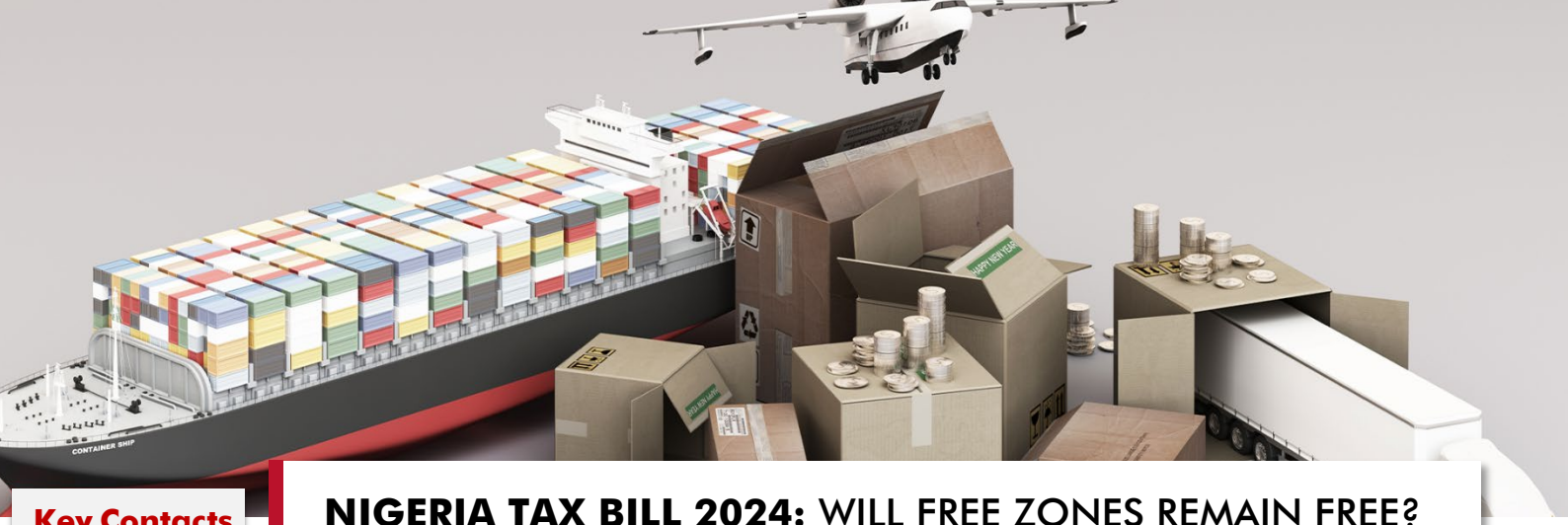

NIGERIA TAX BILL 2024: WILL FREE ZONES REMAIN FREE?

Key Contacts

Oyeyemi Oke
Partner
oyeyemi.oke@ao2law.com

Assumpta Nwaogwugwu
Associate
assumpta.nwaogwugwu@ao2law.com

Introduction

It is no news that the Federal Government of Nigeria is considering significant tax reforms through a suite of bills before the Nigerian National Assembly.[1] One of such bills is the Nigeria Tax Bill (the **"Bill"**) which is a bill to consolidate various legal frameworks relating to taxation. This briefing note examines the potential impact of the Bill on free zones and entities licensed to operate in free zones in Nigeria (**"Approved Enterprises"**).

Will activities of Free Zone Enterprises be fully tax exempt?

Unfortunately, No. It is necessary to mention that Section 198(2) and (3) of the Bill deletes the tax exemption status of Approved Enterprises under both the Nigerian Export Processing Zones Act and the Oil and Gas Free Zone Act.

Paragraph 3 of the Second Schedule to the Bill grants 100% tax exemption on profits of an Approved Enterprise, provided that 100% of the sales of such Approved Enterprise arises from the export of goods or services produced by the Approved Enterprise or such goods or services serve as input into goods or services exclusively for export. It must be further noted that the 100% tax exemption is subject to the provisions of Section 57 of the Bill.

