

# **Pioneer Status and the “First Year Rule”: The Myth and The Reality**

## | Introduction |

On Wednesday, August 2, 2017, the Nigerian Federal Executive Council approved the addition of 27 new industries and products to the list of industries considered pioneer. An industry or product is designated as pioneer:

- a. if the industry or product is not being carried on in Nigeria on a scale suitable to the economic requirements of Nigeria; or
- b. if it is expedient in the public interest to encourage the development or establishment of such industry in Nigeria.

On the back of the announcement by the Nigerian government, the Federal Ministry of Industry, Trade and Investment (“**FMITI**”) released the “Application Guidelines for Pioneer Status Incentive” (the “**Guidelines**”). The Guidelines, amongst other things, provide for “considerations and mode of application” for Pioneer Status Incentive (“**PSI**”).

One of the considerations under the Guidelines is that an applicant must make an application for the grant of PSI in the first year of production/ service (the “**First Year Rule**”). This briefing note examines the provisions of the Industrial Development (Income Tax Relief) Act (“**IDITRA**”) which is the legal framework for PSI with a view to determine the basis for the First Year Rule, both at law and tax policy-wise.

## | The IDITRA and PSI |

IDITRA has no provision that prescribes that an application for PSI must be made within the first year of production/service of the applicant company.

Section 2 of IDITRA provides for the mode of application of pioneer certificate including the grounds upon which the applicant relies and the required information to be provided by the applicant. It is significant that Section 2 does not provide for the period within which a PSI application should be made. Section 1(3) of the IDITRA provides that both by an existing company or promoters of company in formation can apply for a pioneer certificate or for the inclusion of a specific industry in the list of pioneer industries and products.

Section 6 of IDITRA, relates to the certification of the production day, amongst other things. The production day is used as the date of commencement of the actual tax holiday of a pioneer company. Sections 6(1) and (12) of IDITRA are to the effect that a pioneer company should apply and propose its production day, within one month of reaching commercial scale in the production or provision of its pioneer goods or services as the case maybe.

Section 5 of IDITRA contemplates that a pioneer certificate can operate retrospectively, that is, the benefits of PSI can take effect from a date earlier than the date of the pioneer certificate.

The foregoing provisions implicitly recognize the fact that a PSI application can very well be made after the first year of commencement of commercial production/service, in the particular instance that the provisions and no other provision of IDITRA have said otherwise.

## **The Guidelines and the Pioneer Status Incentive Regulations 2014 should follow IDITRA**

In the absence of any provision of IDITRA mentioning or inferencing the First Year Rule, it is out of place for either the Guidelines or the Pioneer Status Incentive Regulations 2014 ("PSIR 2014") to set this disenfranchising hurdle.

It may be recalled that the PSIR 2014 (Regulation 3(4)) had stated that a PSI application be made within one year of commercial production. Although still not in tandem with IDITRA, the provision is a lower hurdle compared with that under the Guidelines. The first year of commercial production is relatively a longer time away than the first year of production/service.

In any event, the law of the land is that subsidiary legislations such as the Guidelines and the PSIR 2014 are subsidiary legislations that cannot expand the scope of the substantive legislation, IDITRA, in this instance. The First Year Rule may fail in the face of IDITRA should it be set before the Nigerian courts.

## **The First Year Rule Discriminates Against Early Pioneers**

The First Year Rule punishes those who earlier took on the challenges of what today qualifies as a pioneer industry, by making them ineligible to partake in the benefits of the PSI, due to their age in business. It is no gainsaid that some businesses have been, for more than a year, taking risks, particularly in time and money, to understand the rules and vagaries of their chosen industry. Much of the lessons that these businesses learnt may have informed the emergence of new entrants. The First Year Rule simply embraces the new entrants and shuts the door on the real pioneers. Such a reality is economically-insensitive and does not enhance the promotion of entrepreneurial ambitions which should have informed the PSI in the first place. This is beside the point, as highlighted below, that most of these early pioneers are yet to be profitable. This is basically a policy argument.

## **The First Year Rule is insensitive to Business Cycles**

The rationale for the First Year Rule is questionable when viewed from the background of the current loss cycle of early pioneers. More often than not very few companies tide into profitability in their first year of production or commencement of service. In a country with high operating costs, especially on power and infrastructure, there is that high possibility of making losses in the first year or most likely for the first few years of commencement of business.

If this were to be the case and the First Year Rule is applied, then a company that makes an application in the first year of commencement of production or service and is granted a pioneer status during its loss cycle enjoys no benefit. Suffice to state that the corporate minimum tax rule contemplates that a company may operate at a loss for its first 4 years in business. The First Year Rule is insensitive to this statutory reality. In the circumstance that a typical company would seek to claim loss relief on the losses it has accumulated over the years from profits of subsequent years before considering utilization of the PSI, the introduction of the First Year Rule, only presents the PSI as a myth.

## | Conclusion |

The tax system stands on a tripod of policy, law and administration. The policy direction of the Nigerian government in encouraging certain industries in its economy through the PSI is laudable. The particular expansion of the list of pioneer industries, although may affect government's fiscal projections, but ultimately should stimulate greater economic activities, if government is not to be the loser. The IDITRA as the enabling law for PSI provides the framework for the grant of pioneer status and does not contemplate the First Year Rule. Application of the First Year Rule makes the PSI more of a myth than a reality. The Guidelines and the PSIR 2014 should be amended to be in line with the policy and law guiding the grant of PSI. Where the position of the FMITI and the NIPC are that the First Year Rule is actually the policy, then it would fall flat in the face of the law. Such arguments are needless at this momentous period of Nigeria's emergence as an economic power block among its peer countries. An active and coordinated process of engagement between Government and affected industries or businesses is recommended.

*For further information on the foregoing, please contact Oyeyemi Oke ([oyeyemi.oke@ao2law.com](mailto:oyeyemi.oke@ao2law.com)) or Bidemi Olumide ([bidemi.olumide@ao2law.com](mailto:bidemi.olumide@ao2law.com)) with the subject: "Pioneer Status and the "First Year Rule": The Myth and The Reality"*



**Bidemi Daniel Olumide - Partner**

BD (Bidemi Daniel), as he is popularly called, leads the Tax, Corporate Commercial, Trusts and Criminal Law Practices of the firm. At the core of his professional life is his ability to provide Clients with time and cost-effective solutions to the most complex legal challenges. BD is known to avail the most-sophisticated Clients, a one-stop shop in legal advisory, management and representation services.

A practicing barrister and solicitor, BD's legal experiences straddle the following economic sectors: agriculture, energy, entertainment, construction, fast-moving consumer goods, financing, Government, information & communication technology, medical services, not-for-profits, professional services, real estates, solid minerals, telecommunications and transportation.

Prior to joining AO2 Law, BD was Senior Associate at the commercial law firm of Adepetun Caxton-Martins Agbor & Segun.



**Oyeyemi Oke - Partner**

Oyeyemi Oke leads the Energy, Finance and Projects group of the firm. He is dual qualified as a lawyer and chartered accountant, and holds a Masters of Law from the University of KwaZulu-Natal in South Africa. Oyeyemi graduated with second class upper division from the Nigerian Law School and the Lagos State University, where he made distinctions in Company Law, Land Law and Public International Law.

Oyeyemi has about a decade of experience and has worked in the legal services division of an indigenous oil and gas company, where he advised on various energy, finance, mergers, acquisition and tax related issues.

Prior to joining AO2 Law, Oyeyemi was Senior Associate at Templars where he specialized in Energy, Projects, Finance and Tax practice areas.