

FINANCE ACT 2021:

HOW THE CAPITAL MARKET AND THE REAL ESTATE SECTORS ARE IMPACTED

INTRODUCTION

The Finance Act 2021 (the "FA 2021") introduced changes that could have significant implications for the Nigerian capital markets and real estate sectors. In this publication, we have addressed some of the changes that we consider relevant.

Capital Gains on Sale of Shares

The blanket tax exemption granted under the Capital Gains Tax Act ("**CGTA**") for the disposal of shares has now been modified. Gains accruing to a person or a company for the disposal of shares in any Nigerian Company registered under the Companies and Allied Matters Act ("**CAMA**"), are now subject to capital gains tax ("**CGT**") at the rate of 10%, subject to certain exceptions, such as where the proceeds of the disposal are reinvested in the acquisition of shares of the same company or any other Nigerian company within the same year of assessment, or where the total proceeds from the disposal of shares are less than NGN100 million in any consecutive 12-month period, or where the shares are transferred between an approved borrower and lender in a regulated Securities Lending Transaction as defined under Companies Income Tax Act ("**CITA**").

These changes impact transactions in the capital market in the following ways:

- a. The exemption of gains on disposal of shares used to be an attraction for equity investments, but with the amendments, institutional investors may need to evaluate the implication of investing in either equity or debt instruments, particularly Nigerian Government securities. The CGTA exempts the gains on disposal of Nigerian Government securities from CGT. These securities include Nigerian Treasury Bond, Savings Certificate, Premium Bond issued under the Savings Bonds and Certificate Act, or any other long-term securities issued by the Nigerian Government. It is not clear whether this exemption will apply to securities issued by state governments. With the exemption of Nigerian Government securities from CGT, investors may be inclined to invest more in debt instruments than equities.
- b. The use of holding companies for purposes of holding title to real estate was a common scheme used by real estate developers, individuals, and estate managers, to manage CGT exposure and reduce the timelines for the perfection of title at the state land registries. With the withdrawal of the CGT exemption, this is no longer efficient.
- c. The exemption of the application of CGT to chargeable gains on shares transferred between an approved borrower and lender in a regulated securities lending transaction should drive interest in securities lending in Nigeria. One concern, however, is that some securities lending transactions are not necessarily regulated by the Securities and Exchange Commission ("**SEC**") especially if the securities to be borrowed are Nigerian securities, but the borrowers and agents to both the lenders and borrowers are outside



Nigeria. This may pose a challenge because the definition of a regulated securities lending transaction is one regulated by the SEC. By virtue of Section 3 of the CGTA, the gains from lending securities in a Nigerian company could be subject to CGT in Nigeria, notwithstanding that the intention is to exempt gains from securities lending transactions. This amendment therefore requires further clarification.

Franked Interest Income for Unit Trusts

Prior to the amendment introduced by the FA 2021, interest earned by a Nigerian company that holds units in a unit trust was subject to income tax at 30%. This is because unlike dividends distributed by a unit trust, interest distributed to a unit trust under a collective investment scheme (“CIS”) was not exempted from tax. This increased the tax exposure for unit holders whose fund managers invest in debt instruments. With the amendment introduced by the FA 2021, corporate unit trust holders will only be subject to 10% WHT as final tax on interest received from investments made under a CIS.

Real Estate Investment Vehicles

Investment in real estate assets in the Nigerian capital market could be through a Real Estate Investment Companies (“REICO”) or a Real Estate Investment Trust (“REIT”). A new definition has been introduced for REICOs. This definition expands the definition of REICOs to include REITs duly approved by the SEC as a Real Estate Investment Scheme. The amendment to this definition attempts to cure what used to be an unclear and inefficient way of taxing REITs. For context, before the Finance Act 2019, REICOs used to be in a position where dividend and rental income received by a REICO would be taxed in the hands of the REICO, and also taxed in the hands of the final recipients who are shareholders in the REICO. This was onerous, because REICOs are merely pass-through vehicles for investment in real estate assets, therefore, only the ultimate beneficiary should suffer tax on the dividend and rental income from the investments in such real estate assets. The Finance Act 2019 and 2020 cured this anomaly by exempting dividend and rental income received by a REICO on behalf of its shareholders, from tax, provided that (i) a minimum 75% of dividend and rental income is distributed, and (ii) such distribution is made within 12 months of the end of the financial year in which the dividend or rental income was earned.

However, such REICOs are required to deduct WHT when redistributing the dividend and rental income to their shareholders. It was, however, not clear whether REITs were covered by this exemption, because REITs are not companies. There were possibilities that the trustee in a REIT that receives dividend or rental income from real estate investments could suffer income tax on such income and the unit holders would also suffer tax when the income is redistributed to them. The amendment by the FA 2021 now clarifies that REITs will also enjoy this exemption, therefore, the rental and dividend income should not be taxed in the hands of the trustee, but in the hands of the final recipients.



Securities Lending Transactions

One of the major highlights of the Finance Act 2019 was the introduction of a regime for taxation of regulated securities lending transactions. Under the Finance Act 2019, dividend was defined to include “*compensating payments received by a lender from its approved agent or borrower in a Regulated Securities Lending Transaction, if the underlying transaction giving rise to the compensating payment is a receipt of dividends by a borrower on any shares or securities received from its approved agent or a lender in a Regulated Securities Lending Transaction*”. The FA 2021 has amended this definition to read “*dividends include compensating payments received by a lender from its approved agent or borrower in a Regulated Securities Lending Transaction*”.

The impact of this amendment is that every compensating payment that a lender receives from the borrower will be construed as dividend, notwithstanding the nature of the underlying transaction giving rise to the compensating payment. For instance, where the lender lends quoted debt instruments like bonds to a borrower, and while the bond is temporarily under the control of the borrower, the borrower receives interest from the issuer of the bond, the interest on that bond when transferred to the lender will be considered as dividend in the hands of the lender, notwithstanding that the underlying transaction is with respect to debt securities.

Based on the above, with the amendment introduced by the FA 2021, a lender who lends debt securities will be able to enjoy the exemption under Section 23 (1)(t) of CITA which exempts from CIT, the compensating payments, which qualify as dividends, received by a lender from its approved agent or a borrower in a Regulated Securities Lending Transaction. Such payments are deemed to be franked investment income and shall not be subjected to further tax in the hands of the Lender.

This amendment is an incentive for debt securities lending transactions as much as it is for equity-based securities lending transactions.

Conclusion

The FA 2021 has made changes that have significant implications for capital market investment transactions. Whilst some issues still require further clarification, the impact of the changes appears to achieve a potential increase in revenue for government, without necessarily impeding opportunities for investment in the Nigerian capital markets. The extent of this balance would, however, only be determined as the implementation progresses.

We will in our subsequent publications consider how the changes introduced by the FA 2021 affect other sectors.

This update is for general information purposes only and does not constitute legal advice. If you have any questions or require any assistance or clarification on how this update could apply to you or your business or require litigation advice on any aspect of the Nigerian laws, please contact taxteam@uubo.org.