172,500	
	1,062,500	
Relieved	(1,062,500)	(1,062,500)
Capital Allowance carried forward	**NIL**	
Taxable Profit		**775,450**
Tax Payable at 30%		232,635

Minimum Tax Payable		₦	₦
The highest of:			
(i)	0.5% of Gross Profit (19,100,000 x 0.5%)	95,500	
(ii)	0.5% of Net Asset (37,500,000 x 0.5%)	187,500	187,500
(iii)	0.25% of Turnover (42,000,000 x 0.25%)	625	
(iv)	0.25% of Paid Up Capital (50,000,000 x 0.25%)	125,000	

Add:	
0.125% of (42,000 – 250)	52,188
Minimum Tax Payable	239,688

Since the minimum tax payable of ₦239,688 is higher than the computed tax per account of ₦232,635, the amount to be paid shall be the minimum tax for Charles Darwin Nigeria Limited

SELF-ASSESSMENT EXERCISE 4

1. Minimum tax is not applicable to certain some companies. List them?

2. XYZ Limited has provided the following information from which you are expected to compute the tax payable:

	₦
Adjusted Profit	918,975
Capital allowance for the year	445,000
Capital allowance brought forward	86,250
Paid up share capital	25,000,000
Net Assets employed	18,750,000
Turnover for the year	21,000,000
Gross Profit for the year	9,550,000

4.0 SUMMARY

This unit highlighted issues on tax relief for small companies in Nigeria. However, the following issues were covered:

- Meaning of Small Companies
- Computation(s) of Relief for Small Companies
- Minimum Tax for Small Companies
- Exemption from Minimum Tax

5.0 TUTOR-MARKED ASSIGNMENT

1. What do you understand by small company or trade or business?

2. What is the basis for computing minimum tax for small companies?

3. XYZ Limited has been in trade for some time now. However, the information relates to the company from which the tax payable is to be computed:

Year	**Turnover**	**Adjusted Profit**	**Capital Allowance**
	₦	**₦**	**₦**
2013	352,000	328,000	250,500
2014	452,000	384,000	275,200
2015	551,000	490,500	275,400

Required: Compute the tax liability for the relevant tax years

6.0 REFERENCES/FURTHER READING

Fasoto, F. (2007). *Nigerian taxation.* Lagos: Hosrtosaf Limited

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Ologhodo, C.J. (2007). *Taxation principles and practices in Nigeria: A practical approach.* Jos: University Press Limited

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MODULE 5: TAXATION OF SPECIALIZED BUSINESSES

UNIT 4: BASIS FOR TAXATION OF ENTERPRISES IN FREE TRADE ZONES

CONTENTS

1.0 INTRODUCTION

In Nigeria, companies that trade in "Free Trade Zone" or Export Processing Zone (EPZ) is regulated by the Company Income Tax Act (CITA) 2011. As part of the provisions meant for EPZ companies, they are granted allowances. There could be foreign and individual companies operating in any EPZ zone and all such companies are exempted from tax on their profits provided that the undertaking is 100% export oriented.

These sets of companies are not to be entitled to an investment allowance. The companies in this category encompasses assembling, processing of goods for export provided the value of exported goods is not less than 75% of the total turnover during the assessment year.

This is a tax incentive granted to companies in the Free Trade Zone to encourage exporting of goods so as to diversify the economy and improve the revenue base of the government. This would also provide job opportunities for unemployed people in the country. However, this dealt with companies trading in a free zone.

2.0 OBJECTIVES

The aims/objectives of this unit are to:

- identify the categories of assessment of companies in Free Trade Zones
- know the Free Trade Zone allowance
- ascertain the taxable and non-taxable incomes for companies trading in a free zone
- know the allowable and non-allowable expenses for companies trading in a free zone

3.0 MAIN CONTENT

3.1 Assessment of Companies in Free Trade Zones

In Nigeria, companies in free trade zones can be assessed to tax based on "Best of Judgment Assessment" (BOJ). BOJ is a term used to describe the estimation used by the relevant tax authority as the basis of assessment in a situation where no financial records or returns are submitted by such company in a free trade zone to the tax authority.

This may also be used in circumstances where the financial records are found to be unreliable. Furthermore, the assessment of companies in Free Trade Zones are similar to Company Income Tax.

The basis of assessment of Company Income Tax have been treated in module 4. Students may refer to this module (Unit 1 and 2) for further details on how companies are assessed to tax in Nigeria.

For instance, company income tax in Nigeria provides the following considerations on the basis for charging company income tax:

(i) The comprehensive (global) profits of resident companies regardless of whether or not they were brought into or were received in Nigeria are liable to tax. Dividend income to a resident company is treated as Franked Investment Income (FII) on which no income tax is payable.

(ii) The quota of the profits of non-resident companies derived from such companies' operations in Nigeria is liable to tax.

(iii) Dividends, interest or royalties due to non-resident companies are assessed at 10% (withholding tax rate) on the gross amount due and only the net is payable to the respective companies.

SELF-ASSESSMENT EXERCISE 1

1. In Nigeria, the manner in which companies trading in a free zone are assessed to tax are similar to those of company income tax. How are companies assessed to tax in a Free Trade Zone in Nigeria?

3.2 Free Trade Zone Allowance

Allowance is granted to a company in a free trade zone which has incurred an expenditure in its qualifying building and plant equipment in an approved manufacturing activity. The rate granted for companies trading in a free trade zone is 100 per cent capital allowance in any year of assessment. It is worthy to note that such companies operating in a free trade zone are not entitled to an investment allowance.

