CHARTERED INSTITUTE OF TAXATION OF NIGERIA
APRIL 2018: PROFESSIONAL EXAMINATION
PT 3: OIL & GAS TAXATION

ATTEMPT ALL QUESTIONS. SHOW ALL WORKINGS. TIME: 3 HOURS.

1. Dando Oil Limited has a diversified portfolio of investments in the oil and gas sector in Nigeria. The following were extracted from the books of the company for the accounting year ended 31 December, 2015.

   (i) 5,000,000 barrels of crude produced and lifted by the company at a price of $50/bbl. Incidental income amounted to $120,000.

   (ii) The company has a refinery with a production capacity of 2million litres of Premium Motor Spirit (PMS) per day. It was gathered that the company has a commission of ₦2 per litre of PMS refined. However, only 70% of the installed capacity was refined.

   There were no obstructions in operations throughout the year. Other costs allocated to refinery business include:

   - Administrative and general costs = ₦245,000,000
   - Production costs incurred = ₦198,000,000
   - Capital allowance attributable to Refinery = ₦325,000,000
   - Other costs incurred = ₦90,000,000

   20% of other costs incurred were discovered to have been incurred for crude oil production.

   (iii) Dando Oil Ltd delved into the gas utilization business in January 2015 committing the sum of ₦1,200,000,000 on construction activities during the year. The project has an estimated completion period of 36 months with a balance of ₦800,000,000 to be paid at the end of 24months of construction.

   Required:
   Compute the Companies Income Tax and Tertiary Education Tax payable based on the information provided. (20 Marks)

SOLUTION TO QUESTION 1

DANDO OIL LIMITED
Computation of Companies Income Tax & Tertiary Education Tax for 2016 Year of Assessment.

	₦	₦
Gross Income (W1)		1,022,000,000
Less Associated Refinery Cost:		
Administration & General	245,000,000	
Production Cost	198,000,000	
Other Cost (80% of 90m)	72,000,000	
		515,000,000

Assessable Profit	507,000,000
Less Capital Allowances	325,000,000
Total Profit	182,000,000
CIT @ 30%	54,600,000

Education Tax

Adjusted/Assessable Profit 507,000,000	
EDT @ 2% of 507,000,000	10,140,000

Workings

W1

Turnover	Litres
Litres of PMS per day	2,000,000
Percentage achieved	70%
Total litre achieved per day	1,400,000
No of days in a year	365
Total premium motor spirit per year	511,000,000 litres
Commission earned:	N
N2 per litre of PMS refined	2
Turnover per annum	1,022,000,000

W2

Other costs	90,000,000
Less 20% incurred on crude oil production	18,000,000
Other costs admissible	72,000,000

NB: Remark

The cost incurred on the gas utilization project is a capital cost and the project is still on going with a completion time of 36 months.

Thus the cost incurred of ₦1.2b and the outstanding of ₦800m are not relevant in this computation more so that the project is still work-in-progress at this time.

2. Bonga Exploration and Production Company Limited has been operating in Nigeria for a while and filed its 2017 Petroleum Profits Tax (PPT) Estimates on February 2017. Due to operational dynamics, the estimates were revised in July and November of same year with the following results.

February 2017 (Initial estimate)	=	$720,000,000
July 2017 (1st revision)	=	$428,000,000
November, 2017 (2nd revision)	=	$510,000,000

Required:

(i) Determine the monthly PPT payable based on the annual estimate stated above (15 Marks)

(ii) If the actual PPT for 2017 accounting period is $542,150,225, compute the 13th Instalment payable (if any). (2 Marks)

(iii) What is the due date for filing PPT estimates? (1½ Marks)

(iv) What is the due date of payment of 13th instalment? (1½ Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 2

Bonga Exploration and Production Company Ltd

(i) Computation of monthly PPT estimates payable.

Instalment	**Month Due**	**Amount ($)**
1st	March 2017	60,000,000
2nd	April 2017	60,000,000
3rd	May 2017	60,000,000
4th	June 2017	60,000,000
5th	July 2017	23,500,000
6th	August 2017	23,500,000
7th	September 2017	23,500,000
8th	October 2017	23,500,000
9th	November 2017	44,000,000
10th	December 2017	44,000,000
11th	January 2018	44,000,000
12th	February 2018	44,000,000
		510,000,000

(ii) Computation of 13th Instalment:

Actual PPT Payable	542,150,225
Less: PPT instalments paid	(510,000,000)
13th Instalment	32,150,225

(iii) Due Date for filing PPT estimates:

Section 33 (1) of the Petroleum Profits Tax Act CAP P13 LFN 2004 (as amended) provides for the due date as follows:

"*Not later than two months after the commencement of each accounting period of any company engaged in petroleum operations, the company shall submit to the Board a return, the form of which the Board may prescribe, of its estimated tax for such accounting period";*

(iv) Due Date for payment of 13th instalment:

Section 45 (4) of the PPTA provides that the thirteen payment shall be due and payable within Twenty one (21) days after the service of the Notice of Assessment of tax for such accounting period .

Workings

(1) Computation of initial monthly PPT estimate payable:

PPT liability estimated $720,000,000
:. Monthly Payable = 720,000,000/12
= $60,000,000

(2) Computation of revised monthly PPT estimate payable (1st revision)

Revised PPT for the year	$428,000,000
PPT already paid *1st to 4th instalment)	
= ($60,000,000 x 4)	240,000,000
	188,000,000

Revised monthly PPT = 188,000,000/8 months outstanding.
= $23,500,000
Computation of revised PPT estimates

(3) Second revision (in November).

Revised PPT estimate for the year has estimates	$510,000,000
already paid (1st – 8th instalment)	
= (60m x 4) + (23.5m x 4)	$334,000,000
	176,000,000
Revised monthly estimate payable =	176,000,000/4 months
	$44,000,000

3. Briefly explain the roles of the following agencies in the operations of explorations and production companies in Nigeria.

(i) Department of Petroleum Resources (5 Marks)

(ii) Organisation of Petroleum Exporting Countries (OPEC) (5 Marks)

(iii) American Petroleum Institute (API) (5 Marks)

(iv) Nigeria National Petroleum Corporation (NNPC) (5 Marks)
(Total 20 Marks)

SOLUTION TO QUESTION 3

(i) <u>Department of Petroleum Resources (DPR):-</u>

DPR has the statutory responsibility of monitoring of operations at drilling sites, producing wells, production platforms and flowstations, crude oil export terminals, refineries, storage depots, pump stations, retail outlets, any other locations where petroleum is either stored or sold, and all pipelines carrying crude oil, natural gas and petroleum products,

(i) Supervises all Petroleum Industry operations being carried out under licences and leases in thecountry.

(ii) Monitors the Petroleum Industry operations to ensure they are in line with national goals and aspirations including those relating to Flare down and Domestic Gas Supply Obligations.

(iii) Ensures that Health Safety& Environment regulations conform with national and international best oil field practice.

(iv) Maintains records on petroleum industry operations, particularly on matters relating to petroleum reserves, production/exports, licences and leases.

(v) Advises Government and relevant Government agencies on technical matters and public policies that may have impact on the administration and petroleum activities.

(vi) Processes industry applications for leases, licences and permits,and

(vii) Ensures timely and accurate payments of Rents, Royalties and other revenues due to government. .

(viii)Generates and collects the following revenues on behalf of Federal Government of Nigeria:

- concession rentals
- signature bonus
- gas flare penalty
- royalty on oil production
- royalty on gas sales and
- miscellaneous oil revenue.

(ii) <u>Organisation of Petroleum Exporting Countries (OPEC):-</u>

The Organization of the Petroleum Exporting Countries is an intergovernmental organization of 15 nations, founded in 1960 in Baghdad by the first five members, and headquartered since 1965 in Vienna, Austria. Nigeria is a member of OPEC. She is both a producer nation of crude oil and a consumer nation of refined products. Becoming a member of OPEC grants any oil producing country an opportunity to enjoy the benefits of policies instituted by the global oil body. OPEC countries control about 40 percent of the world's oil production and more than 80 percent of established oil reserves.

OPEC is responsible for the "coordination and unification of the petroleum policies of Member Countries and the determination of the best means for safeguarding their interests, individually and collectively, these coordination efforts have made it attractive to Nigeria and many oil producing countries that were hit by the oil price dip in 2014.

OPEC is a cartel – that seeks to ensure that oil producing countries desire maximum value from the exploitation of crude oil. It controls or regulates the supply of products into the international market by member countries through the issuance of quota as benchmark for export. OPEC also ensures participation of member countries in the exploitation of crude oil.

