



NIGERIA

INFORMATION CIRCULAR

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Subject: EXPLANATORY NOTES ON THE CRITICAL TAX ISSUES FOR THE OPERATION OF BANK HOLDING COMPANY STRUCTURE IN NIGERIA

This circular is made to address issues arising in connection with the taxation of Bank Holding Companies and their Subsidiaries pursuant to Section 61 of the Federal Inland Revenue Service (Establishment) Act, 2007, Cap F36, Laws of the Federation of Nigeria, 2004. The circular shall apply to all Bank Holding Companies and their Subsidiaries in Nigeria.

1.0 Introduction

The Central Bank of Nigeria (CBN) recently issued its Regulations on Scope of Banking Activities & Ancillary Matters, No 3, 2010 (Regulation 3 of 2010), repealing the erstwhile Universal Banking Licence regime and modifying the scope and framework for banking business in Nigeria. In line with requirements of the CBN Regulations aforesaid, some banking groups in Nigeria are restructuring their business operations by incorporating one or more Holding Companies to aggregate shareholder capital and hold ownership interest in operating companies conducting Banking and other permitted businesses separately.

As a result of the foregoing, the Federal Inland Revenue Service pursuant to its powers under Section 61 of the FIRS (Establishment) Act, hereby issues the following guidelines to provide an enabling tax framework for compliance with the CBN Regulation.

2.0 Clarification on the Relevant Tax Issues

2.1 Avoidance of double taxation on dividends paid

The FIRS clarifies that any dividend paid by subsidiary companies within each Group to their parent Holding Company (HoldCo) is Franked Investment Income which would not form part of the said Holding Company's total profits for tax purposes including consideration of total profits chargeable to tax in the contemplation of the anti-tax avoidance provisions in the Companies Income Tax Act (CITA), Cap C21, LFN, 2004 (as amended) particularly Section 19 thereof.

For purposes of clarity, Section 19 of CITA, CAP C21, LFN, 2004 states that:

“Where a dividend is paid out as profit on which no tax is payable due to-

- (a) no total profits; or*
- (b) total profits which are less than the amount of dividend which is paid, whether or not the recipient of the dividend is a Nigerian company,*

the company paying the dividend shall be charged to tax at the rate prescribed in subsection (1) of section 40 of this Act as if the dividend is the total profits of the company for the year of assessment to which the accounts, out of which the dividend is declared, relates”.

Section 80 (3) of CITA, CAP C21, LFN, 2004 however provides that:

“Dividend received after deduction of tax prescribed in this section shall be regarded as franked investment income of the company receiving the dividend and shall not be charged to further tax as part of the profits of the recipient company.....”

Section 80(3) regards dividend received by a company after deduction of withholding tax as Franked Investment Income (FII), which should not be subjected to further tax (income tax) and by extension WHT. Therefore, FII received by a HoldCo (including Intermediate Holdco), as the case may be, from its operating subsidiaries should not be subjected to further companies income tax. Accordingly, the provisions of Section 19 of CITA will not apply to such FII upon redistribution of dividends to such Holdco's ultimate shareholders.

In the light of the above and to the extent that any Holdco's income profile may consist of dividend received from its subsidiaries, such dividend will not be subjected to any further tax. However, this exemption does not extend to any other income or profits earned by the HoldCo from other sources aside from dividends from its subsidiaries.

2.2 Treatment of Withholding Tax on Dividend

Under the HoldCo arrangement, the FIRS understands that existing shareholders of the Bank would receive shares in HoldCo in exchange for all or most of shares they currently hold in the Bank, so that HoldCo emerges as owner (or majority shareholder)

of the operating Banks and other subsidiaries, including Intermediate HoldCo. The principal source of income for a HoldCo would be dividends received, net of WHT deduction, from its operational subsidiaries. Where a re-distribution of the dividend income to HoldCo's shareholders occurs, Section 80 of CITA allows for the shareholders to take credit for the WHT suffered by HoldCo on that income and, thus, avoid any further tax on the income.

Under existing WHT administrative framework, WHT deducted by the operating Banks and other subsidiaries, including Intermediate HoldCo, would be remitted to the FIRS since the recipient is a Company, taxable under CITA. However, WHT on eventual distribution to individual shareholders in HoldCo would be due to the particular revenue authority administering the taxes of that shareholder. In the case of individual shareholders, the relevant State Internal Revenue Service (SIRS) will be the appropriate authority, while for corporate entities the FIRS would be the appropriate authority.

In view of the above and in order to avoid administrative challenges that may occur for the companies, FIRS permits the obligation to deduct and remit WHT to be exercised at the HoldCo level, as against the operational subsidiary or Intermediate HoldCo level. Consequently, the gross amount of dividends should be paid by operational subsidiaries to a HoldCo, who will then distribute to its shareholders less WHT. The HoldCo shall ensure that within 30 days of receipt of dividends, the appropriate withholding tax is deducted and remitted to the relevant tax authority of their respective shareholders, and also comply with other existing WHT compliance procedures and regulations.