Section 57 of the Bill provides that where the effective tax rate of a company is less than 15%, such company shall recompute and pay an additional tax that makes its effective tax rate equal to 15%.[2] Specifically, the provisions of Section 57 apply to a company that is part of an MNE Group[3] and any other company with an aggregate turnover of NGN 20billion and above in a relevant year of assessment. Therefore, where an Approved Enterprise is part of an MNE Group or has an aggregate turnover of NGN20billion or more, such Approved Enterprise is expected to pay an effective tax rate of 15% irrespective of whether such entity has 100% tax exemption under paragraph 3 of the Second Schedule to the Bill.

---

[1] The Bills before the Nigerian National Assembly include:
   a. Nigeria Tax Bill
   b. Joint Revenue Board (Establishment) Bill
   c. Nigeria Revenue Service (Establishment) Bill
   d. Nigeria Tax Administration Bill

[2] Under the Bill, the Effective Tax Rate is defined as *"the rate produced by dividing the aggregate covered tax paid by a company for a year of assessment by the qualifying profits before tax of the company, determined under regulations issued pursuant to Section 57 of this Act."*

[3] The Bill defines "MNE Group" as *"any Group that includes two or more enterprises the tax residence for which is in different jurisdictions, or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction."*

It must be further noted that proportionate taxes on profits shall apply on profits of sale within the customs territory with respect to an Approved Enterprise that sells or exports at least 75% of goods or services it produces, or that is used as input for goods and services which are exported.

Scrapping of all incentives to Free Zone Enterprises which sell more than 25% of their goods and services in the Customs Territory

Perhaps in a bid to encourage sales within the relevant free zones, the Paragraph 5 of the Second Schedule to the Bill provides that in any year of assessment where an Approved Enterprise sells more than 25% of its goods and services in the Customs Territory, the whole profits of the Approved Enterprise shall be taxed in Nigeria and all other reliefs to Approved Enterprises under the Bill and the law of the relevant zone shall not apply.

While it is understood that the driver for the provisions of paragraph 5 of the Second Schedule to the Bill is to encourage and limit economic activities of Approved Enterprises to a free zone, we believe that total scrapping of incentives for an Approved Enterprise which falls under the category contemplated under paragraph 5 is not only extreme but disincentive to investment. In our view, application of proportionate taxes to activities within the Customs Territory and limitation of the relevant incentives to the actual activities that take place within the zone would achieve the same purpose. Although we recognize that an argument against our proposition may be the issue of the ease of delineating activities that happen within the zone from sales in the Customs Territory, it is our view, that this potential challenge can be mitigated through clear tax administrative procedures that can be implemented by the Federal Inland Revenue Service (FIRS) to ensure that Approved Enterprises (which decide to make sales within the Customs Territory) keep separate records for activities within the Customs Territory and activities within the relevant free zone.

Income Attribution and the Effective Tax Rate Conundrum

Section 6(2) of the bill provides as follows: *"Where a foreign company, which is controlled by a Nigerian company has not, in a year, distributed profits to its shareholders, the proportion of the profits of the controlled foreign company attributable to the Nigerian company, which could have been distributed without detriment to the company's business shall be construed as distributed and included in the profits of the Nigerian company for the purposes of subsection (1) of this section."*

An examination of the foregoing provisions of the Bill may lead to a question as to whether an Approved Enterprise will be regarded as a Nigerian company within the context of Section 6(2) of the Bill. Section 203 of the Bill defines a company as *"a company or corporation, including Limited Liability Partnership, established by or under any law in force in Nigeria or elsewhere (emphasis ours)."* It can be argued that an Approved Enterprise that has been granted a license by a Free Zone Authority can be regarded as a company within the context of Section 6(2) of the Bill. The basis for our position is founded in Section 10(2) of the Nigeria Export Processing Zones Act which provides that *"the grant of a license by the Authority shall constitute registration for the purposes of the company registration within the Zone."*

Thus, as established by the foregoing arguments that an Approved Enterprise may be regarded as a company under the Bill, the provisions of the Bill with respect to income attribution may apply to Approved Enterprises. The effect of the provisions of Section 6(2) of the Bill on Approved Enterprises is that such enterprises may be subject to tax on the undistributed profits of subsidiaries attributable to such Approved Enterprises as such undistributed profits shall be deemed to have accrued in Nigeria.