The mission of OPEC is "to coordinate and unify petroleum policies of its member countries and ensure the stabilization of **oil** markets in order to secure an efficient, economic, and regular supply of petroleum to consumers in a steady and efficient manner.

The Joint OPEC / Non-OPEC Ministerial Monitoring Committee (JMMC) graciously granted Nigeria an exemption from the output cuts imposed on OPEC member countries in January

2017. This exemption, which was extended in September 2017, significantly helped Nigeria in her most challenging time.

(iii) American Petroleum Institute (API):

The American Petroleum Institute (API) founded on 20 March 1919 and based in New York City is the largest U.S. trade association for the oil and natural gas industry. It claims to represent about 650 corporations involved in production, refinement, distribution, and many other aspects of the petroleum industry.

Scope of Membership Activity

API's members are involved in the Institute's through a variety of mechanisms, most commonly on API's committees. API has three main standards committees with a subordinate committee structure that ensures API standards maintain technical relevance.

For more than 75 years, API has led the development of petroleum and petrochemical equipment and operating standards. These represent the industry's collective wisdom on everything from drill bits to environmental protection and embrace proven, sound engineering and operating practices and safe, interchangeable equipment and materials. API maintains more than 500 standards and recommended practices. Many have been incorporated into state and federal regulations; and increasingly, they're also being adopted by the International Organization for Standardization, a global federation of more than 100 standards groups.

API's standards are used worldwide and cover all aspects of the oil and natural gas industry. API's Monogram Certification program is used not only in the U.S. but also worldwide to ensure the availability of manufactured product and material built to API standards. API's Engine Oil Licensing Systems verifies that engine oil meets API standards for durability and engine protection.

Since 1924, the American Petroleum Institute has been a cornerstone in establishing and maintaining standards for the worldwide oil and natural gas industry. API helps the oil and gas industry invent and manufacture superior products consistently, provide critical services, ensure fairness in the marketplace for businesses and consumers alike, and promotes the acceptance of products and practices globally.

The API basically certifies the quality and grading of crude blends. This ensures that crude blends produced in Nigeria meat international grading standards.

(iv) Nigeria National Petroleum Corporation (NNPC):-

The NNPC is Nigeria's oil and gas company through which the Federal Government participates and regulates the petroleum industry. NNPC was established on 1 April 1977 as a merger of the Nigerian National Oil Corporation and the Federal Ministry of Mines and Steel.

NNPC is empowered to manage the joint venture between the federal government and a number of foreign multinational corporations, such as Agip, ExxonMobil, Chevron, and Texaco (now merged with Chevron), Royal Dutch Shell, Total S.A, through collaboration with these companies, the Nigerian government conducts petroleum exploration and production. The NNPC has seven operational units which include the following:

- Upstream Company
- Downstream Company
- Refining Company
- Ventures Company
- Gas & Power Company

NNPC has sole responsibility for upstream and downstream developments, and is also charged with regulating and supervising the oil industry on behalf of the Nigerian Government. In 1988, the corporation was commercialised into 11 strategic business units, covering the entire spectrum of oil industry operations: exploration and production, gas development, refining, distribution, petrochemicals, engineering, and commercial investments. The subsidiary companies include: Nigerian Petroleum Development Company (NPDC). The NNPC operates in the upstream sector through the Nigerian Petroleum Development Company (NPDC) and Integrated Data Services Limited (IDSL).
IDSL was established in 1988 as a subsidiary company of the NNPC, to provide hydrocarbon exploration services in the local and international Oil and Gas industry.

In the Downstream sector, NNPC operates through the followings:

- Nigerian Product Marketing Company (NPMC),
- Nigeria Pipeline & Storage Company (NPSC),

NNPC Retail, formerly Pipelines and Products Marketing Company (PPMC) and the refineries; Warri Refining and Petrochemical Company (WRPC), Kaduna Refining and Petrochemical Company (KRPC), and Port Harcourt Refining and Petrochemical Company (PHRC).

In the gas sector, NNPC operates through the Nigeria Gas Processing and Transmission Company (NGPTC), Nigeria Gas Marketing Company (NGMC) and the Gas and Power Investment Company who are all subsidiaries of the Nigerian National Petroleum Corporation (NNPC). Other subsidiaries are Duke Oil, National Petroleum Investment Management Services (NAPIMS) and the Crude Oil Marketing Department (COMD).

The NNPC also relates with international organisations such as the OPEC to ensure that business in the industry is conducted with international best practice.

The NNPC is also engaged in marketing government crude oil in addition to participation in exploitation and production activities.

4. (a) The Upstream Exploration and Production Companies are faced with the risk of the host Government changing the agreed tax regime applicable to the Oil and Gas project.

Briefly outline:

(i) Three (3) ways by which the host Government may alter the tax regime. (3 Marks)

(ii) Two (2) of the instruments available to the investor (oil company) to defend any change that the host Government may want to introduce into an existing regime. (2 Marks)

(b) (i) List Two (2) areas of conflict in a transfer pricing audit. (2 Marks)

(ii) Briefly define and explain the following concepts with regards to transfer pricing.

- Resale price (3 Marks)

- Transactional profit split (3 Marks)

- Comparable uncontrolled price (3 Marks)

(c) Highlight Four (4) objectives of the Nigerian Transfer Pricing regulations. (4 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 4

(a) (i) Ways that Host Government can alter tax regime.

(1) Increase the company income tax rate or special tax rate applicable to the taxable income of the project.

(2) Introduce new supplementary charges or increase the charges that is already applicable to the oil revenue.

(3) It can delay VAT refunds due to the company or disregard any utilizable tax losses accumulated by the company in the initial years of the project.

(4) It can introduce new restrictions or custom charges to the import and export of equipment used in the exploration and production.

(5) It can introduce new withholding taxes on income streams.

(ii) Instruments available to the company for defence

(1) The company can include stabilization clause in the contract agreed with the host Govt. of National Oil Company.

(2) The company may also rely on arbitration clauses to start an international arbitration case for a breach of contract.

(3) The company can rely upon existing Bilateral investment treaties signed between countries to protect companies from each of the signatory Government against harmful measures to the foreign investor.

(b) (i) Areas of Conflict in Transfer Pricing

(1) Conflict could arise from adjustments in taxable profits resulting in increased tax liabilities.

(2) Double taxation may arise where adjusted profits have been taxed in other jurisdiction.

(3) Conflict may arise from different interpretation of provisions of the regulations.

(ii) Comparable Uncontrolled Price (CUP)

This is a method in which the price charged for property or services transferred in a controlled transaction is compared with the price charged for property or services transferred in a comparable uncontrolled transaction.

<u>Resale Price Method:-</u> This is a method in which the resale margin that a purchaser of property in a controlled transaction earns from reselling the property in an uncontrolled transaction is compared with the resale margin that is earned in a comparable uncontrolled purchase and resale transaction.

Transactional Profit Split Method:- This is a method in which the division of profit or loss that a company achieves in a controlled transaction is compared with the division of profit or loss that would be achieved when participating in a comparable uncontrolled transaction.

(c) Objectives of Transfer Pricing

Transfer price is the price charged in a transaction. The term 'transfer price' is used to describe the actual price charged between the associated enterprises in an international transaction. Thus transfer pricing issues arise when entities of multinational corporations resident in different jurisdictions transfer property or provide services to one another. The objectives include the following**:**

(i) To ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activities deployed by taxable persons in Nigeria, including in their transactions and dealings with associated enterprises.
(ii) To reduce the risk of economic double taxation.
(iii) To provide the Nigeria authorities the tools to fight tax evasion through over or underpricing of controlled transactions between associated enterprises.
(iv) To provide a level playing field between multinational enterprises and independent enterprises doing business within Nigeria.
(v) To provide taxable companies with certainty of transfer pricing treatment in Nigeria;

- To reduce profits artificially so that tax effect is reduced in a specific country;
- To facilitate decentralization of production so that efforts are directed to concentrate profits in the State of production where there is no or least competition;
- To remit profits more than the ceilings imposed for repatriation;
- To use it as an effective tool to exploit the fluctuation in foreign exchange to advantage; and
- To accurately measure the imports and exports for the nations where the relevant entities are located.

5. Olorunsogo Petroleum Company is an old established company engaged in petroleum operations. The production statistics of the company for the month of December, 2016 include the following:

Production

Type of crude oil	**Quantity (barrels)**	**API^0**
Bonny light	10,000,000	40^0
Bonny medium	5,000,000	24^0

The prices of Nigerian crude oil as advised by the NNPC for September 2016 were as follows:

Type	**API**	**US$**
Bonny light	37^0	31.477
Bonny medium	26^0	29.205

Other relevant details are as follows:

- For every degree increase or decrease in API gravity above standard API gravity, the posted price is adjusted by US$.03. While Bonny Light was sold at ₦5,100/bbl., Bonny Medium was sold at ₦4,900/bbl.

