

THE TAX APPEAL TRIBUNAL HAS HELD THAT DIVIDENDS REGARDED AS FRANKED INVESTMENT INCOME ARE LIABLE TO 'EXCESS DIVIDEND TAX' WHEN REDISTRIBUTED



The Lagos Division of the Tax Appeal Tribunal (the "Tribunal") recently held, in the case of UAC of Nigeria PLC ("UAC") v. Federal Inland Revenue Services (the "FIRS") (Appeal No: TAT/LZ/CIT/025/2018) (the "UAC Case"), that dividends received by a company which are classified as franked investment income are liable to 'excess dividend tax' when such dividends are redistributed by the recipient company to its shareholders. This will be in cases where the recipient company redistributing such dividends has (a) no taxable profit; or (b) taxable profit which is lower than the dividend paid. This is the first case which we are aware of that has been brought before the Tribunal which relates to the application of the 'excess dividend tax' rule to dividends redistributed (classified as franked investment income) by a non-bank holding company ("Holdco") to its shareholders under the Companies Income Tax Act 2004 (as amended) (the "CITA"). In practice, the FIRS has only exempted bank holding companies from the application of the 'excess dividend tax' rule.

Background

A summary of the facts of the UAC Case are as follows: UAC's 2016 companies income tax ("CIT") returns for the 2015 year of assessment ("YOA") showed taxable profits of NGN729,636,243 while it distributed NGN3,361,512,000 as dividends. In addition, UAC's 2015 CIT returns for the 2014 YOA showed taxable profits of NGN316,374,360 while it distributed NGN3,361,512,000 as dividends. Lastly, UAC's 2014 CIT returns for the 2013 YOA indicated taxable profits of NGN40,826,386 while it distributed NGN2,561,152,000 as dividends. In each YOA, the difference between the taxable profits and the dividends distributed to its shareholders arose from the dividends which UAC received from its subsidiaries in those years. The dividends received from the subsidiaries are regarded as franked investment income which is not subject to further tax.

In each of those years, UAC paid CIT only on the income which it derived directly from its operations and excluded the dividends which it received from its subsidiaries. This was on the grounds that the dividends are franked investment income which are not liable to further tax under the CITA, and UAC declared and distributed dividends to its shareholders from a combination of its profits after tax and the dividends which it received from its subsidiaries. The FIRS objected to this and issued additional tax assessment notices to UAC on the ground that the dividends declared by UAC in each YOA exceeded its total taxable profits. The FIRS, therefore, treated such distributed dividends as UAC's profits for each YOA and imposed 'excess dividend tax' at the rate of 30%. UAC objected to the FIRS' additional assessment and appealed to the Tribunal. The Tribunal, in refusing UAC's appeal, held, among other things, that the dividend declared by UAC which was higher than its taxable profits in each YOA was liable to 'excess dividend tax' at the rate of 30%.

What is franked investment income?

The term is derived from section 80(3) of the CITA (dealing with the withholding of tax on dividends) which provides that *"dividend received after the deduction of tax ... shall be regarded as franked investment income of the company receiving the dividend and shall not be charged to further tax as part of the profits of the recipient company. However, where such income is redistributed and tax is to be accounted for on the gross amount of the distribution ..., the company may set-off the withholding tax which it has itself suffered on the same income."*

The first sentence of section 80(3) of the CITA is clear and means that any dividends received by a Holdco (such as UAC) from its subsidiaries should not be subject to the imposition of CIT as part of the profits of such Holdco. The second sentence, although less clear, simply means that where the dividends received by a Holdco are to be paid out as dividends to Holdco's shareholders (i.e. "redistributed"), and where Holdco would be required to account to a tax authority for the tax it is required to withhold from such dividends, Holdco may set-off any tax withheld by its subsidiaries (before the subsidiaries paid the dividend to Holdco) against the amount of tax which Holdco has to remit to the tax authority. It is based on this provision that UAC, in the UAC Case, did not include the dividends from its subsidiaries as part of its taxable profits.

The 'excess dividend tax' conundrum!

What has complicated the application of section 80(3), which the FIRS relies on regularly, is section 19 of the CITA. This section provides that where dividend is paid out of profits on which no tax is payable as a result of no total profits, or total profits which are below the amount of the dividend paid, the company paying the dividend will be charged tax at the rate of 30% as if the dividend paid is the total profit of the company for the year of assessment to which the account, out of which the dividend is declared, relates. This section 19, therefore, imposes what is now described as an "excess dividend tax" on dividends.

The interpretation which the FIRS has given is that section 19 is applicable to a company's entire income, notwithstanding its source and regardless of whether that income has been exempted from tax under another provision of the CITA, or other laws. In the context of a Holdco which derives its income primarily from dividends received from its



subsidiaries, the FIRS' interpretation would mean that if a Holdco were to pay dividends to its shareholders, and if the amount of such dividends were to exceed Holdco's taxable profits, then the Holdco would be liable to pay income tax in an amount equivalent to 30% of the sum it paid as a dividend. This interpretation is unhelpful for companies that invest in equities, government securities and other tax-exempt instruments.

