



THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA
OCTOBER 2019: PROFESSIONAL EXAMINATION
PT 2: INTERNATIONAL TAXATION

WEDNESDAY 9TH OCTOBER, 2019

EXAM NO.....

ATTEMPT ALL QUESTIONS.

TIME: 3 HOURS.

1. The profit of a company other than a Nigerian company from any trade or business shall be deemed to be derived in Nigeria if that company has a fixed base in Nigeria to the extent that the profit is attributable to the fixed base (Section 13(2)(a) of CITA, LFN 2004). Therefore, the term fixed base creates taxable presence for profits of a company other than a Nigerian Company.

Required:

- (a) Discuss the exemptions to the principle of fixed base presence under CITA. (4 Marks)
 - (b) Discuss briefly the other three (3) forms of taxable presence in Nigeria. (6 Marks)
 - (c) Explain “multinational enterprises” based on the report of the OECD Committee of Fiscal Affairs on Transfer Pricing and Multinational Enterprises. (5 Marks)
 - (d) Discuss the extent to which the profit of a non-resident company dealing with its subsidiary in Nigeria is liable to tax in Nigeria? (5 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 1

- (a) Facilities maintained solely for storage, display or delivery of merchandise or processing and those used for purchasing of goods or collection of information shall not be regarded as fixed base.
- (b) Other forms of taxable presence in Nigeria are;
Dependent agent permanent establishment (PE): Where there is no permanent establishment but business is continually or regularly operated through an agent in Nigeria.

The laws specifically mention the following circumstances for an agent to be construed as PE to the principal:

- i. Where the principal habitually carries on trade or business in Nigerian through the agent;
 - ii. Where the agent is authorised to negotiate or conclude contracts on behalf of the principal or company associated to it;
 - iii. Where the principal maintains a stock of goods in Nigeria from where the agent regularly makes deliveries; and
 - iv. Single contract for surveys, deliveries, installations or construction.
- (c) Multinational enterprises are described as groups of associated enterprises operating across national frontiers. Furthermore, it is a ‘related companies operating in a group with some degree of centralised management, yet with the individual numbers of the group operating

under different national laws” in the process, each entity has to conform with the varied and sometimes conflicting national laws of the countries in which it operates”.

- (d) Where the transaction between the non-resident company and its subsidiary in Nigeria is not at arm’s length i.e. not based on terms comparable to transaction between unrelated entities. This is otherwise referred to as artificial or fictitious transactions.
Where the transactions are not at arm’s length and the audit conducted by the relevant tax authorities’ result in profit adjustment for the controlled transaction that profit will be liable to tax in Nigeria.

EXAMINER’S REPORT

The question tests candidates understanding of:

- (a) Exemptions to the principle of fixed base prescribe under CITA;
- (b) Forms of taxable presence in Nigeria;
- (c) Explanation of multinational enterprises based and the report of the OECD Committee of Fiscal Affairs on transfer pricing and multinational enterprises;
- (d) Discussion of the extent to which the profit of a non-resident company dealing with its subsidiary in Nigeria and liable to tax in Nigeria.

Candidates’ performance was very good as majority of the candidates scored above 50% of the allocated marks.

2. Explain briefly the following as they relate to tax treaties:

- (a) Tax sparing (5 Marks)
 - (b) Non-discrimination (5 Marks)
 - (c) Entry into force (5 Marks)
 - (d) Exchange of information (5 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 2

(a) Tax sparing

Tax sparing is a provision in a tax treaty (DTA) that enables a contracting state to grant tax credit (not exceeding the tax exempting provided to an enterprise of the other contracting state) against the tax due on a specific foreign income. In order words, tax sparing will deem the tax spared by a source country under its incentive regime as having been paid, and being recognised as such by the residence state.

Tax sparing provisions then enable an enterprise to obtain tax credit for the taxes that have been “spared” (i.e. not actually paid) under the incentive regime of a source state in its home state. In the absence of tax sparing provisions, tax incentive granted to an investor by a source state would end up with the tax authority of the residence state.

The only argument for tax sparing is that it ensures that tax incentives granted by developing countries for the purposes of developing its economy remain with the targeted investors.

(b) Non-discrimination

The concept of non-discrimination forbids a contracting state from treating differently enterprises of both contracting state caring on similar business activities under similar circumstances.

The scope of non-discrimination under a tax treaty includes:

- (i) Nationality i.e. a contracting state should not discriminate against the nationals of the other contracting state;
- (ii) Statelessness i.e. a stateless person resident in a contracting state should not be treated differently from the nationals of the state;
- (iii) Form of existence i.e. no discrimination between the tax treatment of a company incorporated in the state and a permanent establishment (PE) or branch of a foreign company;
- (iv) Withholding tax credit should be granted to residents of both contracting states under the same conditions; and
- (v) Capital wholly or partly owned or controlled by residents of the other contracting state shall not be subject, in the state, to any taxation or any requirement other than that of residents of the source state.

(c) Entry into force

The provisions of a tax treaty are operational and enforceable only when the treaty has “entered into force”. A taxpayer may not enjoy the benefits conferred by a tax treaty until and after it had entered into force. Similarly, no obligation is imposed on a contracting state until after the relevant treaty had entered into force.

Two pre-conditions for a treaty to enter into force are:

- i. Exchange of instruments of ratification: both contracting parties must exchange the instrument of ratification to signify that all the domestic legislative processes to operationalise the treaty have been complied with; and
- ii. Time threshold i.e. the number of days that would elapse after the exchanges of instruments of ratification for the treaty to enter into force.

(d) Exchange of information

The Exchange of Information (EOI) concept mandates the competent authorities of contracting state to exchange tax information that is foreseeably relevant with each other.

Information exchanged via the EOI mechanism must be treated as secret in the same manner as information obtained under the domestic laws. As such, the information received under the EOI can only be disclosed to persons or authorities (including courts) concerned with the administration of tax.

Exchange of information must be done in accordance with domestic laws and it is only in respect of information that the other contracting state cannot obtain using its own law or administration. Information concerning trade secrets may not be exchanged.

Where a contracting state is requested to provide any information, the requested jurisdiction must use all its information gathering measures to obtain the information even when the information may not be needed for its own tax administration.

Information that can be exchanged includes information held by banks or other financial institutions, agents, nominees and persons acting in fiduciary capacity.

EXAMINER’S REPORT

The question tests the candidates’ knowledge of tax sparing, non-discrimination , entry into force and exchange of information as they relate to tax treaties.

Majority of the candidates attempted this question but did not understand the requirements of the question as a result, performance was very poor.

The commonest pitfall was lack of understanding of the requirements of the question.

Candidates are advised that they should cover all the areas of the syllabus when preparing for future examination.

3. The Ciggy Group is famous for its *e-ciggy* (a brand of e-cigarettes) which it pioneered. Ciggy Holdings Inc. is the ultimate parent and it is resident in CiggyLand for tax purposes. E-ciggy is manufactured through a subsidiary (Ladoo Ciggy) located in Ladoo.

The group intends to explore the e-cigarette business in Obodo. It has a choice of either establishing a branch of Ciggy Holdings or incorporating a wholly-owned subsidiary. The Obodo entity will sell e-ciggy to independent customers.