- ₦165, equivalent to US$1

(a) You are required to compute the posted price per stream of crude oil produced by the company and the fiscal value of crude oil produced in the relevant tax year. (12 Marks)

(b) Briefly explain the following in line with the PPTA;

(i) Concession
(ii) Production Sharing Contract (PSC)
(iii) Oil Prospecting License (OPL)
(iv) Oil Mining Lease (OML) (8 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 5

(a) Olorunsogo Petroleum Company
Computation of Posted Price Per Stream of Crude Oil

	Bonny Light			**Bonny Medium**	
	API	**USD**		**API**	**USD**
Standard	37˚	31.477		26˚	29.205
Actual	40˚			24˚	
Difference	3˚			2˚	
Adjustment (3˚ x $0.03)		0.09	(2˚ x 0.03)		(0.06)
Adjustment Posted Price		31.567			29.145
Adjusted Posted Price @ ₦165/USD		₦5,208.56/bbl			₦4,808.93/bbl
Actual Export Price		₦5,100/bbl			₦4,900/bbl
Appropriate Price		₦5,208.56/bbl			₦4,900/bbl

Olorunsogo Petroleum Company

Computation of Fiscal Value of Crude Oil Produced for 2011 Year of Assessment

	₦'000
Bonny Light (10,000 x 5,208.56)	52,085,600
Bonny Medium (5,000 x 4,900)	24,500,000
	76,585,600

(b) (i) **<u>Concession:</u>** This includes an oil exploration license, oil prospecting license and oil mining license, title or interest in or to petroleum oil in the ground and any option of acquiring any such right, title or interest.

(ii) **<u>Production Sharing Contract (PSC):</u>** This is a contract in which the Nigerian National Petroleum Corporation (NNPC) enters into production sharing contracts (as the proprietary holder of oil prospecting licences or oil mining leases) with exploration and production companies as contractors to the NNPC for the production of crude oil in particular oil fields.

Under production sharing contract arrangements, the NNPC's contractors bear the cost of petroleum operations within the contract area and, in return, can recoup costs (after defraying royalty) and realise profit (after allocating tax oil).
This is a major shift from the terms in Joint Venture arrangements wherein the NNPC funds the operational expenses of the venture in proportion to its share in the joint venture. In PSCs, the petroleum producing companies fund 100% of the contract. The provision for reimbursement of costs to the operator in executing the contract is usually contained in the PSC. This is achieved through an allocation to the operator, a proportion of the oil produced from which the company is expected to recover its cost of producing the oil and of executing the contract generally.

Oil recovered in the contract area is split into
(a) Royalty oil
(b) Cost oil
(c) Tax oil
(d) Profit oil

(iii) **Oil Prospecting License:-** This is a license granted to a company under the Minerals Act, for the purpose of winning petroleum, or any assignment of such license. It is license that provides the holder with an exclusive right to explore and prospect for petroleum within a licensed area.

Oil prospecting licence and oil mining lease holders are prohibited from assigning their licences or leases, or any right, power or interest therein, without the prior consent of the minister of petroleum. Further, the Petroleum (Drilling and Production) Regulations require that the takeover of an oil prospecting licence or oil mining lease is subject to the consent of the Minister of Petroleum.

This position was confirmed by the Federal High Court in *Moni Pulo Limited v Brass Exploration Unlimited*, where the court confirmed that an indirect transfer of interest in an oil mining lease (by way of the sale of shares of a lessee resulting in a change of control) requires ministerial consent.

(iv) **Oil Mining Lease:** It is a license which provides the holder with the exclusive rights within the leased area to conduct exploration and prospecting operation and to win, get, work, store, carry away, transport or export petroleum discovered within the lease area.

- An oil mining lease is granted to oil prospecting licence holders on the discovery of oil in commercial quantities (at least 10,000 barrels per day). It grants the lessee an exclusive right to prospect, explore, produce and undertake marketing activities in connection with the specified acreage for a period of 20 years. An oil mining lease may be renewed subject to the fulfilment of certain conditions.

CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2018: PROFESSIONAL EXAMINATION

PT 3: PRACTICAL CASES IN TAXATION

ATTEMPT ALL QUESTIONS. SHOW ALL WORKINGS. TIME: 3 HOURS.

DETOLL NIGERIA LIMITED

Detoll Nigeria Limited (DNL) was incorporated as a limited liability company by Adetola Daniel in 2001. The directors of the company are:

- Mr. Daniel Adetola;
- Mrs. Deborah Adetola;
- Dr. Jude Adetola;
- Engr. Johnson Adetola; and
- Mr. Ibrahim Idris

The company has a registered share capital of 400,000,000 ordinary shares of ₦0.50 each, out of which 200,000,000 have been issued and fully paid. The beneficiary ownership of the shares are:

- Mr. Daniel Adetola – 100million Shares;
- Mrs. Deborah Adetola – 50million Shares;
- Dr. Jude Adetola – 25million Shares; and
- Engr. Johnson Adetola – 25million Shares.

DNL deals with specialized electrical components and has its office at Agbara Industrial Estate in Ogun State.

BOARD MANAGEMENT AND STAFF

DNL is being run by a board of five members, made up of three executive directors and two non-executive directors. One of the non-executive directors is an independent director who was brought in to give independent advice to the board on all matters.

Mr. Daniel Adetola acts as the non-executive Chairman of the company while Dr. Jude Adetola is the Managing Director and Engineer Johnson Adetola works as the Technical Director. Therefore, the management of DNL is made up of:

- Dr. Jude Adetola – Managing Director;
- Engr. Johnson Adetola – Technical Director;
- Mrs. Tinu Gbadebo – Marketing Manager;
- Mr. Chukwuma Geofrey – Finance Manager; and
- Alh. Danladi Ibrahim – Human Resources Manager

Management meeting is held every Tuesday to consider and review issues and make decisions on how to run the company successfully.

Agbara Industrial Estate, being a border town between Lagos and Ogun States, about 40% of the Company's workforce of 120 staff live in Lagos State while the rest reside in Ogun State. Also, the Managing Director, Dr. Jude Adetola, live in Lagos State together with the Chairman while Engr. Johnson Adetola lives in Agbara Estate Residential Area.

The company pays the rent on the Managing Director and Technical Director's apartments. The current rent paid is ₦2.5m and ₦2.1m per annum respectively. The company also maintains five (5) personal staff for each of them. These are two drivers each, one gardener each and two security officers each. In addition, DNL bought a 25KVA generator for each house at the cost of ₦1.5m. The company spends, on average, ₦50,000 monthly to maintain each of the generators. The average salary of each of the domestic staff is ₦40,000 per month. The total gross emoluments of the Managing Director and the Technical Director are ₦24m and ₦21m respectively.

DECISION TO CLOSE DOWN

Recently, the company has been experiencing dwindling sales due to influx of substandard products into the market. Therefore, in a recent board meeting, the board of the company took a decision to close down the business and move its investment into agricultural business.

A notice of cessation of business was filed with the Federal Inland Revenue Service, (FIRS) Ota, Ogun State on 31 May, 2016 informing the Board that the company will formally stop business with effect from 1 July, 2016.

Also, a decision was taken to dispose off the company's entire plant and machinery in December 2016. This decision was carried out and the machinery was sold for ₦10m. Valuation fee of ₦500,000 was paid to the valuer who valued the plant and machinery before disposal. Also, ₦500,000 was paid as agency commission on the disposal. The plant and machinery was originally purchased for ₦6.5m.

UNUTILIZED CAPITAL ALLOWANCES

The company informed the FIRS of its intention to have its unutilized capital allowances rolled back to ensure refund of taxes the company has overpaid.