Approved Enterprises are also faced with the Effective Tax Rate conundrum, where such an Approved Enterprise has a non-resident subsidiary or an Approved Enterprise is part of a multinational group that has a non-resident company taxable in Nigeria and such non-resident company pays less than the minimum effective tax rate of 15%, the Approved Enterprise shall be made to pay an amount to make the non-resident subsidiary or affiliate's income tax equal to the minimum effective tax rate.[4] This means that an Approved Enterprise which has conducted all its operations within a free zone during a relevant year of assessment and ordinarily should have been entitled to 100% tax exemptions, may be subject to further taxes based on activities of non-resident companies within its group. To the extent that a tax fraud has not been committed with respect to the tax liability payable by a non-resident company, this provision not only calls to question the concept of separate legal personality under Nigerian law, but also defeats the purposes of free zone investments.

Codification of Tax Registration, Tax Filing and Deduction of Withholding Taxes

Paragraph 6 of the Second Schedule of the Bill makes it mandatory for Approved Enterprises to register with the FIRS, and obtain a Tax Identification Number, file tax returns and deduct withholding tax at source.

Application of Transfer Pricing Rules and prevention of Profit Shifting

By virtue of Paragraphs 7 and 8 of the Second Schedule to the Bill, transfer pricing rules will apply to transactions between Approved Enterprises and their related parties. For example, where an entity in a zone contracts outs manufacturing services or any of its approved activity within the zone, to a related or connected resident company that is not an entity in the zones, all income derived from the sale by the entity in the zone of the goods produced shall be treated as income of the related or connected resident company, except the FIRS is satisfied that the transaction provided was conducted at arm's length.[5] Furthermore, where a resident company, which is not an entity in the zones, provides services other than manufacturing services to a related or connected entity in the zones, the provisions of the Transfer Pricing Regulations shall apply to the transaction.[6]

Conclusion:

Based on the foregoing analysis, in the event the Bill is passed as is, Free Zones will no longer be free particularly with the deletion of the absolute tax exemption provisions of Sections 8 and 18(1) of the Nigerian Export Processing Zones Act and the Oil and Gas Free Zones Act. Approved Enterprises that had hitherto been tax exempt may be subject to taxes between 15% - 27.5%.

[4] Please see Section 6(3) of the Bill.
[5] Paragraph 7 of the Second Schedule to the Bill.
[6] Paragraph 8 of the Second Schedule to the Bill.

The essence of creation of free economic zones has always not been tax generation but growth of the economy, therefore, to impose significant tax obligations on Approved Enterprises may be counterproductive with respect to the much-required investment for the Nigerian economy. The potential impact of lack of investment by potential companies who want to operate in free zones also put the investments of Free Zone Developers at risk considering the significant investment associated with provision of infrastructure within the relevant zones.

The applicability of the provisions such as Section 57 of the Bill to Approved Enterprises negates the intent of creation of freezones, and it is necessary that provisions of Section 57 be amended to exclude Free Zones. Provisions of paragraph 5 of the Second Schedule to the Bill with respect to total cancellation of tax incentives for Approved Enterprises that make sales of more than 25% in the Customs Territory may serve as a disincentive to investments in Free Zones and needs to be re-examined.

In conclusion, we believe engagement, advocacy and lobbying by, Approved Enterprises, Free Zone Developers, the Nigerian Export Processing Zone Authority, the Oil and Gas Free Zone Authority, with Nigerian lawmakers, the FIRS and other arms of the Nigerian Executive is necessary to apprise the relevant arms of government of the potential far reaching consequences of some of the implication of the Nigeria Tax Bill on Free Zone developments and investment. Considering that the "Horse is yet to leave the Stable" as the Bill is yet to become Law, we believe now is an appropriate time for the relevant engagements between the stakeholders.

Disclaimer: *The foregoing should not be regarded as legal or tax advice. For further information on the foregoing, please feel free to contact the authors*