THE TAXATION OF M&A TRANSACTIONS IN NIGERIA - WHAT HAS CHANGED?

Businesses continue to explore corporate restructuring transactions as options for shoring up market share, boosting profitability and achieving other corporate objectives. In Nigeria, corporate restructuring transactions are undertaken under various structures ranging from mergers and acquisitions (“**M&A**”), share and asset sale transactions, demergers, and capital reorganisations, and these transactions attract different transaction taxes.

The focus of this paper is to highlight the taxes that would typically apply to corporate restructuring transactions in Nigeria, as well as key tax considerations to be borne in mind by parties, particularly in light of the recently enacted Finance Act. The prevalent tax issues associated with corporate restructuring transactions revolve around the scope of the Nigerian tax laws and their applicability to the variants of transaction structures, the treatment of legacy tax obligations and the transfer of tax assets.

Transaction Taxes

Pursuant to the Companies Income Tax Act (“**CITA**”), parties are required to obtain the direction and clearance of the Federal Inland Revenue Service (“**FIRS**”) in relation to any merger, take-over, transfer or restructuring of trade or business in order to determine the Capital Gains Tax (“**CGT**”) payable on the transaction.

Capital Gains Tax

For asset sale deals, the gains accruing from the disposal of the assets are subject to CGT at the rate of 10%. CGT is chargeable on the disposal of chargeable assets. Chargeable assets generally include options, debts and incorporeal property, goodwill, copyrights, real property, chattels etc. With respect to share sale, there is an express provision of the CGTA exempting the assessment of CGT on such transactions. The exemption notwithstanding, one of the recurrent issues on acquisition transactions in Nigeria is engaging the tax authority to justify the exemption of CGT on transfer of shares especially on transactions involving a combination of share and asset sale.

Value Added Tax

Another tax applicable to corporate restructuring transactions is Value Added Tax ("**VAT**") which is chargeable on the supply of "goods and services" excluding goods and services exempt from VAT. Whilst VAT are chargeable on the transfer of assets and on professional fees of advisers, VAT is not chargeable on share sale transactions. Until the enactment of the Finance Act, it was debatable whether or not VAT was chargeable on supply of intangible assets such as goodwill, intellectual property and also whether "transfer of business" constitute supply of "goods or services" for purposes of VAT. Our analysis below on the relevant provisions of the Finance Act provides insights on how the new enactment has further expanded the assets to be subject to VAT in an M&A scenario.

Withholding Tax

Withholding tax deduction may arise in respect of commission, consultancy, legal fees, audit fees, and other professional fees payable by the Nigerian party in connection with a corporate restructuring transaction. For non-resident service provider, withholding tax may be deductible where the non-resident entity is liable to Nigerian companies income tax.

Stamp Duty

Corporate restructuring transaction typically involves the execution of transaction instruments such as assets purchase agreement, share sale agreement, ancillary agreements such as lease agreements, transition services agreement (where applicable) etc. These instruments attract stamp duty either at an *ad valorem* or nominal rate (depending on the instrument under consideration) given that under Nigerian law stamp duty is payable on any agreement or instrument executed in Nigeria or relating, whatsoever, to any property situated in or to any matter or thing done in Nigeria. The tax authority on occasions has issued assessment on *ad valorem rate* basis as against the applicable nominal rate. Specifically, in respect of share sale and purchase agreement, notwithstanding the express provision of the Stamp Duty Act which provides for nominal rate for stamping of share transfer instrument the tax authority has argued on some occasions that "share sale and purchase agreement" qualifies as a "sale agreement" and therefore should attract *ad valorem* rate of 1.5%. Such *ad valorem* assessment could result in significant transaction costs for parties and in view of this, parties are advised to always seek professional advice regarding their share sale transactions.

Other Tax Considerations

Transfer Pricing Risks

Corporate restructuring transactions also raise transfer pricing concerns particularly in relation to the valuation of assets for related parties' transactions. Under Nigerian law, sale, purchase and transfer of assets between related parties are regulated transactions which require that the pricing of such transactions should be at arms' length in accordance with the Income Tax (Transfer Pricing Regulations) 2018 ("**TP Regulations**"). Parties to corporate restructuring transactions involving connected persons should always obtain adequate transfer pricing advice in order to ensure full compliance with the TP Regulations. Further, corporate restructuring transactions could trigger certain TP reporting obligations under the following circumstances (a) merger of the taxable person's parent with another company outside the group; (b) acquisition of up to 20% of the taxable person's parent by a person not connected with the group; (c) merger of the taxable person with another company; (d) acquisition of up to 20% of the taxable person by persons not connected to the group; (e) merger or acquisition of the taxable person by another company outside the group; (f) sale or acquisition of a subsidiary by the taxable person; (g) any other change in the structure, arrangement or circumstance of the taxable person which influences whether it will be considered connected or not connected to another person.

The penalties for non-compliance with the TP Regulations are quite significant as the defaulting party could be liable to pay administrative penalty of up to N10,000,000 (approx. US$33,000) and N10,000 (approx. US$33) for each day the failure continues.

Transfer of Tax Assets

Regarding the transfer of tax assets, generally, under Nigerian law, tax assets such as allowances, losses, tax reliefs are not transferrable to a newly formed/resulting entity following the completion of an M&A transaction. This issue do not however apply to share deals, i.e. the purchase of majority stake which results in the acquisition of the target without any of the entities ceasing its business, as the target entity would still remain in existence and would be able to utilize its accrued tax benefits.