Details of the company's tax record with the FIRSare given below:

Years of Assessment	**Assessable Profit/(Loss)**	**Capital Allowance**	**Total Profit**	**Tax Paid**
	₦	₦	₦	₦
2011	(1,800,000)	4,600,000	--	--
2012	3,800,000	5,800,000	1,300,000	390,000
2013	9,200,000	4,100,000	3,100,000	930,000
2014	7,500,000	6,500,000	2,500,000	750,000
2015	11,500,000	9,000,000	3,800,000	1,140,000
2016	4,600,000	4,100,000	1,500,000	450,000

The company submitted the following details to the Board in respect of 2016 financial year:

(i) Adjusted loss ₦2,505,000

(ii) Capital Allowance ₦3,550,000

The tax computations as agreed with the Board for the various years of assessment, as above, are as follows:

(i) Accounting year ended 31 December, 2010:
2011 Year of Assessment

	₦	₦
Loss		(1,800,000)
Capital allowances carried forward		4,600,000

(ii) Accounting year ended 31 December, 2011:
2012 Year of Assessment

	₦	₦
Total Assessable Profit		3,800,000
Deduct Loss Brought Forward		(1,800,000)
		2,000,000
Deduct Capital Allowances:		
Unutilized brought forward	4,600,000	
Current year	5,800,000	
	10,400,000	
Restricted to 2/3 of Assessable Profit	(1,333,333)	(1,333,333)
Unutilized Capital Allowance C/f	9,066,667	
Total Profit		666,667
Companies Income Tax Payable at 30% of ₦666,667		200,000

(iii) Accounting year ended 31 December, 2012:
2013 Year of Assessment

	₦	₦
Assessable Profit		9,200,000
Deduct: Capital Allowances:		
Brought Forward	9,066,667	
Current Year	4,100,000	
	13,166,667	
Restricted to 2/3 of Assessable Profit	(6,133,333)	(6,133,333)
Unutilized Capital Allowance C/f	7,033,334	
Total Profit		3,066,667
Companies Income Tax Payable @ 30% of ₦3,066,667		920,000

(iv) Accounting year ended 31 December, 2013:
2014 Year of Assessment

	₦	₦
Assessable Profit		7,500,000
Deduct: Capital Allowances:		
Brought Forward	7,033,334	
Current Year	6,500,000	
	13,533,334	
Restricted to 2/3 of Assessable Profit	(5,000,000)	(5,000,000)
Unutilized Capital Allowance C/f	8,533,334	
Total Profit		2,500,000
Companies Income Tax Payable @ 30% of ₦2,500,000		750,000

(v) Accounting year ended 31 December, 2014:
2015 Year of Assessment

	₦	₦
Assessable Profit		11,500,000
Deduct: Capital Allowances:		
Brought Forward	8,533,334	
Current Year	9,000,000	
	17,533,334	
Restricted to 2/3 of Assessable Profit	(7,666,667)	(7,666,667)
Unutilized Capital Allowance C/f	9,866,667	
Total Profit		3,833,333
Companies Income Tax Payable @ 30% of ₦3,833,333		1,150,000

(vi) Accounting year ended 31 December, 2015:
2016 Year of Assessment

	₦	₦
Assessable Profit		4,600,000
Deduct: Capital Allowances:		
Brought Forward	9,866,667	
Current Year	4,100,000	
	13,966,667	
Restricted to 2/3 of Assessable Profit	(3,066,667)	(3,066,667)
Unutilized Capital Allowance C/f	10,900,000	
Total Profit		1,533,333
Companies Income Tax Payable @ 30% of ₦1,533,333		460,000

OGUN STATE BOARD OF INTERNAL REVENUE

The Ogun State Board of Internal Revenue carried out an audit exercise on the company's compliance with Personal Income Tax Act provisions for the periods 2014 to 2016. The Board came up with a total additional liability of ₦25.6m for the period of the audit.

On closer examination of the details of the liability by DNL's Finance Manager, he discovered that the Board has captured the entire staff of the company in their calculations and assessment. He has contacted you, as a Tax Consultant, to take up the matter on behalf of the company.

QUESTIONS

1. (a) What is the provision of the tax law in respect of carrying back of unutilized capital allowances on cessation of business? (5 Marks)

   (b) Compute the revised assessment of Detoll Nigeria Limited on cessation basis, taking into consideration unutilized capital allowances. (25 Marks)

(Total 30 Marks)

SOLUTION TO QUESTION 1

(a) The provisions of the Companies Income Tax Act is that unutilized capital allowances, on cessation of business, can be carried back to the previous five years of assessment, before the year of cessation, starting from the penultimate year, that is, year preceding the cessation.

The company must make a claim for this relief before it can be given. Where the deduction cannot be made for any preceding year of assessment by reason of any assessment for a year having become final and conclusive, the FIRS may, with respect to the year, make such repayment or set-off of the tax, or of any part of such tax, paid or charged for the year, as may be appropriate, in lieu of making the deduction.

(b) DETOLL NIGERIA LIMITED
Assessment Year 2016 – 1/1/16 – 30/6/16

	₦	₦
Adjusted loss		(2,505,000)
Deduct:		
Unutilized capital allowances carried backward	10,900,000	
Current capital allowances for the period	3,550,000	
Unutilized capital allowances on cessation	14,450,000	
Assessment year 2015		
Total profit		3,800,000
Unutilized capital allowances carried backward		(14,450,000)
Unutilized capital allowances carried backward		10,650,000
Companies income tax liability		NIL
Assessment year 2014		
Total profit		2,500,000
Unutilized capital allowances carried backward		(10,650,000)
Unutilized capital allowances carried backward		(8,150,000)
Companies income tax liability		NIL
Assessment Year 2013		
Total profit		3,100,000
Unutilized capital allowances carried backward		8,150,000
Unutilized capital allowances carried backward		5,050,000
Companies income tax liability		NIL
Assessment Year 2012		
Total profit		1,300,000

Unutilized capital allowances carried backward		(5,050,000)
Unutilized capital allowances carried backward		(3,750,000)
Companies Income Tax liability		NIL
Assessment year 2011		
Total profit		0
Unutilized capital allowance carried backward		(3,750,000)

Capital allowances carried back against the remainder of profits are as follows:

	₦
2015	3,800,000
2014	2,500,000
2013	3,100,000
2012	1,300,000
2011	-
	10,700,000

EXAMINER'S REPORT

The question tests candidates' understanding of the provisions of the Companies Income Tax Act on unutilized capital allowance on cessation of business and the calculation of revised assessments on cessation basis, taking into consideration unutilized capital allowances.

Candidates' performance was poor as 95% of the candidates scored below average.

The commonest pitfall of candidates was their inability to calculate revised assessment taking into consideration the unutilized capital allowance on cessation of business.

Candidates are advised to practice on practical questions when preparing for future examination.

2. (a) Determine the tax refundable by Federal Inland Revenue Service (FIRS) for the relevant years of Assessment, if any. (10 Marks)

(b) Calculate the Capital Gains' Tax Liability of the company, if any. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) Tax refundable by FIRS will be based on capital allowances carried back for each year of assessment as computed in solution (1)b as follows:

		Tax Refund
	₦	₦
2011 Year of Assessment 30%	NIL	
2012 Year of Assessment 30%	1,300,000	390,000
2013 Year of Assessment 30%	3,100,000	930,000
2014 Year of Assessment 30%	2,500,000	750,000
2015 Year of Assessment 30%	3,800,000	1,140,000
Total tax to be refunded		3,210,000

(b) Capital Gains Liability

	₦	₦
Sales proceeds of plant and machinery		10,000,000
Disposal expenses:		
Valuation fees	500,000	
Agency commission	500,000	1,000,000
		9,000,000
Less cost		6,500,000
Capital gains		2,500,000
tax @ 10% of ₦2,500,000		250,000

EXAMINER'S REPORT

The question tests candidates' understanding of determination of tax refundable by Federal Inland Revenue Service and the calculation of capital gains tax.

Candidates' performance was below average in the part (a) of the question while almost all the candidates performed very well in the part (b) of the question, the calculation of capital gain tax.

The candidates' commonest pitfall was their inability to calculate tax refundable by the tax authority.

Candidates are advised to practice on practical questions adequately when preparing for future examination.

3. With respect to corporate governance, distinguish between executive directors, non-executive directors and independent non-executive directors. (15 Marks)

SOLUTION TO QUESTION 3

(a) Executive Directors are employee of the company and are covered by employment law. They hold a managerial role in addition to their responsibilities as members of the board of directors.
Their appointment could be determined based on the terms of their employment contracts. They are involved in the day to day management of the company.

(b) Non-executive directors are not employees of the company and they are not part of the management hierarchy involved in the day to day management of the company.

(c) Independent non-executive directors are non-executive directors who have no direct link with the company. They have no relationship with the company that could affect the exercise of their independent judgement. Those who are not independent have some link with the company, such as close family ties to the chairman, being a representative of dominant shareholders, having previously served as executive of that company, and so on.

In Detoll Nigeria Limited, Mr. Daniel Adekola and Mrs. Deborah Adetola are non executive directors; Dr. Jude Adekola and Engr. Johnson Adekola are executive directors; and Mr. Ibrahim Idris is an independent and non-executive director.

EXAMINER'S REPORT
The question tests candidates' understanding of types of directors on a company's board. Candidates' performance was very poor as more 90% of the candidates scored below average.

The commonest pitfall of the candidates was their inability to distinguish between, executive directors, non-executive directors and non-executive independent directors.

Candidates are advised to revise all the subjected they have previously passed in the Institute's examination as they are to assist them to do well in practical cases in taxation examination.