The qualifying expenditure incurred by companies trading in a free zone on building, plant and equipment in an approved manufacturing activity are claimable on the following:

(a) **Buildings expenditures:** These are usually referred to as qualifying building expenditure. They take the form of industrial non-industrial building. Industrial building expenditure include structures or works of a permanent nature (e.g. warehouse, dock, port, jetty, wharf etc) while non-industrial building expenditure include structures of permanent nature other than industrial building (e.g. office complex);

(b) **Plant, machinery, fixtures and fittings**: They are usually referred to as qualifying plant expenditure;

(c) There are also qualifying capital expenditure for housing estate, construction and manufacturing industrial plants.

Note that any expenditure which is an allowable deduction in computing profits of the company's trade or business in accordance with the provision of CITA, shall not be treated as qualifying expenditure.

SELF-ASSESSMENT EXERCISE 2

1. Briefly describe how companies trading in a free trade zone are granted capital allowance?

3.3 Taxable and Non-Taxable Incomes

3.3.1 Taxable Incomes

Taxable income of companies trading in a free zone are similar to those of corporate entities in Nigeria. Thus, taxable income of companies operating in a free zone for a tax year is the gross income of the EPZ Company less

a) items of income specifically excluded; and

b) the amount of deductions allowed

Note that gross income of the companies trading in a free zone is the aggregate of economic benefits the company derives during a tax year.

3.3.2 Non-Taxable Incomes

There are adequate provisions of the law on incomes that are non-taxable for companies in Nigeria which are similar to those of companies operating in a free trade zone. For instance,

(a) dividend received from investments in wholly export oriented businesses;

(b) incomes of any Nigerian company in respect of goods exported from Nigeria provided that the proceeds from such export are repatriated to Nigeria and are used exclusively for the purchase of raw materials, plant, equipment and spare parts;

(c) incomes of a company whose supplies are exclusively inputs to the manufacturing of products for export provided that the exporter shall give a certificate of purchase of the inputs of the exportable goods to the seller of the supplies power to exempt.

(d) incomes of a company established within an export processing zone or free trade zone, provided that 100 percent production of such company is for export otherwise tax shall accrue proportionately on the profits of the company.

Note that the non-taxable incomes of a corporation are contained in Module 4. Thus, students can refer to those non-taxable incomes of a corporation as they are similar to those of companies operating in a free trade zone

3.4 Allowable and Non-Allowable Expenses

Allowable expenses are those permissible expenditures or deductions that have been provided for by the relevant tax laws in Nigeria for companies and individuals in order to reduce their tax burden, thereby creating what is often referred to as *"tax shield"*. The allowable expenses of companies are similar to those operating in a free trade zone.

Allowable deductions are expenses or expenditures incurred by a company wholly, exclusively, necessarily and reasonably in the creation of profits. This means that any expenditure incurred to meet the above conditions is deemed allowable in arriving at the chargeable profits of the company. This may not be the case where such expenditures are specifically forbidden under any provision of relevant tax laws.

The tax laws in Nigeria provides for allowable deductions provided that they are incurred for the purpose of acquiring the profits being subject to tax. For instance, allowable expenses encompasses:

(i) interest on borrowed money and capital employed;

(ii) rental sum and premiums with respect to land or buildings used for the purpose of acquiring profits.

(iii) Repairs and renewal costs relating to the premises, plants, fixtures, furniture's etc utilized in the business.

(iv) Bad and doubtful debts to the extent that they are respectively estimated to the satisfaction of the Revenue Service to have become bad or doubtful of collection.

(v) Contributions to approved pension, provident or other retirement benefits fund, society or scheme;

(vi) Any expenses incurred during the year in respect of:
(a) salaries, wages or other remuneration disbursed to employees;

(b) cost to the company of any benefit or allowance provided for the senior staff and executives which shall not exceed the limit of the amount prescribed by the collective agreement between the company and the employees and approved by the Federal Ministry of Employment, Labour and Productivity and the productivity, prices and income/revenue service as the case may be; and

(c) the expenses provided to the satisfaction of the Revenue Service to have been incurred by the entity on Research and Development for the period including the amount of levy paid by it to the National Science and Technology Fund (NSTF).

Apart from the once listed above, there are other expenses that are allowable, likewise those that are non-allowable. Thus, students may further refer to Module 4 for more detailed explanation for allowable and non-allowable expenses of corporate entities in Nigeria.

SELF-ASSESSMENT EXERCISE 3

1. List the taxable and non-taxable incomes of companies trading in a free trade zone in Nigeria?

2. List the allowable and non-allowable incomes of companies trading in a free trade zone in Nigeria?

4.0 SUMMARY

This unit highlighted issues on companies trading in a free trade zone in Nigeria. However, the following issues were covered:

- The categories of assessment of companies in Free Trade Zones
- The Free Trade Zone allowance
- Taxable and Non-Taxable Incomes of companies operating in a Free Trade Zones
- Allowable and Non-Allowable Expenses of companies operating in a Free Trade Zones

5.0 TUTOR-MARKED ASSIGNMENT

1. In Nigeria, the manner in which companies trading in a free zone are assessed to tax are similar to those of company income tax. How are companies assessed to tax in a Free Trade Zone in Nigeria?

2. Briefly describe how companies trading in a free trade zone are granted capital allowance?

3. List the taxable/non-taxable incomes and allowable and non-allowable expenses of companies trading in a free trade zone in Nigeria?

6.0 REFERENCES/FURTHER READING

Fasoto, F. (2007). *Nigerian taxation.* Lagos: Hosrtosaf Limited

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