TAX INCENTIVES AND EXPENDITURE ALLOWANCES - SEPTEMBER 2014

INTRODUCTION

To encourage further and continuing investments, various Tax Incentives and Tax Capital or Expenditure Allowances are embedded in the Statute Books waiting to be taken advantage of by businesses. Some of these investment incentives and expenditure allowances are succinctly highlighted in the following paragraphs.

Note however that only expenditures that are wholly, exclusively, necessarily and reasonably incurred in the trade or business of the tax payer can be claimed as a capital expenditure.

Also note that the depreciation of the assets of a company is not allowed under the Companies Incomes Tax Act in Nigeria. Instead, Capital Allowances are allowed.

PIONEER STATUS

By the Industrial Development (Income Tax Relief) Act, the Nigerian Investment Promotion Commission Act and the Pioneer Status Incentive Regulations 2014, companies engaged in gazetted pioneer industries and products are entitled to apply for Pioneer Status, and when granted, enjoy tax exemption/relief/holidays, for an initial term of three (3) years, starting from the date that the pioneer company commences business. The tax holiday period may be extended for a period of one (1) year, and a further one (1) year term, subject to the level of development and the relative importance at the time of the industry to the development of the country.

To qualify to apply for Pioneer Status however, the Applicant Company must among other things be registered as a corporate entity in Nigeria; and must have incurred qualifying capital expenditure of not less than Ten Million Naira (N10Million) in the pioneer industry concerned. Also, the application for the Pioneer Status must be submitted within one (1) year of the Applicant Company's commencement of commercial production.

SOLID MINERALS

A new company engaged in the mining of solid minerals is entitled to tax exemption for the first three (3) years of its operations.

AGRICULTURAL AND FOREIGN LOANS

Interest payable on loans granted to agricultural trade or businesses, local plant and machinery fabrication, and working capital for any cottage industry, is/are also exempted from tax provided that the moratorium of the loan is not less than eighteen (18) months, and the rate of interest on the loan is not more than the base lending rate at the time the loan was granted.

Also, losses arising from an agriculturally based trade or business are allowed to be carried forward indefinitely.

For foreign loans, interest payable on foreign loans is exempted from tax in the manner prescribed in the Table in the Third Schedule of the Companies Income Tax Act ("CITA").

HOTELS TOURIST INCOME

Twenty-five per cent (25%) of the income derived by a Hotel, in internationally convertible currencies, from tourists using the services of such a Hotel, are exempted from any form of tax, provided that such income is paid into a domiciliary account Reserve Fund, to be utilised within five (5) years in the building expansion of new Hotels, conference centres and other new facilities which promote tourism development.

RURAL INVESTMENT ALLOWANCE

Where a company provides for the purposes of its trade or business infrastructural facilities like electricity, water or tarred roads, which must be at least twenty (20) kilometres from such facilities provided by the Government, such a company will be entitled to claim both the Initial Allowance on such expenditure, and a further Rural Investment Allowance whose rate is graduated based on the scale of the facilities provided.

Where no public facilities exist, a hundred percent (100%) Rural Investment Allowance will be allowed by the tax authorities on such rural infrastructural expenditure(s).

A Rural Investment Allowance cannot however be carried forward.

RECONSTRUCTION INVESTMENT ALLOWANCE

To compensate businesses that incur expenditures on plant and machinery, CITA allows to such companies a ten per cent (10%) Reconstruction Allowance of the actual expenditure incurred on such plant and equipment. This is in addition to the initial allowance granted on such plant and equipment.

A Reconstruction and a Rural Investment Allowance cannot however be claimed on the same expenditure.

RESEARCH AND DEVELOPMENT (R & D) ALLOWANCE.

Companies and other organisations engaged in Research and Development activities ("R&D") for commercial purposes, are entitled to claim a twenty per cent (20%) investment tax credit on their R&D qualifying expenditures.

Other companies who undertake R&D activities to promote their trade or business are also entitled to claim the expenses incurred on such R&D provided that the R&D expenditures do not exceed ten per cent (10%) of the company's total profits in the financial year that the expenditure was incurred.

DEPRECIATION AND CAPITAL ALLOWANCES.

As it does not uphold of transparency and equity, the Companies Income Tax Act ("CITA") disallows a company depreciating its assets. In place of the depreciation of a company's assets, CITA makes provision for a transparent capital allowances regime which is encapsulated in CITA's Second Schedule.

It is however only the qualifying expenditure expended on the assets of a company, which assets are wholly, exclusively, necessarily and reasonably utilised in the company's trade or business, that are entitled to submit such claims for any kind of tax allowances.

INITIAL AND ANNUAL ALLOWANCES.

CITA allows a company to claim in its first year of use, an Initial Allowance on a capital expenditure expended on a business asset. The rates allowed for each asset group as an Initial Allowance is set out in Table 1 of Schedule 2 of the CITA.

For the following years that the asset is in use, the owner of the asset can claim an Annual Allowance which is the remainder of the Initial Allowance permitted under Table II of the Second Schedule of CITA.

Where a company purchases new plants and machineries in replacement of its old plants and machineries, such a company is allowed a once and for all ninety-five per cent (95%) capital allowance in the first year of the use of the asset. The remainder five per cent (5%) of the value of the asset is required to be retained in the financial books of the company until the asset is disposed off.

BALANCING ALLOWANCES AND BALANCING CHARGES

Balancing Allowances and Balancing Charges are other tax reliefs that a company can claim when it disposes of an asset.

A Balancing Allowance is the difference between the residual value of the asset and its sale value. This difference in an allowable tax deduction which can be written against the profit and loss accounts of the affected company.

Where the value of the asset at the point of its disposal is higher than the residual value of the asset, a Balancing Charge arises with the excess value written back to the profits of the company and taxed accordingly.

Note however that the maximum claim for capital and investment tax allowances that will be granted by the tax authorities is ninety-five per cent (95%) of the total cost of the qualifying asset.

EXPORT INCENTIVES

To promote the indigenous manufacture of products for export, various Export Incentives exist; like the Manufacture-In-Bond Guarantee; Duty Drawback Schemes; etc. Also in existence are Export Processing Zones for oil, gas and none oil and gas enterprises.

Products manufactured in Export Free of Export Processing Zones can only enjoy tax exemption if they are exported to another country, other than Nigeria.

CONCLUSION

In conclusion, fictitious, artificial or none bona-fide expenditures will not qualify to claim any tax allowance or relief.

DISCLAIMER NOTICE