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TAX REFORM UPDATES
NIGERIA PLANS TO INTRODUCE CFC RULES

The four bills, which form the backbone of Nigeria's ongoing tax reform efforts, have been passed by the House of Representatives and are awaiting passage by the Senate. One of the key changes proposed is the introduction of Controlled Foreign Corporation (CFC) rules. These rules are designed to prevent companies from deferring taxes through foreign subsidiaries. In this article, we'll explore what these new CFC rules could mean for Nigerian businesses and the broader tax landscape.

One of the objectives of the Nigerian tax reform is to introduce additional anti-avoidance measures to align with the OECD BEPS action plan. Since the OECD issued the BEPS actions, Nigeria has introduced more stringent anti-avoidance measures, including revised transfer pricing rules and an interest deductibility rule that neutralizes thin capitalization practices. As part of its ongoing reforms, Nigeria is proposing a controlled foreign corporation regime.

A controlled foreign corporation/company rule ("CFC rule") is an anti-avoidance rule that prevents tax deferral on the foreign source income of resident companies. Foreign source income is usually taxed after it is accrued, brought into, or received as income in the recipient's country of residence. If a resident company has shares in a foreign subsidiary company, it is possible to defer or avoid the tax payable on such income at home until it is repatriated by the subsidiary.

The objective of CFC rules is to prevent such tax deferral by extending the residence tax rules to the income of the foreign subsidiary company.

A CFC rule requires that the undistributed income of the foreign subsidiary company is attributed to the resident shareholder and taxed as if the profit had been distributed.

There are several reasons why countries adopt CFC rules. One such reason is to stop the transfer of income to related non-resident companies. The fundamental feature of a CFC rule is that it targets the income earned and accumulated in a foreign entity that is controlled by a resident person. The scope of application can, however, vary from country to country. Also, CFC rules usually target the deferral of passive income of controlled entities in zero or low-tax jurisdictions. However, some jurisdictions apply CFC rules to both passive and active income.

Nigeria's proposed CFC rule states that "*where a foreign company which is controlled by a Nigerian company has not, in a year, distributed profits to its*

shareholders, the proportion of the profits of the controlled foreign company attributable to the Nigerian company, which could have been distributed without detriment to the company's business shall be construed as distributed and included in the profits of the Nigerian company for the purposes of sub-section (1) of this section.". Sub-section (1) states that *The profits of a Nigerian company are deemed to accrue in Nigeria wherever the profits arise and whether or not such profits have been brought into or received in Nigeria.*

The features of a CFC regime include;

(i) A control test, which is a set of rules to determine when a foreign entity is a CFC;

(ii) Determination of attributable income – these are rules that determine how income is attributed to a CFC. Some regimes adopt the locational or designated jurisdiction approach, while others may adopt a transactional approach or an entity approach;

(iii) How the attributed income is taxed; and (iv) the definition of exempted income. These rules vary from one jurisdiction to another.

The Nigerian CFC rule applies in scope to a Nigerian company that controls a foreign company and appears to target only passive income. The provision is, however, silent on the level of control requirement (i.e., control test) to determine when an entity will be regarded as a CFC. The draft Bill states that detailed rules will be issued for the implementation of the proposed CFC regime. Such guidelines will provide more clarity and direction to taxpayers when the Bill becomes law.

In the meantime, Nigerian companies that have foreign subsidiaries should be mindful of the implications that a CFC regime would have on their businesses.