For shareholders of subsidiary companies other than Holdco, the subsidiary company shall deduct withholding tax on its dividends and remit same to the relevant tax authority of such shareholders.

2.3 Exemption from Commencement and Cessation Rules

The reorganization of existing banking entities and subsidiaries into a HoldCo structure would trigger the occurrence of the following transactions:

- Incorporation of new entities e.g. a HoldCo, which may include an Intermediate HoldCo;
- Cessation of some existing businesses e.g. capital market operations which the CBN no longer permits a bank to undertake;
- Movement of assets and other business attributes of existing banks into the various new companies being established pursuant to the CBN Policy; or
- Mergers between existing subsidiaries to improve group efficiency.

In this regard, the provisions of Section 29(9) of CITA, CAP C21 LFN, 2004 (as amended) states that *"where a trade or business carried on by a company is sold or transferred to a Nigerian company for the purpose of better organization of that trade or business or the transfer of its management to Nigeria and any asset employed in such trade or business is sold or transferred, if the board is satisfied that one company has*

control over the other or that both are controlled by some other person or are members of a recognised group of companies, the Board may in its discretion direct that:

- (a) *the provisions of Section 29 (3) and (4) (that is Commencement and Cessation rules) of this section shall not apply to such trade or business; and*
- (b) *for the purposes of the second schedule to this Act, each such asset shall be deemed to have been sold for an amount equal to the residue of the qualifying expenditure thereon on the day following such sale or transfer’.*

In view of the CBN Regulation No. 3 of 2010, the Board of FIRS has directed that commencement and cessation rules shall not apply provided that:

- (i) the formation of the HoldCo in compliance with the CBN Regulation does not result in any change in ownership structure of the existing Banking Group;
- (ii) the business of the HoldCo and the subsidiaries are not discontinued; and
- (iii) the assets are sold or transferred at an amount equal to the residue of the qualifying expenditure, that is, at their tax written down values (TWDV).

2.4 Capital Gains Tax

The CBN Regulations has mandated banks to divest from non-banking activities, as a result of which the banks have to re-organize and move assets around the successor entities, including HoldCos. The transfer/disposal of such assets will likely result in an exposure to Capital Gains Tax.

In this regard, Section 32 of Capital Gains Tax Act Cap C1 LFN, 2004 provides that “*a person shall not be chargeable to tax under this Act, in respect of any gains arising from the acquisition of the shares of a company either taken over, or absorbed or merged by another company as a result of which the acquired company loses its identity as a limited company, provided that no cash payment is made in respect of shares acquired*”

In line with the provisions of the Section 32 of Capital Gains Tax Act Cap C1 LFN, 2004, any assets transferred at TWDV (as provided in 2.3 above), shall not be subject to Capital Gains Tax as no capital gains would be derived from the transaction. Also, even where the assets are transferred at a value higher than the TWDV, consequent upon the acquisition of the ordinary shares of a subsidiary, Capital Gains Tax shall not be applicable provided that no cash payment is made with respect to the shares acquired.

2.5 Value Added Tax

The operation of the bank holding company structure will require to re-organize and move assets around the successor entities (including HoldCo), which will continue different lines of business within their group. In this way, businesses previously

conducted through a single company will now be undertaken by multiple entities under control and supervision by HoldCo.

The transfer of assets within the group, will attract value added tax in line with Section 2 of the Value Added Tax (VAT) Act Cap V1, LFN 2004 (as amended), which provides that *“The tax shall be charged and payable on the supply of all goods and services (in this Act referred to as “taxable goods and services”) other than those goods and services listed in the First Schedule to this Act”*.

In addition, Section 46 of the VAT Act states inter alia:

“supplies” means any transaction, whether it is the sale of goods or the performances of a service for a consideration, that is, for money or money’s worth”

“supply of goods” means any transaction where the whole property in the goods is transferred or where the agreement expressly contemplates that this will happen and in particular includes the sale and delivery of taxable goods or services used outside the business, the letting out of taxable goods on hire or leasing, and any disposal of taxable goods”.

Based on the above provisions of the VAT Act, it is clear that intra group transfer of assets at the residue of the qualifying expenditure is not an exempted transaction and is therefore liable to value added tax.

2.6 Minimum Tax

Companies in Nigeria are liable to pay minimum tax under the Companies Income Tax Act, Cap C21, LFN 2004. This arises, where in any year of assessment, the assessable profits of a company result in a loss or where the total profits result in no tax payable or tax payable, which is less than the minimum tax payable under the CITA. The rationale for the minimum tax is to ensure that the Government receives a fair share of return from every economic entity.