Notwithstanding the general restriction on transfer of tax assets, for related parties transactions, the FIRS may in deserving circumstances, direct that an M&A transaction which would have otherwise resulted in the commencement of a new business be treated as continuing, and therefore permitting the continuing entity to take benefit of the outstanding tax assets of the "old" entity. Also, the tax authority could on that basis exempt CGT from applying to the transaction.[1]

In view of the restrictions highlighted above, parties should ensure that adequate tax advice is obtained commencing from the structuring of, and until the completion of the M&A transaction in order to preserve tax benefits for the surviving entity.

Tax Indemnities and Warranties

In the negotiation of tax indemnity and warranty provisions, for a seller, the focus is typically to minimize liabilities by negotiating for a limited scope of warranties and indemnities. For a buyer however, key considerations would usually be to obtain adequate protection from the seller with respect to pre-completion tax obligations. It is important to note that the FIRS is allowed under relevant tax legislations to issue additional assessments where it discovers an underpayment of tax by a taxpayer within six years after the expiration of the relevant year of assessment and not otherwise. An exception to this is where it is shown that the tax payer is guilty of fraud, willful default, neglect or the production of a document or the making of a statement which was untrue in any material particular. This statutory window for additional tax assessments makes it very imperative for parties, especially the buyer to seek ample protection against pre-completion tax liability that may arise after the completion of the transaction.

In particular, it is crucial for the parties to undertake extensive tax due diligence on the target's level of tax compliance. Also, due consideration should be given to the target's tax assets as well as the quantum of its non-allowable tax expenses and/or deductions in order to have a more comprehensive view of the potential tax liability of the target and to the extent possible address them as part of the seller's pre-transaction housekeeping measures, or have parties factor same in the negotiation of, and pricing of the transaction.

[1] We will discuss in subsequent paragraph of this paper the changes that have been introduced by the Finance Act in relation to the treatment of such related parties' transaction by the FIRS

What Does the Finance Act Say?

CIT - With respect to the treatment of surviving/resulting entity, a laudable impact of the Finance Act is the repeal of the cumbersome commencement/cessation rules under the CITA which had resulted in the double taxation of some basis periods of the income of companies during the first three years of commencement of business. With this amendment, CIT liability of resulting entities from M&A transactions would for the first year be charged on the assessable profit from the date of commencement of business to the end of the first accounting period and subsequently, on assessable profits accruing from the day after the end of the previous accounting period to the end of the accounting period under consideration.

Related to the amendment on the commencement/cessation rules, with respect to the concession granted to related parties by the FIRS which allows resulting entity to be treated as continuing, and therefore permit the continuing entity to take benefit of the outstanding tax assets of the "old" entity, including exemption from payment of CGT, the Finance Act has now provided that for such concession to be valid, the related party relationship must have been in existence at least 365 days prior to the reorganisation and the assets acquired pursuant to the reorganisation must not be disposed within 365 days from the completion of the transaction.

The Finance Act has also introduced thin capitalization rule by providing for a cap (30% of EBITDA) on deductible interest expense payable by a Nigerian company or by a fixed base of a non-resident company in Nigeria to a foreign connected person. This does not however apply to a Nigerian subsidiary of a foreign company engaged in banking or insurance business. Also, the sliding scale graduated tax exemption which previously allowed upto 100% exemption from withholding tax deduction on interest accruing to foreign loans (depending on the tenor and grace period of the loan) now allows for a maximum of 70% exemption. In light of these amendments, parties considering debt financing for their corporate restructuring transactions would need to ensure that proper analysis of the tax implications of the finance arrangements are undertaken in order to properly manage tax risks and exposures.

VAT - In addition to the increase of the VAT rate from 5% to 7.5%, under the Finance Act, "goods" chargeable to VAT now extend to intangible product, asset or property over which a person has ownership or right, or from which the person derive benefit, and which can be transferred from one to another, excluding interest in land. With this provision, transfer of intangible assets, including the transfer of "business" would be subject to VAT once the beneficial owner of the right is a taxable person in Nigeria and the "goods or right" is situated, registered or exerciseable in Nigeria. Also, the Finance Act clarifies that Nigerian VAT regime operates on the basis of the destination principle. From the amendments introduced by the Finance Act, services rendered by foreign services provider (including advisers) to a person in Nigeria will be subject to VAT and the tax authority is authorised to recover the applicable VAT from the consumer of the services in Nigeria under the reverse charge regime.

Stamp Duty - Regarding stamp duty, the Finance Act has now introduced the regime for stamping of electronic documents. Prior to the enactment of the Finance Act, the meaning of "instrument" for purposes of stamp duty contemplated only written documents and as such, where a document which is liable to stamp duty is executed outside Nigeria, the obligation to pay stamp duty will likely not be triggered until the document is received in Nigeria. Now, the Finance Act has expanded the definition of instrument to include "electronic documents".

Conclusion

The emergence of the Finance Act has no doubt revolutionized the tax landscape in Nigeria given its numerous provisions which cut across the principal tax legislations in Nigeria. These amendments have significant implications for persons doing or intending to do business in Nigeria. Corporate restructuring transactions are also caught in this paradigm shift and therefore it is crucial for parties to seek proper tax advice prior to executing such transactions relating to any entity in Nigeria.

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