There is a double taxation agreement (DTA) between CiggyLand and Obodo which is based on the OECD model tax convention. Both countries also have transfer pricing legislation based on the OECD transfer pricing guidelines.

The Group is considering one of two models for the implementation of the proposed arrangement:

Model 1: Profits derived from the sale of products through the branch in Obodoland will be treated as profits belonging to Ciggy Holdings and the branch will not file income tax return in Obodo.

Model 2: A separate legal entity will be incorporated in Obodo, and the Group will set transfer price of the cigars charged to the subsidiary as the cost of manufacture plus a 7.5% mark-up. This will result in a guaranteed profit to the Obodo subsidiary in relation to the sale of cigars.

You are required to:

- (a) Explain your understanding of the concept of a 'permanent establishment'. (2 Marks)
- (b) How will transfer pricing provisions apply to a permanent establishment? (3 Marks)
- (c) Considering compliance and reputational issues, which of the two options will you recommend to Ciggy Group and why? (5 Marks)
- (d) Mention five (5) DTA provisions that may apply to either of the arrangements in Obodo? (5 Marks)
- (e) Explain how transfer pricing rules will apply to the arrangements proposed. (5 Marks)
(Total 20 Marks)

SOLUTION TO QUESTION 3

- (a) Permanent Establishment (PE) refers to a fixed place of business through which the business of an enterprise is wholly or partly carried on.

The concept of PE is used to answer the nexus question in taxation i.e. connection of an enterprise with a tax jurisdiction. It is this link or connection of an enterprise with a jurisdiction that determines the right of the tax authority in that jurisdiction to tax the profits of an enterprise of another jurisdiction. Under Article 7 (Business profits), the profits of an enterprise of another state if nexus is proven

The forms of PE include:

Fixed place PE: i.e. a fixed location or address such as place of management, a branch, an office, a factory, a workshop or a place of extraction of natural resources (e.g. mine, oil well, etc).

A fixed place of business may not constitute PE if it is used for solely preparatory or auxiliary activities such as storage or display of goods, collection of information, purchasing activities, etc.

Building or installation project PE: A construction projects (e.g. building, road, bridge, etc) or installation projects (equipment, machinery, etc) would constitute PE.

Dependent agency PE: A PE will exist for a non-resident person where a person resident in another state habitually acts on it to conclude contracts or habitually plays principal roles leading to the conclusion of contracts.

Service PE: the furnishing of services by an enterprise through employees or other personnel engaged by the enterprise may constitute a PE for the enterprise.

- (b) Transfer pricing provisions will apply to a branch or PE in the same manner as a domestic company. For example:
- All transactions between the PE and its head office or any other member of the Ciggy Group must be priced on the basis of the arm's length principle by reference to comparable transactions between unrelated parties;
 - Accurate disclosures must be made to the tax authority based on extant domestic legislation; and
 - Adequate transfer pricing documentation must be maintained in respect of all controlled transactions according to domestic legislation.
- (c) Option 1 would result into the branch or PE situated in Obodo returning no income for tax purposes despite economic activities taking place in that jurisdiction. This portends a number of issues for the group e.g.
- Reputational backlash for the company: the company will find it difficult to justify how its business of trading in e-ciggy perpetually results into no taxable profit.
 - The company would find itself on the wrong end of the compliance spectrum and become a target of frequent tax audit which may result into lingering disputes.
 - The business of the Ciggy Group as a going concern will be in jeopardy. Maintaining a "no taxable profit" in Obodo over a long period may result into regulatory sanction that may drive the company out of the state.

For the above-stated reasons, option 2 is recommended to Ciggy Group. The option ensures that Ciggy Group complies with tax rules of Obodo. And if the 7.5% mark-up is adjudged comparable to what independent parties would do, tax audit may be avoided.

(d) Five (5) DTA provisions that may apply to option 1 in Obodo are:

Article 1 “Persons Covered” applies to option 1. This article defines who can benefit from the treaty;

Article 2 “Taxes Covered” applies to option 1. This is the article that defines the taxes that are covered by the DTA. If any tax is not covered by the DTA, Ciggy Group will not be able to claim benefits;

Article 5 “Permanent Establishment” applies to option 1 as this article defines what constitutes a PE;

Article 7 “Business Profits” will apply to option 1 as it deals specifically with a company-PE situation. This results in a ring fencing of the PE and treatment as an independent entity;

Article 9 “Associated Enterprises” provision will apply to option 1. The article requires dealings between associated enterprises be conducted in a manner constituent with the arm’s length principle.

This covers both company-PE as well as Holding-subsidiary company situations.

Article 24 “Non-Discrimination” will apply to option 1. This article forbids treatment of a PE of non-resident company on less favorable terms than that of an enterprise of the source state.

Article 25 “Mutual Agreement Procedure” will apply to option 1. The article provides for the settlement of any dispute arising from the taxation of an enterprise of either contracting states.

Article 26 “Exchange of information” applies to option 1. Under this article, the tax authority in Obodo may request for information from the tax authority of Ciggy land in respect of transactions involving the PE.

Article 27 “Assistance in the Collection of Taxes” will apply to option 1. The tax authority in either contracting state may request the other to assist in the collection of tax against the company.

Article 29 “Entitlement to Benefits” will apply to option 1.

Article 31 “Entry into Force” will apply to option 1. The entry-into-force article determines when provisions of the DTA become enforceable.

Article 32 “Termination” will apply to option 1. The article provides for the cessation of the DTA. Once the DTA is effectively terminated, its provisions are no longer enforceable.

(e) Transfer pricing (TP) rules will apply to the proposed arrangements by considering whether or not the dealings between the enterprise in Obodo (branch or subsidiary) and e-ciggy supply (Ciggy Holdings or Ladoo Ciggy) are at arm’s length i.e. whether the conditions imposed on the dealings are similar to what independent parties dealing under similar circumstances would do.

The main issues under TP rules would include:

- TP methodology used – whether appropriate TP method was applied;
- Comparable transactions – whether comparable transactions used by the enterprise to benchmark its pricing are those between independent parties.
- Degree of Comparability – whether the comparable transactions complied with relevant comparable transactions adopted are indeed comparable to the transaction being tested.

EXAMINER'S REPORT

The question tested candidates' knowledge of:

- (a) The concept of a PE.
- (b) Application of transfer pricing provision to a PE.
- (c) Considering compliance and reputational issues relating to two options of selling through branches and selling to a subsidiary.
- (d) Five (5) DTA provisions that may apply to either of the options arrangement.

Performance was very poor.

The commonest pitfall was lack of understanding of the requirements of the question.

Candidates are advised to cover every aspect of the syllabus when preparing for future examination.