4. As the company's Tax Consultant, how would you deal with the additional tax liability from Ogun State Board of Internal Revenue Service? Your outline of the steps to be taken should include the application of the appropriate provisions of the income tax laws. (20 Marks)

SOLUTION TO QUESTION 4

(a) As the tax consultant of Detoll Nigeria Limited, the following steps will be taken to address the additional liability from Ogun State Board of Internal Revenue:
- (i) The payroll and other relevant documents will be collected from the company;
- (ii) Determine the company's tax liability in accordance to the relevant laws;
- (iii) From the above, ascertain the correct additional liability of the company to Ogun State Board of Internal Revenue.
- (iv) A letter of objection, which must be within 30 days of receiving the additional demand liability, will be written to the Board. The ground of objection will be stated in the letter. Also, a copy of any calculation of the additional liability together with a cheque for part payment of the additional liability will be attached to the letter of objection;
- (v) The letter of objection will also include information about the residence of the staff that are residing in Lagos State, the Managing Director and other staff attached with the relevant evidences. Specifically, it will be pointed out that, according to Section 2 of the Personal Income Tax (as amended), residence rule is used to determine the state to which staff tax is payable;
- (vi) When a letter of invitation for a reconciliation meeting with the tax authority is received, I will attend the meeting to present the company's case;
- (vii) When a notice of amendment of assessment is received, I will compare it with my own calculations;
- (viii) If it is acceptable, I will advise the company to pay the balance on the demand notice, after deducting the part payment as in (iv) above;
- (ix) If the amended liability is not acceptable, based on my previous calculations in (ii) above and the provisions of the income tax law, I will send a letter objecting to the amended liability; and
- (x) The process of (v) and (vi) will be followed until the liability is finally agreed and settled.

EXAMINER'S REPORT
The question tests candidates' understanding of the responsibilities a tax consultant in resolving personal income tax audit liabilities for his client.

Candidates demonstrated lack of understanding of the question and 95% of the candidates scored below average of the marks allocated.

The candidates' commonest pitfall was lack of understanding of the stages a tax consultant should take to resolve personal income tax audit liability.

Candidates are advised to familiarize themselves with the work of a tax practitioner when preparing for future examination.

5. Determine the Personal Income Tax payable by the Managing Director and the Technical Director, stating which state the tax is to be paid. (20 Marks)

SOLUTION TO QUESTION 5

(a) Calculation of personal income tax payable
Managing Director: Dr. Jude Adetola

	₦'000	₦'000
Total Emolument:		
Gross Salary	24,000	
Other benefits:		
Rent	2,500	
Generator 5% of ₦1.5m	75	
Generator maintenance ₦50,000 x 12	600	
Domestic Staff 5 x ₦40,000 x 12	2,400	
Total Gross Emolument		29,575
Less consolidated allowance 1% plus 20% of ₦29,575,000		6,210.75
Taxable emolument		23,364.25
Tax payable:		
First ₦300,000 @ 7%	21	
Next ₦300,000 @ 11%	33	
Next ₦500,000 @ 15%	75	
Next ₦500,000 @ 19%	95	
Next ₦1,600,000 @ 21%	336	
Balance ₦20,164,250 @ 24%	4,839.42	
Tax payable		5,399.42

Since the Managing Director is resident in Lagos State, his tax will be paid to Lagos State Board of Internal Revenue.

(b) Technical Director Engr. Johnson Adetola

	₦'000	₦'000
Total Gross Emolument:		
Gross salary	21,000	
Other Benefits:		
Rent	2,100	
Generator 5% of ₦1.5m	75	
Generator maintenance ₦50,000 x 12	600	
Domestic staff ₦40,000 x 5 x 12	2,400	
Total Gross emolument		26,175

	₦'000	₦'000
Less: Consolidated allowance 1% + 20% of ₦26,175,000		5,496.75
Taxable Emolument		20,678.25
Tax payable:		
First ₦300,000 @ 7%	21	
Next ₦300,000 @ 11%	33	
Next ₦500,000 @ 15%	75	
Next ₦500,000 @ 19%	95	
Next ₦1,600,000 @ 21%	336	
Balance ₦17,478,250 @ 24%	4,194.78	
Tax payable		4,754.78

Since the Technical Director is resident in Ogun State, his income tax will be paid to Ogun Board of Internal Revenue.

EXAMINER'S REPORT

The question tests candidates' understanding of calculation of personal income tax liability candidates' performance was impressive as more than 95% of the candidates scored above average marks.

CHARTERED INSTITUTE OF TAXATION OF NIGERIA
APRIL 2018: PROFESSIONAL EXAMINATION
PT 3: SOLID MINERALS TAXATION

ATTEMPT ALL QUESTIONS. SHOW ALL WORKINGS. TIME: 3 HOURS.

1. (a) The Nigerian Minerals and Mining Act, 2007 states that "Exploration and Mining operations shall be liable to royalty payment".

(i) Define "Mining royalty" (2 Marks)
(ii) State any Three (3) purposes of mineral royalty payment. (3 Marks)

(b) Gadafi and Company Limited is engaged in the mining of copper in Zamfara State. The following information was provided for you for the year ended 31 December 2016.
Ore body – 12,000,000 tonnes of ore
Mill capacity – 1,000,000 tonnes of ore per year
Average ore grade – 2.75%
Mill recovery – 80%
Smelter recovery – 95%

The smelter return is 2000 pounds at ₦4 per pound International Market Price Premium – Assume a 2% premium to the stated price per pound.

Capital investment – ₦1.00billion over 30 months. Approved capital allowances for the year is ₦30million. The Management further provided the following additional information.

Operating costs:

	₦
Mining	7.00 per pound
Milling	10.00 per pound
Overhead	12.00 per pound
Freight	6.00 per pound
	35.00

The fixed fee per pound is ₦0.25 per pound.

You are required to calculate the royalty due for the year using the following approaches:
(i) Profit based (assuming a royalty of 8%). (11 Marks)
(ii) Unit based method. (4 Marks)
(Total 20 Marks)

SOLUTION TO QUESTION 1

(a) (i) Mining Royalty
Mining Royalty is an economic compensation paid to the State as owner of the minerals for the exploration of non-renewable mineral resources. It is the charge incurred by miners for exploiting a resource that is the property of the State.

(ii) **Purposes of Mineral Royalty Payments**

Mineral Royalty payments are made to owners of the mineral resource in return for the removal of the minerals from the land.

(1) It is a payment in return for permission that gives the mining company access to the minerals.
(2) It gives the company the right to develop the resources for its benefits.
(3) The payment will provide the government with a relatively fiscal policy tool.
(4) It provides another source of raising revenue for the government.

(b) **GADAFI AND COMPANY LIMITED**
Calculation of Royalties for the year ended 31 December 2016

(i) Profit Based Method

Calculation of total ponds
= 1,000,000tonnes x (2,000 x 0.0275 x 0.8000 x 0.9500)
= 1,000,000 x 41.8 = 41,800,000 pounds.

			₦
Total gross sales 41,800,000 x ₦4 per pound =			167,200,000
Less: Operating Costs:			
Mining	7.00		
Milling	10.00		
Overhead	12.00		
Freight	6.00		
	35.00	x 1,000,000 =	(35,000,000)
			132,200,000
Less: Capital Allowances			(30,000,000)
			102,200,000
Royalty = ₦102,200,000 x 8% =			8,176,000

(ii) Unit Based Method

Total pounds = 1,000,000 x (2,000 x 0.0275 x 0.8000 x 0.9500)
= 1,000,000 x 41.8 = 41,800,000 pounds

The Royalty = Total units multiply by the fixed fee
= 41,800,000 x ₦0.25
= ₦10,450,000

2. OZ Mining Limited, an Australian Company wishes to exploit a gold reserve in Nigeria, it has formed a wholly owned Nigerian subsidiary, OZ Mining Nigeria Limited (OMN) with issued share capital of ₦50million.

OMN has acquired mining rights for ₦20million. These were acquired from RightCo, a Nigeria Company. RightCo had previously acquired these rights for ₦5million with a view to selling them again as part of its normal trade.

The entire production of 90% purity gold bars will be sold to an unrelated minerals trading company in Switzerland, and will be shipped directly to South Africa for further refining.

The mine site is located in a rural area where there is no road, electricity or water supply within 20km. OMN currently has no employees but will employ 100 people after development work starts and retain them for the duration of the project which is estimated to be 10 years.

OMN will make a provision of ₦5million per year for the eventual cost of rehabilitating the mine site after mining has ceased. This rehabilitation is a condition of the mining license. OMN will not have any other sources of income.