Judicial application of section 19 of the CITA

The FIRS' interpretation of section 19, as set out above, was relied on by the Tribunal for its decision in the case of *Actis Africa (Nigeria) Limited ("Actis") v. FIRS* (Appeal No: TAT/LZ/EDT/014/2017) where it held that section 19 of the CITA applied to the dividends paid by Actis in the years of assessment when it recorded no taxable profits and held that Actis was liable to pay 'excess dividend tax' on the dividends declared. In the *Actis* case, the Tribunal relied on the decisions of the Federal High Court and Court of Appeal in the case of *Oando Plc v. Federal Board of Internal Revenue* (reported in (2009) 1TLRN 99 and (2015) 18TLRN 1 respectively) in which both courts held that where a company declared and paid dividends that exceeded its taxable profits, or where the company has no taxable profits in a given year of assessment, such dividends should be deemed to be its profits and subject to companies income tax at the rate of 30%, regardless of whether the earnings from which the dividends are paid have been previously taxed.

Both the *Actis* and the *Oando* cases involved a declaration of dividends by the affected companies from retained earnings which were higher than their respective taxable profits, or when they had no taxable profits, and this can be distinguished from the facts of the *UAC* Case. The *UAC* Case relates to franked investment income which the CITA declared should not be liable to further tax. Yet, the Tribunal relied on the decisions in the *Actis* and *Oando* cases to hold that the 'excess dividend tax' provision applied to *UAC*.

Unlike dividends, which the CITA regarded as franked investment income and, therefore, are not liable to further income tax (a) in the hands of the recipient; and (b) when redistributed to the recipient's

shareholders, there is no similar provision in the CITA which can be interpreted to exempt dividends declared from retained earnings from income tax. The Tribunal, therefore, ought to have held in the *UAC* Case that section 80(3) is an exception to section 19 and decide in favour of *UAC*.

When "no tax is payable"!

In the *UAC* Case, the Tribunal held that section 19 of the CITA provides for when and how a company becomes liable to pay companies income tax on a dividend that is paid out of profits "*on which no tax is payable*". This position of the Tribunal is, in our view, not correct in all cases, as it should not apply to (a) redistributed dividends which is franked investment income from which tax has been withheld; and (b) dividends from tax-exempt incomes. This is because, in the case of the former, such redistributed dividend has already been taxed and net amount declared by the CITA as franked investment income which is not subject to any further tax and, in the case of the latter, has been expressly exempted from tax by law.

It is, therefore, incorrect to regard dividend as profits "*on which no tax is payable*" under section 19 of the CITA. If the CITA had not made this exemption for franked investment income, the tax withheld on the dividends would have been an advance payment of income tax which the recipient would have been able to set off against future income tax.

Our position on the application of section 19 vis-a-vis section 80(3)

By virtue of section 80(3) of the CITA, section 19 of the CITA should not be applicable where a Holdco (such as *UAC*) has received dividends from its subsidiaries which have already been taxed, and is re-distributing such dividends to its own shareholders. The Tribunal ought not to have relied on the decisions in the *Actis* and *Oando* cases as the facts are distinguishable as we have shown above. We have relied on the basic rules of statutory interpretation to come to

this conclusion. One of such rules is that when the words of a statute are clear and unambiguous, the statute should be given its natural and grammatical meaning. The words of section 80(3) are clear and unambiguous. It provides that such dividends *“shall not be charged to further tax as part of the profits of the recipient company.”*

Another rule of statutory interpretation is that when two provisions of a statute appear to be in conflict with each other, one general in nature and the other specific to a particular subject, the specific provision will prevail over the general provision and will be read as an exception to the general act prescribed by the general provision. More specifically, the provisions of section 19 of the CITA are general in nature and apply to a company's income generally, while section 80(3) of the CITA, on the other hand, isolates and confers a specific exemption from further taxes on that part of a company's income which the section refers to as *“franked investment income”* - i.e., dividends paid by other companies on which tax has been withheld. On this reading, section 80(3) of the CITA represents an exception to the “excess dividend tax” that is provided for in section 19 of the CITA.

The Implication of the decision in the UAC Case

The implication of the Tribunal's decision in the UAC Case, if not overturned by a higher court, is that where a company (such as UAC) receives dividends from its subsidiaries or other companies as franked investment income and redistributes such dividends to its shareholders where it (a) makes no profits in the year in which it redistributes the dividends; or (b) redistributes the dividends in excess of its taxable profits in any year, the dividends will be deemed to be the company's taxable profits which will be subjected to 'excess dividend tax' at the rate of 30%. It will make no difference that the income from which such dividends were redistributed (i) has already been subjected to the withholding of tax and which the CITA has declared should not be liable to any further tax or (ii) is exempted from tax by the CITA or other laws. This will ultimately have a negative impact on non-bank holding companies in Nigeria, and will serve as a disincentive to the setting up of holding companies which solely hold shares in subsidiaries in Nigeria.

There is a proposed change on the horizon!

There is presently a Finance Bill 2019 (the “Bill”)

pending before the National Assembly which is seeking to make sweeping changes to various Nigerian tax laws, including the CITA. The Bill is seeking to amend, among other things, section 19 of the CITA, and currently provides that the 'excess dividend tax' provisions of section 19 shall not apply to:

- (i) dividends paid out of profits that are exempted from income tax;
- (ii) dividends paid out of the retained earnings of a company which have already been subjected to income tax; and
- (iii) profit or income of a company that is regarded as franked investment income etc.

The above exemption will apply regardless of whether such dividends are paid out of profit of the year in which the dividend is declared or out of profits/retained earnings of previous reporting periods.

In view of the aforementioned exemption, the Bill, if passed into law as currently drafted by the National Assembly and assented to by the President, will render the decisions in the Actis, Oando and UAC cases ineffective.

This update is for general information and does not constitute legal advice. Should you have any questions or require clarification regarding this or any other developments, please contact:



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