4. (a) Mention three (3) major objectives of the Nigeria transfer pricing (TP) regulations are: (3 Marks)
- (b) A connected taxable person may apply a transfer pricing method other than those listed in the TP regulations. What are the conditions for this? (5 Marks)
- (c) What are the challenges of setting appropriate transfer price in related party transactions? (3 Marks)
- (d) When can a transaction be said to be "mispriced". (2 Marks)
- (e) TP methods are broadly divided into two categories. What are these categories and which methods fall under each category? (7 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 4

- (a) Major objectives of the Nigeria transfer pricing (TP) regulations are:
- To give the country the opportunity to have a fair share of the profit of connected taxable persons' transactions and dealings;
 - To provide the tools to fight artificial transactions and shifting of profits out of their jurisdiction by connected taxable persons;
 - To reduce the risk of economic double taxation;
 - To provide a level playing field between connected taxable person and independent enterprises doing business within the country; and
 - To provide connected taxable persons with certainty of transfer pricing treatment in the country.
- (b) The most appropriate transfer pricing method shall be used by taking into account:
- The respective strengths and weaknesses of the transfer pricing method in the circumstances of the case;

- The appropriateness of a transfer pricing method having regard to the nature of the controlled transaction determined, in particular, through an analysis of the functions performed, assets employed and risks assumed by each person that is a party to the controlled transaction;
 - The availability of reliable information needed to apply the transfer pricing method; and
 - The degree of comparability between controlled and uncontrolled transactions, including the reliability of adjustments, if any, that maybe required to eliminate any differences between comparable transactions.
- (c) Most TP issues involve significant transactions between related parties where one or more parties are in low tax jurisdictions (such as Africa) e.g. representative office, sole dealership etc. the major problems associated with the process are:
- In the event of transfer of intangibles to related enterprises- difficulty in valuation;
 - For specific service charges (e.g. interest, insurance premiums, royalties, etc) to related parties – how to quantify value addition
 - With respect to shared services – relationship of the service with resulting income and whether the service provider should charge market prices. If market prices are fixed, can an entity (group) make profit from itself? How will resultant income tax paid on notional profits be treated?
 - Business restructurings – determining the appropriate prices for second-hand assets transferred to associated companies;
 - Loss making and loss merging – should business not have the liberty of merging losses within the group?
 - Effective tax rate – multinational enterprises do set for themselves acceptable effective tax rate. One way of keeping within this effective rate is to shift profits from high tax-rate jurisdictions to low tax-rate ones;
 - Poor/non-existent documentation – globally, TP documentation is still a major challenge. Many TP audits are done years after the transactions have been closed; and
 - Excessive debt – Certain industries rely greatly on debt funding (technology, oil & gas etc).
- (d) Transfer mispricing occurs where transfers are priced arbitrarily without regard to the contributions (assets employed and risk borne) of the respective parties to the transaction.
- (e) Traditional method-
- i. Comparable uncontrolled price (CUP)
 - ii. Resale price method (RPM)
 - iii. Cost plus method (CPM)
- Transactional method
- i. Transactional net margin method (TNMM)
 - ii. Transactional profit split method (TPSM)

EXAMINER'S REPORT

This question tests the candidates' knowledge of two categories of transfer pricing and methods under transfer pricing and mispriced transactions. Performance was very poor.

Candidates' commonest pitfall was lack of understanding of the requirements of the question.

Candidates are advised to ensure coverage of the entire syllabus when preparing for future examination.

5. XYZ Ltd., a company incorporated in Nigeria and DDJ Ltd, a Non-Resident Company (NRC) have been awarded a single contract for the engineering, procurement and construction arrangement (“EPC Contract”) for the supply, installation and commissioning of gas turbine in Nigeria. In performing the contract, DDJ Ltd. will carry out the engineering and procurement part of the contract, entirely offshore of Nigeria, while the remaining part of the contract will be carried out by XYZ Ltd, onshore of Nigeria.

Required:

Explain the concept of the single contract for EPC works as contained in Section 13(2)(c) of the Companies Income Tax Act (as amended) including its applicability in the determination of a taxable presence for a non-resident entity in Nigeria. (20 Marks)

SOLUTION TO QUESTION 5

A single contract is typically described as a turnkey project of surveys, deliveries, installations or construction activities of project.

With respect to taxation of income from turnkey projects, Section 13 (2c) of CITA provides that a taxable presence is created for a non-resident entity on its income derived from trade or activities in Nigeria if that trade or activity involves a single contract of surveys, deliveries, installations or construction (i.e., a turnkey project), the profit from that contract (regardless of whether a portion of the contract is performed outside Nigeria).

Furthermore, the court also clarified in the case of Saipem Contracting Nigeria Limited (and affiliates) vs the Federal Inland Revenue Service (FIRS) that even where there is a double tax treaty, the single contract (i.e. turnkey contract) provisions of section 13(2) of the CITA should override the general provisions provided in the double tax treaty as to determination of fixed base/taxable presence as outlined within the CITA. Thus, where a non-resident entity derives income from a turnkey contract, notwithstanding that certain aspects of the project may be performed offshore and should ordinarily not be subject to income tax in Nigeria, the entire income from the project should be subject to tax in Nigeria.

Furthermore, even when the non-resident performs only the offshore portion of a tripartite contract, the non-resident’s income should still be subject to tax in Nigeria.

EXAMINER’S REPORT

This question tests candidates’ knowledge of the concept of single contract as contained in section 13(2) of CITA including its applicability in the determination of a taxable presence for a non-resident entity in Nigeria.

Candidates understood the requirements of the question and as such, performed well above average.

The commonest pitfall of the candidates was their inability to properly arrange their solution to the question.

Candidates are advised to always prepare very well by covering all areas of the syllabus for future examination.



THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA
OCTOBER 2019: PROFESSIONAL EXAMINATION
PT 2: TAXATION OF E-COMMERCE

WEDNESDAY 9TH OCTOBER, 2019

EXAM NO.....

ATTEMPT ALL QUESTIONS.

TIME: 3 HOURS.

1. You have just attended a seminar on the use of information technology in an organisation.

Required:

Explain briefly the following to your colleagues who did not attend the seminar:

- (a) Electronic spreadsheet. (3 Marks)
 - (b) Two (2) examples of spreadsheet. (2 Marks)
 - (c) Five (5) features available in a spreadsheet. (10 Marks)
 - (d) Advantages of using spreadsheet. (5 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 1

- (a) Electronic Spreadsheet – An electronic spreadsheet is an interactive application for organisation, sorting and analysing of data. It is an electronic version paper spreadsheets used by Accountant. It consists of a matrix of rows and columns. Each element in the matrix is called a CELL.
Spreadsheets can be used for cash flow analysis, budgeting, monitoring, management and financial planning.
- (b) Examples of electronic spreadsheet are: Microsoft Excel, Star Office, VisiCalc, Lotus 123, Google sheets.
- (c) Features available in electronic spreadsheet include:
 - (i) Data analysis;
 - (ii) Report generation and communication;
 - (iii) Automatic calculations
 - (iv) Visual display/presentation of Data Charts and Graph;
 - (v) What if analysis;
 - (vi) Dynamic updates;
 - (vii) Data management;
 - (viii) Modeling;
 - (ix) Sorting;
 - (x) Filtering;
 - (xi) Formatting; and

- (xii) Toolbars.
- (d) Advantages of using electronic spreadsheets include:
- (i) Time savings/speed;
 - (ii) Automatic calculations and adjustments;
 - (iii) Formulas;
 - (iv) Building scenarios;
 - (v) Portability;
 - (vi) Storage; and
 - (vii) Electronics document/paperless environment.