(a) What Nigerian taxes will apply to OMN and OZ Mining, and at what rates? (Ignore VAT and royalties). (3 Marks)

(b) List Ten (10) tax incentives available to OMN. (10 Marks)

(c) How will VAT apply to OMN? Consider both sales and expenses. (2 Marks)

(d) How can OMN obtain a tax deduction for the eventual rehabilitation cost? (2 Marks)

(e) List Six (6) benefits that Nigeria may derive from this Mining project in addition to the Corporate Income Taxes, VAT and royalties. (3 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 2

(a) Nigerian taxes applicable to OMN and OZ Mining and the rate of the taxes are:
- (i) Companies Income Tax at 30%
- (ii) Tertiary Education Tax at 2%
- (iii) Withholding tax on dividends at 10%

(b) Ten (10) incentives available to OMN are:
- (i) Pioneer tax holiday under the Industrial Development (Income Tax Relief) Act.
- (ii) 3 years tax holiday under the Companies Income Tax Act.
- (iii) Tax holiday in the Minerals and Mining Act 2007.
- (iv) Rural investment allowance of 95%.
- (v) Infrastructure tax relief at 30% of public infrastructure.
- (vi) Export sales profit exemption under the Companies Income Tax Act, section 23(q).
- (vii) 95% capital allowance on acquisition of mining rights.
- (viii) Exemption from customs and import duties in respect of plant, machinery, equipment and accessories imported exclusively for mining operations.
- (ix) Grant of personal remittance quota for expatriate personnel free from any tax imposed by any enactment for the transfer of external currency out of Nigeria.
- (x) All infrastructure cost provided by the mining company and approved by the Mining Cadastre Office to be capitalized and capital allowance claimed at 95% in the first year of operation.
- (xi) The minister may grant concession for deferral of royalty payable for a number of years if approved by the Federal Executive Council.
- (xii) Actual amount incurred out of reserves made for environmental protection, rehabilitation and reclamation and closure costs, subject to certification.

(c) On the sales, the gold bars are exported and therefore qualify to be zero-rated. On the expense side, all overhead expenses will be expensed along with the VAT suffered on the expenses while on the capital expenditure, the VAT will be capitalized along with the cost of the assets. There are no raw materials in a mining venture.

(d) Section 30 of the Minerals and Mining Act 2007 provides for deductibility of rehabilitation costs. It states that "A tax deductible reserve for environmental protection, mine rehabilitation, reclamation and mine closure costs shall be established by companies engaged in the exploitation of mineral resources, provided however, that the appropriateness of the reserve is certified by an independent qualified person taking into account the determination made under the provisions of the Act.

(i) The reserve is recorded in the audited financial statements of the companies.
(ii) Tax deductibility will be restricted to actual amount incurred for the purpose of the reclamation; and
(iii) A sum equivalent to the reserve amount is set aside every year and invested in dedicated account or trust fund managed by independent trustees appointed pursuant to the Act.

(e) Benefits that Nigeria may derive from the Mining project in addition to the Corporate Income Taxes, VAT and Royalties are:

(i) Employment
(ii) Tax/PAYE from the employees
(iii) Services and goods supplied to the mine i.e. increased subcontractor
(iv) Development of the rural area
(v) Foreign direct investment
(vi) Foreign currency inflow from sales to balance trade.
(vii) Enhancing the reputation of Nigeria as a mining destination

3. Explore Co. Ltd operates a gold mine in Nigeria. It produces 10,000 ounces of gold per year, which it sells at $1,320 per ounce. The exchange rate is ₦350 per $1. Operating costs are ₦360,000 per ounce of gold produced. Finance costs incurred is ₦50,000 per ounce.

(a) Assuming a corporate tax rate of 30%, what is the company's profit before and after tax? (4 Marks)

(b) If a royalty of 5% is imposed,
(i) How much royalty is payable? (1 Mark)
(ii) What will be the company's profit after tax? (1 Mark)

(c) Alternatively, if a royalty of ₦35,000 per ounce of gold is levied.
(i) What royalty is payable? (1 Mark)
(ii) What will be the company's profit after tax? (1 Mark)

(d) Explore Co. Ltd expects finance costs to increase to ₦60,000 per ounce, and the price of gold sold to decrease to $1,250 per ounce in the next financial year. Assuming the exchange, tax and royalty rates remain unchanged:
Calculate the expected royalty and profit after tax for both
(i) Ad valorem royalty on sales; (3 Marks)

(ii) Value royalty per ounce. (3 Marks)

(e) Is the financial result in (d) above attractive to Explore Co. Ltd. for both (i) and (ii)? (2 Marks)

(f) State any Four (4) possible courses of action that a company may take to ensure its mining operations remain economically sustainable? (4 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 3

EXPLORE CO. LTD
Determination of Profit before tax and Profit after tax

(a)	Sales: 10,000 ounces @ $1,320 =	$13,200,000
	Exchange rate @ 350 =	₦4,620,000,000
	- Operating costs 360,000 x 10,000	(₦3,600,000,000)
	- Finance costs 50,000 x 10,000	(₦500,000,000)
	- Profit Before Tax (PBT)	₦520,000,000
	- Tax @ 30%	(₦156,000,000)
	Profit After Tax	₦364,000,000
(b)	- PBT before royalty	520,000,000
	- Royalty (5% of ₦4,620,000,000)	(231,000,000)
		₦289,000,000
	- Tax @ 30%	(₦86,700,000)
	Profit After Tax	202,300,000
(c)	- PBT before royalty	520,000,000
	- Royalty (₦35,000 per ounces/10,000ounces)	(350,000,000)
	Profit Before Tax	170,000,000
	- Tax @ 30%	(51,000,000)
	- Profit After Tax	119,000,000
(d)	Sales: 10,000ounces @ $1,250 =	$12,500,000
	Exchange rate @ 350	₦4,375,000,000
	- Operating costs (360,000 x 10,000)	(3,600,000,000)
	- Finance costs (60,000 x 10,000)	(600,000,000)
	Profit Before Royalty	175,000,000
	(i) Royalty @ 5% of N4,375,000,000	(218,750,000)
	PBT (Loss)	(43,750,000)
	Tax	--
	Profit After Tax (Loss)	(43,750,000)
	(ii) Profit Before Tax and Royalty	175,000,000
	Royalty (₦35,000 x 10,000)	(350,000,000)
		(175,000,000)
	Profit Before Tax (Loss)	--
	Tax	(175,000,000)

(e) The financial result above is not attractive to Explore Co. Ltd for both (i) and (ii) above.

(f) Four possible courses of action to make mining economically sustainable are:
- Reduce operating cost by apply cost cutting measures.
- Close mine
- Negotiate lower royalty
- Mine operations of a higher grade to increase profit per tonnes.
- Manage finance costs.

4. Mine Co. Limited is a Nigerian company which operates a coal mine in Enugu State, Nigeria. The mine has been in operation for ten (10) years.

In the accounting year ended 31 December 2016, the following capital costs were incurred for the purpose of mining business: (Assume all prices are VAT exclusive).

		₦
(i)	Exploratory drilling to discover additional coal reserve. This was paid to Drill Contractor Limited, a Nigerian company.	10,000,000
(ii)	License fee for additional mining lease area, paid to the Federal Government.	2,000,000
(iii)	Payment to a Nigerian University to determine, the energy content of coal, to ensure it meets potential customer requirements.	1,500,000
(iv)	New dregline for overburden removal. A further ₦5,000,000 will be incurred in 2017, at which time the dregline will be brought into operation. This payment was made to Equipco Limited, a manufacturer of the equipment.	10,000,000
(v)	Replacement of existing dense media separation plant, used for separating coal from water rock. This payment was made to the manufacturer (Equipco Limited).	6,000,000
(vi)	New houses for Mine employees, in village located close to the mine paid to Amen Constructions Limited.	1,000,000
(vii)	New building to expand the capacity of the Mine Hospital, which is used to treat employees and their dependents paid to Duller Constructions Limited.	1,000,000
(viii)	A new road to haul the coal produced to the nearest public road of adequate load bearing capacity. The road is 10km long, of which 200 metres is located in the mine lease area. The local government and communities have decided that the company cease using the existing public roads, due to the dangers posed to other users. The new road will be available for public use. Paid to Country Construction Limited.	5,000,000

Required:

(a) Compute the capital allowance and/or other deductions for the 2017 Year of Assessment. Please provide brief explanations. (16 Marks)

(b) Assuming all suppliers were Nigerian Companies, what withholding tax should the Mining Company deduct for each capital cost incurred? (4 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 4