The bank holding company structure will result in HoldCo becoming a non-operating, investment vehicle carrying on minimal economic activity as all substantive economic activities would be undertaken by the operational subsidiaries, in line with the CBN’s Regulations. Therefore HoldCo entities risk being subjected to minimum tax provisions as though it were a fully active economic entity based on the provisions of CITA.

For purposes of clarity, Section 33 subsections (1), (2) and (3) of CITA, provides as follows:

- (1) *Notwithstanding any other provisions in this Act, where in any year of assessment, the ascertainment of total assessable profits from all sources of a*

company results in a loss, or where a company's ascertained total profits results in no tax payable or tax payable which is less than minimum tax, there shall be levied and paid by the company the minimum tax as prescribed by subsection (2) of this section.

(2) For the purposes of subsection (1) of this section, the minimum tax to be levied and paid shall-

(a) If the turnover of the company is N500,000 or below and the company has been in business for at least four calendar years be –

(i) 0.5 per cent of gross profit; or

(ii) 0.5 per cent of net assets; or

(iii) 0.25 per cent of paid-up capital; or

(iv) 0.25 per cent of turnover of the company for the year, whichever is higher; or

(b) If the turnover is higher than N500,000, be whatever is payable in paragraph (a) of this subsection plus such additional tax on the amount by which the turnover is in excess of N500,000 at a rate which shall be 50 per cent of the rate used in paragraph (a)(iv) of this subsection.

(3) The provisions of this section shall not apply to-

(a) A company carrying on agricultural trade or business as defined in subsection (9) of section 11 of this Act.

(b) A company with at least 25 per cent imported equity capital; and

(c) Any company for the first four calendar years of its commencement of business

In applying the above provision of CITA to the bank Holdcos and in order to avoid double counting, the capital deployed within the group, the following definitions shall apply:

- (i) the turnover of Holdco shall not include the dividends it received from its subsidiary companies and intermediate Holdco for investments from abroad;*
- (ii) net assets of Holdco shall not include the amount of investments it held in its subsidiaries prior to the restructuring;*
- (iii) the share capital of Holdco shall not include the share capital of the subsidiaries recognised in the holding company's capital.*

2.7 Payment of Stamp Duties

The re-organisation of the existing banking entities and subsidiaries into a Holdco structure would trigger the occurrence of a number of documented transactions, which will likely attract payment of stamp duties. These transactions include:

- incorporation of new entities e.g. a Holdco, which may include an intermediate Holdco;
- mergers between existing subsidiaries
- increase in share capital of existing companies
- transfer of vested security interest between re-organising banking entities and
- perfection of amendments to contractual arrangements necessary to fully comply with CBN Regulations.

In this regard, the relevant provisions of Section 104 of Stamp Duties Act, Cap S8, LFN 2004 will apply to exempt Holdco from payment of stamp duty. Section 104 will be read into the transaction and apply as follows:

“If in connection with a scheme for the reconstruction of any company or companies or the amalgamation of any companies, it is shown to the satisfaction of the Commissioner of Stamp Duties that certain conditions are met, relief from capital and transfer duty may be enjoyed by the reconstruction group subject to the following conditions:

- (i) the Holding company is to be incorporated or is required to increase its share capital with a view to consummating the acquisition of the bank shareholding; and*
- (ii) The consideration for the acquisition consists of not less than 90% of the shares of the bank and vice-versa”*

Where the above conditions exist, the HoldCo shall not be subjected to stamp duties charge on its incorporation.

2.8 Dividends and Income Earned from Abroad

The CBN Regulations have approved an Intermediate HoldCo as an alternative structure to warehouse foreign subsidiary companies owned by the Banks. In this case, the dividend incomes from foreign subsidiaries would be received by the Intermediate HoldCo, which will then subsequently distribute the income to the HoldCo, as dividends.

In this regard, Section 23(k) of CITA provides that *“dividends, interest, rent, or royalty derived by a company from a country outside Nigeria and brought into Nigeria through “Government approved channels”, are exempted from tax in Nigeria.*

The government approved channels as defined in Section 23(k) are the Central Bank of Nigeria, any bank or other corporate body appointed by Minister as authorised dealer under the Foreign Exchange (Monitoring and Miscellaneous Provisions) Act or any enactment replacing that Act.

Based on the above, dividend incomes received from abroad by an intermediate Holdco or Holdco when re-distributed shall not be liable to further tax provided such dividend is

brought into Nigeria through the government approved channels stated in Section 23(k).

3.0 Enquiries:

All enquiries on any aspect of this circular should be directed to the office of:

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Wuse Zone 5, Abuja

Or
Director, Tax Policy and Legislation Department
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