EXAMINER'S REPORT

The question tests the candidates' knowledge of electronic spreadsheet definition, examples, features and advantages.

Candidates performance was very good, more than 70% of the candidates scored above 50% of the marks allocated.

2. E-business has improved organisations and extended their market reach, however, there are still some disadvantages.

Required:

Identify and discuss four (4) disadvantages of e-business. (20 Marks)

SOLUTION TO QUESTION 2

The disadvantages of e-business include:

- (i) Security and integrity issues- Hacking and identity theft are common. Need to invest time and money on security measures to ensure website integrity. The security measures used include digital signatures and data encryption;
- (ii) Purchase and delivery time – There is always a time lag between purchase and delivery of physical goods. This might be faster in case of physical goods in conventional business;
- (iii) Monetary intangibility – Human interaction and personal touch is missing in online transactions. This places a limitation on e-business;
- (iv) Sectional Limitations – Some companies are challenged in terms of expertise and availability of technology. Some items may be uneconomical to transport, others may be legally restricted such as explosives ammunitions;
- (v) Costly maintenance – Resources are required to set up online business and may also need upgrades of and software, from time to time and personnel training; and
- (vi) Piracy issues – Private information of customers can be collected if not adequately secured. Cookies can be used to track customers online. Internet, technologies are useful for business, but might be used to breach information privacy right and/or steal identity data.

EXAMINER'S REPORT

The question tests candidates knowledge of disadvantages of e-business. Performance was good as 60% of the candidates scored above 50% of the allocated marks.

3. (a) Discuss the issue of jurisdiction as it affects e-commerce. (4 Marks)
- (b) Mention two (2) examples of offshore e-commerce application areas. (4 Marks)

- (c) E-commerce is buying and selling across the globe. As a result of this, individuals and corporate bodies far and near are involved.

Required:

What do you understand by:

- (i) Non-resident company.
- (ii) A resident individual.
- (iii) Permanent establishment.

(12 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 3

- (a) One major enforcement issue in e-commerce taxation is identifying the state, country or counties that have tax jurisdiction over income generated by electronic transactions. Electronic commerce permits a foreigner to engage in multiple business transactions with customers in different countries without stepping into them.

There are no laws transcending borders on the internet as different countries have different legal systems, contract law, taxation law e.t.c, which results in legal tussle. This kind of relationships is a problem of e-commerce taxation, in addition to the enforceability of the contract.

- (b) Off-shore e-commerce application areas include offshore opportunity for:
- (i) Physical sales and distribution – Offshore opportunities for marketing, sales and distribution to consumers and businesses;
 - (ii) Digital sales and distribution;
 - (iii) Offshore banking and financial services; and
 - (iv) Offshore corporate functions – locating core functions offshore.

(c) **Non-resident company**

This is a company that is not registered or incorporated in Nigeria but earns income from Nigeria.

The fact that a company is incorporated outside Nigeria does not exempt such company from income tax payment on income derived from Nigeria. Activities carried on by that company through such permanent establishments which results in profits/losses are recognised for the purpose of taxation in the name of non-resident company or its representatives.

A Resident individual

An individual is said to be resident in a particular year of assessment if he:

- Is domiciled in Nigeria
- Sojourns in Nigeria for a period or periods in all amounting to 183 days or more in a 12-month period.
- Serves as a diplomat or diplomatic agent of Nigeria in a country other than Nigeria.

Permanent establishment

A permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on. It includes a sales outlet and the operation of a dependent agent.

EXAMINER'S REPORT

The question tests candidates' understanding of e-commerce in respect to jurisdiction and residency.

Candidates have very good understanding of the question and performance was very good as more than 70% of the candidates scored over 50% of the allocated marks.

4. The term e-business is commonly used in business transactions today.

Required:

- (a) Define e-business. (2 Marks)
- (b) Describe five (5) advantages of e-business. (10 Marks)
- (c) Describe two (2) roles of information system in an organisation. (4 Marks)
- (d) Information can be categorised by different levels in an organisation. Identify two (2) of them. (4 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 4

(a) E-business

Electronic business is the administration of business operations via electronic means like the internet. This includes the buying and selling of goods and services along with providing technical or customer support through the internet.

(b) Advantages of e-business

- Cost – Effective Marketing: Marketing drive is enhanced by internet e.g. use of email marketing, article marketing, social media networking and e-newsletters.
- Flexible business hours: E-business breaks down the time barriers that location based businesses encounter. Internet is available 24 hours a day.
- Eliminate geographical boundaries – E-business allow business to extend its reach worldwide.
- Low overhead costs – E-business have less expensive rent, utility bills and personnel cost than businesses with physical locations.
- Personalised service – E-business allows provision of personalised service to different customers based on particular needs.
- High quality customer service – Customers can provide feedback or complaints real time in case of online business as compared to offline business.
- Electronic catalogues – Electronic catalogues have advantages over paper catalogue and this can be distributed electronically.
- Improved supply chain management:- If suppliers have online presence, the manufacturers can place orders electronically and this can be processed quickly on the supplier side.

(c) The important roles of information system in the organisation is on different levels:

- Operations – A business information system carries out specific functions in support of operations including payrolls, employee records storage, preparing and storing company documents.
 - Controls – Information systems are involved in monitoring and controlling the activities of employees.
 - Decisions – Information systems provide management support in making decisions, complete and accurate information make decisions more effective.
- (d) Different levels of information in an organisation include:
- Strategic level – Senior managers;
 - Management level – Middle Managers;
 - Knowledge level - Knowledge level workers; and
 - Operational level – Operational managers.

EXAMINER'S REPORT

The question tests candidates' knowledge of e-business and information system in an organisation.

The candidates understanding of the question was above average with about 70% of the candidates scoring above 60% of the allocated marks.

5. (a) What is an online transaction? (2 Marks)
- (b) State five (5) problems with online transactions as perceived by tax collecting authorities. (10 Marks)
- (c) Identify four (4) challenges faced by tax authorities regarding e-commerce transactions. (8 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 5

- (a) Online transactions describe any transaction that is delivered online. For tax authorities these transactions are very difficult to handle.
- (b) Problems with online transactions.
- (i) Inability to identify a transaction.
 - (ii) Encryption of transaction.
 - (iii) Collecting the tax from millions of end-users rather than a small number of intermediaries.
 - (iv) Difficulties in determining where a product is produced or consumed.
 - (v) Definition of goods and services.
 - (vi) Distinctions between types of services.
- (c) Challenges before tax authorities regarding e-commerce are:
- Identifying the tax payer, especially when an internet user is involved;
 - Identifying audit risks and developing audit trails to ensure compliance;
 - Obtaining access to verifiable information and documents;
 - Obtaining access to encrypted data; and
 - Developing a response to the advent of electronic money (e-cash) and ensuring efficient mechanism for collecting tax especially from non-resident taxpayers.

EXAMINER'S REPORT

The question tests candidates' understanding of online transactions and their tax implications. Performance was poor as about 70% of the candidates scored below 40% of the allocated marks.

The commonest pitfall of the candidates was mistaken online transactions with computerization. The candidates are advised to ensure they cover the whole syllabus when preparing for future examination.



THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA
OCTOBER 2019: PROFESSIONAL EXAMINATION
PT 2: STRATEGY, RISK & ETHICS

TUESDAY 8TH OCTOBER, 2019

EXAM NO.....

ATTEMPT ALL QUESTIONS.

TIME: 3 HOURS.

1. (a) Distinguish between risk exposure and residual risk. (5 Marks)
 - (b) Explain briefly the dynamism of risk. (5 Marks)
 - (c) Define the term “risk appetite” and explain the variations in risk appetite. (10 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 1

- (a) Risk exposure means that an entity will suffer loss if there are unfavourable events or unfavourable changes in condition in the future. Some risk exposure cannot be measured i.e. qualitative risks e.g. damage to a company’s reputation.
Residual risk refers to risks that controls cannot eliminate completely, as such there are always some residual risks even after taking suitable control measures to control a risk, but this must be kept at acceptable level. It is derived from the word ‘residue’.
- (b) The risks faced by entities do not remain static but change over a time and in different situations which is always caused by environmental factors and the risk factors. The exposure to risk can be represented by two theoretical extremes which may not be realistic:
 - There is never any change in the external or internal environment of an organization.
 - The external or internal environment of an organization changes constantly.
- (c) Risk appetite refers to the acceptance of the risk of making a loss in order to create a chance to make profit. The risk appetite of a management in any particular situation will depend on:
 - The nature and essentiality of the decision
 - The amount and nature of the potential gain or losses.
 - The reliability of the information available to help the board or management to make their decision.

The variations in risk appetite between different companies will include the following:

- Small companies are often more entrepreneurial than larger companies.
- Large companies can afford to take bigger risk than small companies when they are well-diversified.
- As companies become larger with a hierarchical management structure they might become more bureaucratic and less entrepreneurial.
- Companies investing in new markets takes higher risk or are more entrepreneurial than companies investing in developed and matured markets.

EXAMINER'S REPORT

The question tests candidates' knowledge of risk exposure, risk residual and risks appetite.

All the candidates attempted the question and performance was poor, as about 99% of the candidates scored less than 50% of the marks allocated.

The commonest pitfall of the candidates was their inability to correctly explain the risk related terminologies.

Candidates are advised to pay attention to all sections of the syllabus for better performance in future examination of the Institute.

2. (a) What do you understand by the term “strategy” in business organisation. (5 Marks)
- (b) What is a strategic plan? (5 Marks)
- (c) Mention any five (5) structural mechanisms for implementing strategies. (10 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 2

- (a) Strategy can be defined as the determination of the basic long-term goals and objective of an organization, and the adoption of courses of action and allocation of resources necessary for achieving these goals and objectives
- (b) A strategic plan is a formalized roadmap that describes how an organization executes the chosen strategy. It is therefore a management tool that serves the purposes of helping an organization to achieve its goals and objectives.
- (c) Structural Mechanisms for implementing strategies are:
- (i) Definition of the major organizational tasks required to implement specific strategies.
 - (ii) Grouping of organizational tasks on the basis of similar skill requirement.
 - (iii) Sub-division of organizational responsibility, and delegation of authority to perform relevant task.
 - (iv) Coordination of segmented company responsibilities.
 - (v) Design and management information system.
 - (vi) Design and management of organizational control system
 - (vii) Design and management of organisational appraisal system.
 - (viii) Design and management of organisational motivation system.
 - (ix) Design and management of organisational development system.
 - (x) Design and management of organisational planning system.

EXAMINER'S REPORT

The question tests candidates' understanding of strategy and strategic plan in business organisation. About 60% of the candidates scored 50% of the allocated marks and performance was above average. Most of the candidates poorly attempted part 'c' of the question as they could not correctly state structural mechanisms for implementing business strategies.

Candidates are advised to read widely and to ensure adequate coverage of the syllabus for better performance in future.

3. (a) What do you understand by an ethical decision-making model? (5 Marks)
- (b) Discuss the three (3) ethical decision-making models. (15 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 3

(a) An ethical decision making model is a framework that leaders use to bring attached principles to the company and ensure they are followed.

(b) The 3 ethical decision making models are:

- (i) System development ethics.
- (ii) Tucker's 5 question model.
- (iii) American accounting association model.

(i) System development ethics

This is based on the view that recruiting and training morally-strong individuals is not sufficient but the institutionalization of a moral-appealing system?

In order to act in a moral way, individuals need support from the system they work in and environment provided by their employers.

Personal improvement and character-building can only occur in moral supportive environments that is rationally-planned and maintained.

(ii) Tucker's 5 question model

This is based on the view that the profit motive is justified, and the purpose of decision-making in business should be to make a profit but in an ethical way.

The model involves asking five questions before making a business decision. If the answer to all five questions is yes, the decision is ethically sound.

The five questions about a decision are:

- Is it profitable?
- Is it legal?
- Is it fair?
- Is it right?
- Is it Sustainable?

(iii) American accounting association model

It is based on a teleological approach and is consistent with professional ethical guidelines.

The AAA model is based on a seven-step approach to decision making.

STEP	QUESTION TO ASK
1	What are the facts?
2	What are the ethical issues?
3	What moral principles, values or norms are relevant to the decision?
4	What are the alternative courses of action for the decision-maker?
5	Which course of action {or courses of action) seems best, because it is consistent with the moral principles and value identified in step 3?
6	What are the consequence of each possible course of action?
7	What is the decision?

EXAMINER'S REPORT

The question tests candidates' knowledge of ethical decision making model.

All the candidates attempted the question, and performance was poor as most of the candidates scored less than 50% of the marks allocated.

The commonest pitfall of the candidates was their inability to discuss the three (3) ethical decision-making models.

Candidates are advised to pay attention to all sections of the syllabus for better performance in future examination of the Institute.

4. Change can be described as a process of making the form, nature, content, future course, technology etc. of an organization different from what it used to be or from what it would be if left alone.
- (a) State five (5) benefits of a change to:
- (i) An organisation (5 Marks)
- (ii) An individual (5 Marks)
- (b) Identify and discuss five (5) reasons why people resist change in an organisation. (10 Marks)
- (Total 20 Marks)

SOLUTION TO QUESTION 4

- (a) (i) **Benefits of change to organisation**
- The organization will be able to respond faster to customers demand.
 - Help to align existing resources within the organisation.
 - Employee performance increases when staff feel supported and understand the change process.
 - Increased returns on investment (ROI).
 - Create an opportunity for the development of best practices, leadership development and team development.
 - Change management provide a way to anticipate challenges and respond to these efficiently.
 - Organisational effectiveness and efficiency is maintained or even improved by acknowledging concerns of staff.
 - An effective change management process lower the risk associated with change.
- (ii) **Benefits of change to individual**
- Improves morale, productivity and quality of work.
 - Improves cooperation, collaboration and communication.
 - Personal loss/gain to individuals is acknowledged and addressed.
 - Change management reduces descriptive aspects and emphasise positive opportunities in the change process.
 - A carefully planned approach to change reduces stress and anxiety and encourage people to stay loyal to the organization.
 - Effective change management support a smooth transition from the old to the new while maintaining morale, productivity and even company image.
 - Provide management and staff support for concerns regarding changes.