Computation of Capital Allowances and Deductions for 2017 Year of Assessment

		₦
(i)	Exploratory Drilling Cost	10,000,000
	Qualifying mining expenditure	
	- Initial Allowance (95%)	9,500,000
	- Annual Allowance	--
	(Search for and discovery of deposits of mineral)	
(ii)	License Fee	2,000,000
	Qualifying mining expenditure	
	- Initial Allowance (95%)	1,900,000
	- Annual Allowance	--
	(in preparation for or connection with working in a mine or)	
(iii)	Payment to Nigerian University	1,500,000
	Qualifying mining expenditure	
	- Initial Allowance (95%)	1,425,000
	- Annual Allowance	--
	Or	
	Qualifying research & development	
	- Initial Allowance (95%)	1,425,000
	- Annual Allowance	--
(iv)	New Dregline	10,000,000
	Qualifying mining expenditure	
	- Initial Allowance (95%)	9,500,000
	- Annual Allowance	--
	(brought into use in basis period for 2018 year of assessment	
(v)	Replacement of dense media separation plant for	6,000,000
	- Initial Allowance	--
	- Annual Allowance	--
	Renewal of asset is deductible under section 24 of CITA	
(vi)	New Staff Houses	1,000,000
	Qualifying mining expenditure	
	- Initial Allowance (95%)	950,000
	- Annual Allowance	--
	(for working on the mine for accommodation)	

(vii)	New Mine Hospital Building	1,000,000
	Qualifying Mining Expenditure	
	- Initial Allowance (95%)	950,000
	- Annual Allowance	--
	(for treating injured employees and their dependents working on the mine)	
(viii)	New Road	5,000,000
	Qualifying mining expenditure	
	- Initial Allowance (95%)	4,500,000
	- Annual Allowance	--
	(the road will be used by the mine non-selective right to use by public	

(b)	**Qualifying Transaction**	**WHT Rate**	**WHT Amount (₦)**
(i)	Drilling contractors' service is not professional in nature but a contract of service	5%	500,000
(ii)	License paid to government parastatals does not qualify	0%	--
(iii)	Nigerian University paid to educational institutions	0%	--
(iv)	Dregline acquired from dealer in the ordinary course of business	0%	--
(v)	Replacement of plant acquired from dealer in the ordinary course of business	0%	
(vi)	New House Construction	5%	50,000
(vii)	New Hospital Construction	5%	50,000
(viii)	New Road Construction	5%	50,000

5. "In order to maintain integrity of Solid Mineral sub-sector, the Nigerian Minerals and Mining Act 2007, highlighted some offences and prescribed penalties for same". In the light of this, explain the following offences and the prescribed penalties.

(a) Illegal Mining (5 Marks)

(b) Use of fraudulent mining scale (5 Marks)

(c) Unlawful interference (5 Marks)

(d) Failure of exporter of solid minerals to make declaration. (5 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 5

(a) **Illegal Mining - Offences**

A mineral title holder shall commit an offence where

(i) He conducts exploration of mine minerals or carries out quarrying operations otherwise than in accordance with provision of the Act.

(ii) In making application for mineral title, knowingly makes a statement, which is false or misleading in any material particular.
(iii) Knowingly gives out information in any report, return or affidavit, which is false or misleading or fails to declare in any material particular.
(iv) Removes, possesses or disposes of any mineral contrary to the provisions of the Act.

Illegal Mining - Penalties
(i) Shall have his license revoked.
(ii) At first instance, will be liable to a fine not less than ₦20million and imprisonment of not less than five (5) years.
(iii) Where the offence is a continuing one, notwithstanding if it is first offence, the convicted person shall in addition, be liable to a fine of ₦20,000 in respect of each day during which the offence continues.

(b) **Use of Fraudulent Mining Scales**
Offences
Where the title holder keeps or uses any false or fraudulent scales or weight for weighing ores, metals or minerals or uses any false or fraudulent assay scale or weight or enriched fluxes used for ascertaining the assay value of minerals knowing them to be false or fraudulent.

Penalty
On conviction the title holder is penalized to a fine:
(i) of not less than ₦100,000 or more than ₦1,000,000.00, or
(ii) imprisonment of not less than one (1) year or to both fine and imprisonment.

(c) **Unlawful Interference and Obstruction**
Offence
(i) Where the title holder, without authority will fully breaks, defaces or removes or in any other way interferes with any boundary mark, beacon pillar or post enacted for any of the purpose of the Mining Act or the regulations made under it, without necessary approval or authority under Mining Act.

(ii) Without Law Cause:
(a) Interferes with or obstructs any mining or quarrying operations authorized under the Mining Act.
(b) Interferes with any machinery, plant work or property on, in under or over land in exercise of a right conferred by or under Mining Act.

Penalty
(a) At the first instance, shall be liable to a fine not exceeding ₦500,000.00 or to imprisonment for a term not exceeding 2 years or to both fine and imprisonment.
(b) At a subsequent offence shall be liable to imprisonment not exceeding 5 years.
(c) Where the offence is continuing, whether it is a first offence or not, the holder shall in addition be liable to a fine of ₦10,000.00 in respect of each day or part of a day during which the offence continues.

(d) **Failure of Exporter to make Declaration**
Offence:

(i) Failure to enter and declare on the appropriate customs entry form the state from which the mineral was extracted.

(ii) Failure on demand to furnish the information relating to any mineral which he has exported within the time and in the manner, as may be required.

Penalty:

(i) At the first instance, to a fine not exceeding ₦500,000.00 or to imprisonment for a term not exceeding 2 years or both fine and imprisonment.

(ii) For subsequent offence, to a fine not exceeding ₦1,000,000.00 or to imprisonment for a term not exceeding 5 years or both.

CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2018: PROFESSIONAL EXAMINATION

PT 3: TAX MANAGEMENT

ATTEMPT ALL QUESTIONS. SHOW ALL WORKINGS. TIME: 3 HOURS.

1. A popular musician asks for your advice on how he can pay his income tax by himself.

   (a) Advise him on the advantages of self- assessment scheme as against government assessment. (3 Marks)

   (b) Identify any Five (5) tax planning opportunities that may be explored when considering setting up a business in Nigeria. (5 Marks)

   (c) With reference to Stamp duties, explain the following:

   (i) Adjudication (3 Marks)

   (ii) Overlapping heads of charge. (3 Marks)

   (iii) Leading and Principal object. (3 Marks)

   (iv) Lost instrument (3 Marks)

   (Total 20 Marks)

SOLUTION TO QUESTION 1

(a) For self-assessment the following are the advantages obtainable by a taxpayer to minimize his or her tax liability.

(i) Taxpayers are encouraged to prepare their own assessments and remit to the tax authority.
(ii) There is 1% rebate for Personal Income Tax (PIT).
(iii) Opportunity of installmental payments over a period of six (6) months.
(iv) It reduces cases of disputed assessment.
(v) It demonstrates transparency in tax administration.

(b) The following tax planning opportunities may be explained when considering setting up a business in Nigeria:

(i) List of approved taxes are levies;
(ii) Timing of fixed assets acquisition;
(iii) Time of fixed assets disposals in view of balancing adjustments;
(iv) Making specific list from general provisions.
(v) Proper and adequate deduction of PAYE;
(vi) Adequate and appropriate deduction of WHT;
(vii) Consideration of current tax incentives (pioneer companies, investment tax credit e.t.c);
(viii) Considering of exempted income and profits;
(ix) Timing of capital allowances claim and amount of claim; and

(x) Consideration of investment in tax favourable sectors such as agriculture and manufacturing.

(c) (i) Adjudication is the process of determining the appropriate amount of duty chargeable on an instrument by the commissioner of stamp duties. All instruments requiring stamping are to be sent to the commissioner for stamp duties for adjudication before stamping is done.

Two commissioners cannot adjudicate on one instrument and anybody who takes an instrument that has been adjudicated by one commissioner to another shall be guilty of an offence.

(ii) Overlapping Heads of Charges
Where an instrument can be charged under more than one head, it will be charged on one head only, this is not the same as when one instrument carries two or more separate transactions and therefore charged with duty as separate instruments.

(iii) Leading &Principal Object
An instruments liability to duty is determined by its leading and principal object. If this does not give rise to duty, no duty is chargeable simply because there is a subsidiary clause with a different object and vice versa.

(iv) Lost Instrument
A lost instrument is presumed to have been duly stamped but where it can be proved that the instrument had not been stamped, it is presumed to remain unstamped. It is possible to present an instrument which is not lost for stamping outside the statutory time limit on payment of penalties but a lost instrument cannot be so presented.

EXAMINER'S REPORT
The question tests the candidates' knowledge of self assessment scheme as against government assessment, tax planning and the workings of stamp duties with reference to overlapping heads of charges, leading and principal object and lost instrument. About 90% of the candidates attempted the question and the performance was very good except for the "c" part.