(b) Reasons why people resist change in an organisation

(i) Fear of the unknown

One of the most common reasons for resistance is fear of the unknown. People will only take active steps toward the unknown if they genuinely believe and perhaps more importantly feel that the risks of standing are greater than those of moving forward in a new direction.

(ii) Lack of competence

This is a fear that people will seldom admit but sometimes changes in an organisation necessitates changes in skills and in some people will feel that they won't be able to make the transition very well.

(iii) Low Trust

When people don't believe that they or the company can competently manage the change there is likely to be resistance.

(iv) Misunderstanding about the need for change

If staff do not understand the need for change you can expect resistance especially from those who strongly believe that the current way of doing things works well.

(v) Poor communication

When it comes to change management there is no such thing as too much communication. There is tendency for resistance, if communication is not adequate.

(iv) Changes to routine

When we talk about comfort zones we are really referring to routine we have them. They make us secure. So there is bound to be resistance whenever changes require us to do things differently.

(vii) Benefits and rewards

Changes can be resisted when the benefits and rewards for making the change are not seen as adequate for the trouble involved.

EXAMINER'S REPORT

The question tests candidates' knowledge of "change" with regard to organisation and individual. All the candidates attempted the question, and performance was good as about 95% of the candidates that attempted the question scored more than 50% of the marks allocated.

Candidates are advised to make use of relevant textbooks and journals for better performance in future examination.

5. Explain the following terms with respect to performance management.

(a) Performance gap (4 Marks)

(b) Aligning results (4 Marks)

(c) Standards (4 Marks)

(d) Measures (4 Marks)

(e) Rewards (4 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 5

(a) Performance Gap

This represents the difference in actual performance shown as compared to the desired standard of performance. In employee performance management efforts, this performance gap is often described in terms of need knowledge and skills which become training and development goals for the employee.

(b) Aligning Results

Performance management puts strong focus on ensuring that all parts of the organization are working as efficiently and effectively as possible towards achieving organisational results. Therefore, the results of all part of the organisation should be aligned with the overall preferred results of the organisation.

(c) Standards

This specify how well a preferred result should be achieved by the domain for example “meets expectation” or “exceeds expectation”.

(d) Measures

Measures provide specific information used to assess the extent of accomplishment of results. Measurements are typically expressed in terms of time, quantity, quality or cost.

(e) Rewards

The performance review process usually adds information about rewarding the employee’s if performance met or exceeded standards. Rewards can take many forms e.g. merit increases promotions, certificates of appreciation, commendation letters etc.

EXAMINER’S REPORT

The question tests candidates’ knowledge of basic terminologies of performance management.

About 85% of the candidates that attempted the question scored more than 50% of the marks allocated, hence performance was good.

Candidates are advised to make use of the Institute pathfinder for better performance in the future examination of the Institute.



THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA
OCTOBER 2019: PROFESSIONAL EXAMINATION
PT 2: TAX AUDIT & INVESTIGATION

TUESDAY 8TH OCTOBER, 2019

EXAM NO.....

ATTEMPT ALL QUESTIONS.

TIME: 3 HOURS.

2. (a) Mr. Charity is the Managing Director of Funso Trading Company Ltd. The Company's financial statements for the year ended 31 December, 2018 show a loss due to the difficulty it had in selling its products. The company's assessment file was transferred to the tax audit department for routine tax audit exercise to be carried out. During field audit exercise it was discovered that the company made a donation of ₦150,000 to the Nigerian Society for the Deaf & Dumb and this amount was disallowed by the tax auditor. Another area where the Federal Inland Revenue Service (FIRS) disagreed with the company include capital allowances claimed on assets for which there were no evidence of legal ownership and same assets were not put to use for the production of the company's products. The amount was equally disallowed by the tax auditor. Mr. Charity was unhappy with the tax auditor that the donation was disallowed, the institution is specifically stated as one of the bodies to which donations may be made. And the assets belong to the company. He has consulted you in your capacity as a tax practitioner for advice on the conditions under which donations and capital allowances are allowed for income tax purposes.

Required:

Discuss the conditions under which donations and capital allowances are deductible for income tax purposes. (10 Marks)

- (b) Discuss the circumstances under which a tax authority may enter a taxpayer's premises, search and seize documents, records, etc. (5 Marks)
- (c) Discuss the provision for penalty under the Companies Income Tax Act for a person on whom a warrant of search is served but refuses to cooperate with the officer executing the warrant? (5 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 1

(a) The Managing Director,
Funso Trading Company Ltd.

08/03/2018

.....
.....

Attention: Mr Charity

Dear Sir,

RE: ALLOWABLE DONATIONS AND CAPITAL ALLOWANCES ON QUALIFYING ASSETS UNDER THE COMPANIES INCOME TAX ACT.

The above matter which was referred to us during the telephone conversation between yourself and the undersigned refers. The issues will be addressed one after the other.

Donations

Our understanding of the issues has to do with the fact FIRS tax auditors did not agree with you that the donations made to the Nigerian Society for Deaf and Dumb should be treated as allowed for Nigerian income tax purposes. On the other hand, it is your belief that because the name of the body is listed on the schedule 5 of CITA, it should be allowed.

After a thorough review of the issue, we are placed to advise as follows:

Donation is an allowable expense under the provisions of the Companies income Tax Act as amended to date.

However, for the donations to be allowed, the following conditions must be satisfied:

- The donations must have been made out of a profit;
- The donations must not be capital in nature. This means that if a non-profit asset is donated, it will be inadmissible for tax purpose;
- The donation must not exceed 10% of the chargeable profit. If the donation exceeds 10% of the chargeable profit the difference would be disallowed;
- The donations must be made to one of the bodies listed on schedule 5 of CITA.

The implication of the above conditions is that, it is not enough for the donation made to satisfy only one of these conditions. It must satisfy all of the four conditions.

In respect of your Company, the fact that donation was made to a body listed on schedule 5 of CITA is not enough because it is paid out of a loss. This means that one of the conditions has not been satisfied. This must have accounted for treatment given to the donations by FIRS auditors.

Capital allowance on qualifying assets:

Conditions for granting capital allowances to taxpayers are as follows:

- The taxpayer must have incurred qualifying capital expenditure in respect of an asset for the purpose of its trade or business;
- The taxpayer must be the legal owner of the asset at the end of the basis period for the year of the assessment;

- The asset must be in use for the purposes of a trade or business carried on by the taxpayer at the end of the basis period for the year of the assessment;
 - The taxpayer must make a claim for capital allowance for a year of assessment before it is granted.
 - Nevertheless, the FIRS may grant an allowance if it is of the opinion that it is of the opinion that it is reasonable and just to do so; and
 - A certificate of acceptance for all qualifying expenditure incurred by a company in a year in excess of ₦500,000 is required to be obtained from the Inspectorate Division of the Federal Ministry of Industries.
- (b) A company's premises may be entered and searched if the FIRS suspects that there is:
- (i) A refusal to file tax returns;
 - (ii) A refusal to remit WHT and VAT deductible at source;
 - (iii) A refusal to allow access to records and books;
 - (iv) Refusal to honour tax office invitation or respond to tax queries;
 - (v) An intelligent report of criminal activities bordering on tax default;
 - (vi) A petitions against the company disclosing serious tax evasions; and
 - (vii) An evidence of the offence or irregularity can be found in the premises, office or place of management of the company or in residence of the principal officer, agent or representative of the company.
- (c) Penalty provision under CITA
- (i) A person on whom a warrant of search is served who refuses to cooperate with the officer executing the warrant is guilty of an offence and is liable on conviction to a fine of ₦10,000.00 or to a maximum of six months imprisonment or to both such fine and imprisonment.

EXAMINER'S REPORT

The question tests candidates' understanding of the treatment of donations and capital allowances, conditions for deduction for income tax purposes, circumstances under which a tax authority may enter taxpayer's premises for search, as well as provision for penalty for default by client's refusal to cooperate with tax officer executing a search warrant. About 99% of the candidates attempted the question, however, less than 15% scored above 50% of marks allocated.

The commonest pitfalls in answering the question was the candidates' inability to separate each points for the examiner to identify rather than writing stories and going in circles.

Candidates are advised to prepare adequately by ensuring they cover all the aspect of the syllabus when preparing for future examinations. They are also advised to familiarise themselves with the Institute's previous pathfinders.

2. In 2017 fiscal year the Federal Inland Revenue Service (FIRS) received application for tax refund and all the applications were processed in accordance with the provision of section 23 of FIRS Establishment Act 2007. However, one of the taxpayers that applied for a refund was aggrieved and contemplating to institute a legal action against FIRS for paying the refund late and without interest. The taxpayer has contacted you as a seasoned tax practitioner for advice.

Required:

- (a) Discuss the conditions under which tax refund cases may arise.
- (b) Explain the conditions that must be met before tax refund can be made.
- (c) State the instruments FIRS uses to manage tax refund scheme.
- (d) Discuss the relevant information that should be included in the application for tax refund from a taxpayer who has overpaid income tax.
- (e) Discuss the two (2) ways by which tax refund could be claimed.

(20 Marks)

SOLUTION TO QUESTION 2

- (a) Some circumstances that could warrant tax refund are:
 - Where withholding tax deduction at source exceeds the tax assessment for a given year;
 - Deduction of VAT at source without corresponding adjustment for input VAT;
 - Where input VAT exceeds output;
 - Input VAT claims by Vatable persons whose goods and services are zero rated;
 - Where final tax liability is higher than estimated tax in the case of companies engaged in petroleum operations;
 - Where tax was remitted to wrong tax authority;
 - Outright over payment or duplication of payment of the same tax liability in error;
 - Arithmetical errors in tax computations;
 - Over assessed tax by taxpayer or relevant tax authority;
 - Application of commencement provisions (right of election)
 - Application for double taxation or commonwealth relief provisions; and
 - Recomputation in respect of shipping or aircraft companies.
- (b) Conditions that must be met before tax refund can be made are:
 - The taxpayer must register with FIRS and obtain Tax Identification Number (TIN);
 - The taxpayer must apply in written for the refund;
 - FIRS must carry out tax refund audit exercise. Section 23 of FIRS Establishment Act 2007 refers;
 - Relevant papers/documents must be attached to the application;
 - All applications must be processed with original documents; and
 - All refund payment must be made through e-payment.
- (c) The instruments used by FIRS to manage tax refund schemes is FIRS (Establishment Act 2007 as amended. (Section 23 of the Act).
- (d) The following information are required to be attached to the application:
 - (i) Bank details showing the following information;
 - * Account name;
 - * Name of Bank;
 - * Address of Ban;
 - * Account number;
 - * Bank sort code; and

- (ii) Tax Identification Number (TIN);
 - (iii) Original FIRS receipt issued; and
 - (iv) Original pay-direct report.
- (e) There are two ways by which tax refund could be claimed.
Mode of payment are:
- (i) Outright refund: under this approach refund is made through e-payment to taxpayers account; and
 - (ii) Utilisation of excess payment. Here, the taxpayer has the option of using the established overpayments as a set-off against future tax liability.

EXAMINER'S REPORT

The question tests candidates' understanding of the treatment of tax refund and conditions to meet before tax payers can be refunded via the instrumentality of Section 23 of FIRS Establishment Act 2007. More than 98% of the candidates attempted the question. Only about 40% scored above 40% of marks allocated.

The commonest pitfalls in answering the question especially part "a" & "b" appears to be similar. Candidates misunderstood "a" for "b", thereby mix up their answers.

Candidates are advised to prepare adequately by ensuring they cover all aspect of the syllabus when preparing for future examinations. They are advised to familiarise themselves with the Institute's previous pathfinders.

3. (a) Your audit team has been assigned to carry out a tax audit of ABC Ltd.

Required:

Describe the various activities that would take place in the tax office before the field audit exercise. (10 Marks)

- (b) You are an inspector of taxes heading a team of tax auditors. Your team has been assigned the audit of Chukwu Trading Company Ltd.

Required:

Discuss the matters/issues you will discuss with the management of the company during your initial meeting (Pre-audit discussion) before the commencement of the actual audit exercise. (10 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 3

- (a) The following preliminary activities must take place in the tax office before audit executives set out to conduct the audit,
- (i) Gathering of the files and grouping them into the number of audit teams to be established;
 - (ii) Audit teams to be acquaint themselves with background information about their cases;
 - (iii) Prepare audit checklist to be used in respect of each company to ensure all necessary areas of audit activities are covered;
 - (iv) Design interview format (if necessary) for each company depending on the problems so as to ensure that all grounds are covered;
 - (v) Assign specific duties among team members;
 - (vi) Review the last audit or investigation report (if any); and

- (vii) Review previous tax returns (self-assessment, Value Added Tax, Withholding Tax, PAYE, etc) and carry out a analysis of the taxpayer's financial statements (using profitability, liquidity/solvency, efficiency, leverage ratios etc).
- (b) Pre-audit meeting
The team leader will use the opportunity to:
- Introduce the audit team members;
 - Brief the taxpayer on the purpose of the audit;
 - Obtain background information about the company or confirm background information earlier obtained from the company's file in the tax office or other source of information. Such information may include: nature of the business, corporate structure, branch network, auditors/tax consultants, bankers, solicitors, secretaries, directors, related companies, shareholding structure, date of incorporation/commencement of business etc;
 - Solicit the cooperation of the taxpayer in terms of providing necessary information, books, records, etc;
 - Inquire about the accounting and operational systems of the company; and
 - Respond to questions from the company's representative(s) on matters that they need clarification for example, the purpose of the audit period covered, duration of the field audit exercise, books/documents and information required for the audit etc.

EXAMINER'S REPORT

The question tests candidates understanding of planning that takes place in the office before an audit team will go out for an assignment, audit engagement and conduct of pre-audit meeting at the tax payer's office. About 99% of the candidates attempted the question. About 60% of the candidates scored above 40% of the allocated marks.

The commonest pitfalls of the candidates was their inability to clearly separate the planning for a field audit from desk audit exercise.