Candidates understood the part a & b of the question while they demonstrated shallow knowledge in the "c" part.

Candidates commonest pitfall was their lack of understanding of the "c" part of the question.

Candidates are advised to read extensively to be able to excel in the Institute's future examination.

2. The Financial Director of White Nigeria Limited has contacted you as a Tax Consultant to explain the tax implications of financing options available to its company. You are required to advise him on the following financing options:

(a) Debt Financing versus Equity Financing.
(b) Debt from Convertible Loans.
(c) Issuance of Stock to acquire assets.
(d) Mergers and Acquisition. (20 Marks)

SOLUTION TO QUESTION 2

2. The tax implication of the following financing options are as stated below:

(a) Debt Financing Versus Equity Financing

The use of debt has a clear tax advantage over equity. A debt instrument generates interest income for the investor and results in interest expense for the borrower which is tax deductible for tax purpose.

The tax implication of interest is that:

- It can be deductible for tax purposes if it is not capital in nature.
- It can be tax exempt if it relates for the right type of debt.
- However, dividend received by shareholders is taxable in the hands of the shareholders when organisations declare profit.

(b) Debt from convertible loans

The tax implications among others are:

To the borrower

- Can expense interest payment from taxable profit.
- It saves additional cost of financing.
- It increases gearing ratio on conversion.

To the lender

- It increases cash flow from financing option (a tax advantage).
- Has additional income flow from dividend that may be tax free.
- Can enjoy tax exemption if interest is structured.

(c) Issuance of stocks to acquire assets

Assets of subsidiaries that have been fully tax depreciated but still have useful economic life could be used in exchange of stock from the parent company. This avoids the payment of interest charges on loan to the parent company. This obviously is a tax disadvantage. Also the stocks may be converted to cash by subsidiary for financing purpose.

(d) Mergers and Acquisition

- Cessation rules will apply to the company being acquired;
- Commencement rules will apply to the new company formed from the merger or acquisition.
- Any qualified capital asset transferred from the old business to the new company is deemed to have been transferred for the purpose of value agreed upon.
- Capital allowance would be calculated on the qualified capital assets but there would be no initial allowance.
- Capital gains tax may be due on chargeable gains accruing from the transfer.
- Registration expenses and stamp duties will be paid to legalize the scheme and these would be disallowed for tax purpose.

EXAMINER'S REPORT

The question tests candidates' knowledge of tax implication of different finance option and it was well attempted by all the candidates and the performance was above average.

3. To stem the incessant incidence of tax avoidance schemes among taxpayers, the Revenue authorities have put in place anti-avoidance legislations.

(a) (i) What is tax avoidance? (4 Marks)

(ii) Outline any Two (2) types of anti-avoidance legislations. (6 Marks)

(b) Suggest any Five (5) ways of combating the incidence of tax evasion in Nigeria. (10 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 3

(a) (i) Tax Avoidance arises in a situation where the taxpayer arranges his financial affairs in a way that would make him/her pay the least possible amount of tax by exploiting loopholes in the tax laws, for example, avoidance of VAT can be achieved by anyone that does not buy goods/services on which VAT is levied.

Two Anti-Avoidance Legislations are:

(i) Specific legislation to block known tax avoidance devices.

(ii) General anti-avoidance legislation which vests the revenue with power to disregard all transactions entered into that could be proved to have been entered into solely for tax avoidance purposes.

(b) The following are ways of combating the incidence of tax evasion:

(i) Regular tax audit/investigation;
(ii) Tax education and awareness;
(iii) Tax amnesty e.g. VAIDS;
(iv) Applying severe punishment to offenders;
(v) Fair tax system;
(vi) Ensuring self assessment scheme;
(vii) Regular desk check and reconciliation;
(viii) Introduction of tax incentives;
(ix) Tax accountability; and
(x) Efficient & Effective refund mechanism.

EXAMINER'S REPORT

The question tests the candidates' knowledge on tax avoidance scheme. About 75% of the candidates that attempted the question scored above 50% of the marks allocated and the performance was good.

The candidates showed good understanding of the question.

4. Permanent establishment is a concept being applied by the FIRS in taxing non-resident individuals and companies engaged in any trade or business in Nigeria.

Explain the concept of permanent establishment. (20 Marks)

SOLUTION TO QUESTION 4

Permanent establishment is defined as a fixed place of business through which the business of an enterprise is wholly or partly carried on. It includes:

- Place of management;
- An office;
- Factory/workshop;
- A branch;
- A building site or construction or assembly project which exists for more than three months;
- A mine, an oil or gas well, a quarry; and
- Installation or provision of supervisory activities in connection therewith incidental to the sale of machinery or equipment where the charges payable for such activities exceed 10% of the free on board sale price of the machinery or equipment.

However, there are some fixed structures that cannot be termed permanent establishment. They include:

(a) The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

(b) Maintenance of a fixed place of business solely for the purpose of carrying on the enterprise or any other activity of a preparatory or auxiliary character;

(c) Maintenance of stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) Maintenance of a stock of goods or merchandize belonging to the enterprise solely for the purpose of storage, display or delivery; and

(e) Maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandize or of collecting information for the enterprise.

Where a fixed place of business is maintained for any of the activities mentioned above and is also used as a sales outlet it shall be regarded as a permanent establishment.

An enterprise in contracting state is not deemed to have a permanent establishment in the other contracting state merely because it carries on business in that other state through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.

A person who acts in a contracting state on behalf of an enterprise of the other contracting state shall be deemed to be a permanent establishment in the first-mentioned contracting state if

(a) He has and habitually exercises in that state an authority to conclude contracts or carry on any business activities not limited to the purchase of goods or merchandise for that enterprise or

(b) He habitually secures orders for the sales of goods or merchandise in that state exclusively or almost exclusively on behalf of the enterprise or other enterprises controlled by it or which have a controlling interest in it.

EXAMINER'S REPORT

The question tests the candidates' knowledge of concepts of permanent establishment as applied to non-resident individual and companies. About 60% of the candidates attempted the question but less than 10% of them scored above 50% and the performance was very poor.

Candidates commonest pitfall was their lack of understanding of the concept of permanent establishment as applied to non-resident.

Candidates are advised to read wide and make use of relevant textbooks while preparing for future examination.

5. **PHILIP SECURITIES**

(a) As a result of the downturn in the capital market, Philip Securities Limited decided to cease business on 5th September, 2015. Jordan Securities Ltd. paid ₦12,500,000 to take over the assets of Philip Securities Ltd. Below are the details of the assets taken over.

Assets	**Cost**	**Fair-Value**
	₦	₦
Plant & Equipment	3,750,000	4,100,000
Motor Vehicles	6,200,000	5,100,000
Building	21,500,000	27,000,000
Goodwill	--	5,000,000
Debtor	1,200,000	--

Ascertain the capital gains tax (CGT) payable. (15 Marks)

(b) Itemize Five (5) Chargeable Assets as stipulated in the Capital Gains Tax Act CAP C1 2004 LFN. (5 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 5

(a) PHILIP SECURITIES LIMITED

Assets	**Cost**	**Market Value**	**Chargeable Gain**
	₦	₦	₦
Plant & Equipment	3,750,000	4,100,000	350,000
Motor Vehicles	6,200,000	5,100,000	--
Building	21,500,000	27,000,000	5,500,000
Debtor	1,200,000	--	--
Goodwill	--	5,000,000	5,000,000
		41,200,000	10,850,000

Capital Gain Tax Payable $\dfrac{\text{Consideration Received}}{\text{Market Value – Assets Exempted}} \times \text{Chargeable Gain}$

$$\frac{12{,}500{,}000}{41{,}200{,}000 - 5{,}100{,}000} \times 10{,}850{,}000$$

= ₦3,756,925.21

Capital Gain Tax @ 10% = ₦375,693

(b) Chargeable Assets

(i) Any building, structure or works of a permanent nature.

(ii) Plants, Machinery, Equipment, Furniture Fittings & Fixture.

(iii) All currencies except the Nigerian currency

(iv) Chattels & other personal attributes
(v) Incorporeal properties
(vi) Options
(vi) Debts

EXAMINER'S REPORT

The question tests the candidates' knowledge and understanding of computation of capital gains tax. About 90% of the candidates attempted the question and the performance was poor as less than 20% of those that attempted the question scored above average.

Candidates demonstrated lack of knowledge and understanding of the question hence the poor performance.

Candidates' commonest pitfall was their inability to compute correct capital gains in ascertaining the capital gains tax arising from the disposal of the asset.

Candidates are advised to make use of relevant text books with the Institute's Pathfinder when preparing for future examination and should not neglect this aspect of the syllabus.