Candidates are advised to prepare adequately by ensuring they cover all the aspect of the syllabus when preparing for future examinations. They are also advised to familiarise themselves with the Institute's previous pathfinders.

4. (a) You were the Head of the tax audit team from the large tax office of the FIRS that went to Dotmak Nigeria Ltd. for a tax audit exercise (The large tax office is responsible for companies with turnover of ₦1billion and above).

In the course of the audit, you came across an invoice from Tomeky Nig. Ltd. valued ₦2.5billion. On further enquiries, you found out that Tomeky Nig. Ltd. was not registered with the FIRS.

Required:

As a Tax Manager with the FIRS:

- (i) Discuss the action you will recommend against Tomeky Nig. Ltd. and why? (2½ Marks)
- (ii) Explain the steps to be taken for the recommended action. (5 Marks)
- (iii) Discuss the point at which such action could be discontinued. (2½ Marks)

- (b) As an assistant director of taxes in Federal Inland Revenue Service (FIRS) and a team leader in the audit department, you have been asked to produce audit procedures that should be adopted to establish the compliance level of government agencies for tax purposes.

Required:

Prepare the audit procedures that would be adopted to establish the compliance level of government agencies with the provisions of the tax laws. (10 Marks)

(Total 20 Marks)

SOLUTION TO QUESTION 4

- (a) (i) Actions to be recommended against Tommeky Nig. Ltd.
- I will recommend Dotmak Nig. Ltd. For a tax investigation exercise. This is because there is suspicious that the company is engaged in tax evasion. Failure of the company to register with the FIRS could be a deliberate action to evade tax.
- (ii) Steps to be taken for the recommended action are:
- Obtain the FIRS management's approval to conduct tax investigation;
 - Assemble the investigation team (i.e. select the officers) to carry out the exercise;
 - Obtain background or preliminary information about the company if possible, by consulting relevant sources of information;
 - Prepare investigation plan (i.e. outline of the work to be done, allocation of work to team members, the timing of the work to be done);
 - Notify the company about the proposed investigation;
 - Visit the company on the due date for the investigation and hold a meeting with its management and tax consultants, if any, before the commencement of the exercise;
 - Carry out the actual tax investigation exercise; and
 - Prepare and submit report to the FIRS management.
- (iii) The tax investigation should be discontinued where:
- There is insufficient evidence to proceed further with the case;
 - It is discovered that there is no criminal intention;
 - The case has become statute barred; and
 - The owner of the company died.
- (b) To establish the level of compliance in respect of deduction and remittance of relevant taxes by government agencies, the following information will be collected:
- (i) Total contract awarded and relatives taxes payable;
 - (ii) Actual deductions made during the period under review;
 - (iii) Actual remittance to FIRS under the period under review;
 - (iv) Deductions yet to be remitted;
 - (v) Schedules (monthly returns) of salaries and wages showing gross pay, allowances deductions and not take home pay for each staff;
 - (vi) Any irregularities in the compliance process viz:-
 - Months for which returns were not filed with FIRS to be detected from the returns file;
 - Months that were skipped in respect of the remittances;
 - Lodging of cheques in non designated banks by the taxpayers;

- Deduction skipped;
 - The date cheques from the organisation are lodged and the dates on tellers;
 - The genuineness of tellers from the banks, (the stamps should be checked);
 - Tellers must be duly dated, the period covered by the payments clearly indicated;
 - In the cheques delivery register, the name of the officer that lodged the cheque and his office must be shown;
- (vii) Preliminary steps
- Visit the taxpayer with a letter of intent.
 - Book appointment to see the permanent Secretary /Chief Executive officer and/or the Director Finance/Accountant before commencing assignment;
- (viii) Prepare schedule of deduction and payment;
- (ix) Make photocopy of contractor's schedules, summarise them and apply 5% for WHT and 5% for VAT.
- (x) Trace payment voucher posted to the cash book.

EXAMINER'S REPORT

The question tests candidates understanding of action to be taken against a company that failed to register with the FIRS, the point at which such action could be discontinued as well as on the audit procedures to establish compliance level of government agencies with the provision of tax laws. More than 90% of the candidates attempted the question. Performance was impressive as more than 70% of the candidates scored more than 60% of the allocated marks.

The commonest pitfalls of the candidates were misinterpretation of the requirements of the question and not relating the case scenario of the question to the mode of the answer provided.

Candidates are advised to prepare adequately by ensuring they cover all the aspect of the syllabus when preparing for future examinations. They are also advised to familiarise themselves with the Institute's previous pathfinders.

5. Garuba Trading Company Nigeria Ltd is a trading company based in Kano. For the past three years, the tax office has been having a running battle with the company on its failure to file self-assessment tax returns. Intelligence report continuously received by the FIRS office revealed that the company has been in good business and that other companies in the same industry may likely follow its steps regarding payment of taxes.

The tax office thereafter recommended the company for investigation as a result of which a letter was sent to the Managing Director informing the company of the intending visit of the tax investigation team.

You are the tax consultant to the company:

Required:

Explain the following to the company's top management team:

- (a) The stages usually involved in tax investigation.
- (b) Circumstances under which tax investigation could be discontinued.

(20 Marks)

SOLUTION TO QUESTION 5

- (a) The stages usually involved in tax investigation are:
- (i) Surveillances or pre-investigation activities. The tax investigator must do his home work before proceeding to the taxpayer's premises to carry out the actual investigation exercise. This entails checking and cross checking the available information and even gathering more information on the purported tax fraud. This must be done with dispatch and discreetly without raising unnecessary alarm.
 - (ii) Evidential audit or investigation. This is the stage of which the tax investigator visits the premises of the taxpayer to carry out an in-depth investigation and take possession of any available evidence for possible prosecution. Any individual can be invited for interview and warrant of arrest may be secured to apprehend the suspect, if necessary. Individuals, offices, houses, may be searched to obtain evidence.
 - (iii) Case preparation
This involves careful examination and critical analysis of the documents obtained to assess their relevance and potency as exhibits in the court of law. Witnesses are collected and suspects are interrogated. The case can be still be stopped at this stage if the available evidence against the accused is not strong enough to warrant litigation.
 - (iv) Arraignment
This is the stage where the case goes to court for criminal prosecution. All the evidence obtained and witnesses secured are made available to the prosecutor who is fully briefed on the case.
- (b) Termination of investigation.
An investigation of tax fraud or evasion can be terminated at any stage based on the following conditions. Any stage based on the following conditions:
- Where there is insufficient evidence to proceed further with the case;
 - Where the managing Director died;
 - Where it is discover that criminality is not involve. Probably a case of tax avoidance mistaken for tax evasion;
 - Where the suspect dies or become insane; and
 - Termination by law, for example where a case becomes statute barred.

EXAMINER'S REPORT

The question tests candidates understanding of the stages involve in tax investigation and the circumstances under which tax investigation could be discontinued. About 90% of the candidates attempted the question. Performance was good as more than 90% of the candidates scored more than 70% of the allocated marks.

The only pitfall noted was the inability of few candidates to interpret the question correctly.

Candidates are advised to prepare adequately by ensuring they cover all the aspects of the syllabus when preparing for future examinations. They are also advised to familiarise themselves with the Institute's previous pathfinders.

