Effect of Taxes on Dividend Policy of Companies in Nigeria

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Session Coverage

• Where it starts

• What we are seeing today

• Direct and Indirect Taxes Impact on Dividend

• Declaration, Payment and Special Rules – The Pioneer Cases

• Dividends Exempted from Taxes

• Next Steps
Where it starts

Financial Management Decisions

- Investment decision
- Financing decision
- Dividend decision

Financial mgt
Where it Starts

Investment decisions

- Undertake new projects
- Invest in new plant
- Research & Dev.
- Advert & marketing
- Take over or merger
- Joint venture
- Divestment
- Closure of a division, subsidiary etc
Where it starts

Financing Decisions:

• Equity
  - Ordinary
  - Preference [variations]

• Debt
  - Long Term
  - Short Term
Where it starts

Basis of Dividend Decision

• Theoretical assumptions (Modigliani & Miller theory, +1000 researchers and financial theorists)

• Practical Considerations:

  • Maintaining a target capital structure based on financial needs of the company

  • Current degree of financial leverage

  • Shareholders need for dividend income
Where it starts

Basis of Dividend Decision

• Pattern of past dividends

• Forms of Dividend [Cash / Stock div (Bonus)]

• Constraints of paying dividend

• Legal rules

• Desire to send favorable signals to investors

• Desire to conform to the industry's dividend payout
Where it starts

• Correlation between Revenue, Expenditure, Profits, Taxes and Dividend

• Profit as a major variable in the formation of dividend policy of the Companies.

• Significant effect of profit on dividend

• Positive correlation between profit, tax and dividend.

• Capitalization as opposed to dividend for considering capital gains in lieu of dividend for high taxpayers

• Unique circumstances of Companies
What we are seeing today

Correlation between:
- Revenue
- Expenditures
- Profits
- Taxes
- Dividends

- Business Arrangements affects Profits, Taxes consequently Dividends

- Types of Revenues and Expenditures affects Profits
**What we are seeing today**

<table>
<thead>
<tr>
<th>Business Arrangement</th>
<th>Marginal field</th>
<th>PSC</th>
<th>Service</th>
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</thead>
<tbody>
<tr>
<td>Oil Sector (Focus on Income Tax Rates )</td>
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<td></td>
</tr>
<tr>
<td><strong>Revenue</strong></td>
<td>1000</td>
<td>1000</td>
<td>1000</td>
</tr>
<tr>
<td><strong>Expenditure</strong></td>
<td>600</td>
<td>600</td>
<td>600</td>
</tr>
<tr>
<td><strong>Profits</strong></td>
<td>400</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td><strong>Taxes</strong></td>
<td>340</td>
<td>200</td>
<td>120</td>
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<tr>
<td><strong>Available Profits</strong></td>
<td>60</td>
<td>200</td>
<td>280</td>
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<tr>
<td><strong>Further Taxes (WHT)</strong></td>
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<td>28</td>
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<tr>
<td><strong>Dividends</strong></td>
<td>60</td>
<td>200</td>
<td>252</td>
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<tr>
<td><strong>Tax Rate</strong></td>
<td>85%</td>
<td>50%</td>
<td>30%</td>
</tr>
<tr>
<td><strong>WHT</strong></td>
<td>0</td>
<td>0</td>
<td>10%</td>
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What we are seeing today

<table>
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<tr>
<th>Business Arrangement</th>
<th>Bank 1</th>
<th>Bank 2</th>
<th>Bank 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks (Focus on Exempted Income)</td>
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</tr>
<tr>
<td>Revenue</td>
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<td>1000</td>
<td>1000</td>
</tr>
<tr>
<td>Expenditures</td>
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<tr>
<td>Non Taxable Income</td>
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<tr>
<td>Taxable Profits</td>
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<td>Available Profits</td>
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<tr>
<td>Further Taxes (WHT)</td>
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<tr>
<td>Dividends</td>
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<td>459</td>
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</tr>
<tr>
<td>Tax Rate</td>
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</table>
What we are seeing today

Industry Focus

- Financial Service
  - Migration strategy and effect on dividend growth [from Non Compliance to Compliance]

- Manufacturing businesses
  - Section 17 Dividend carried forward (IDITA)

- Oil & Gas
  - Petroleum Profits and exemption S 55 and subsequent dividend declaration

How strategic tax planning can help both taxpayers and tax authorities
Direct and Indirect Taxes Impact on Dividend

- Companies Income Tax –
  - When borne by the Investing companies

- Capital Gains Tax
  - Selling Shares – cum div

- Personal Income Tax
  - Salaries for directors (Investors) as against Dividend

- Value Added Tax
  - When borne by the Companies co.

- Other taxes on list of Act 21 of 1998 as may reduce profits and dividend
Declaration, Payment and Special Rules – The Pioneer Cases

✓ Declaration & Payment of Dividend
  - Section 17 Dividend carried forward (Industrial Development Income Tax Relief Act, 1971)
✓ Exempted profits carried forward to post pioneer periods

✓ Effect of Section 19 of Companies Income Tax Act (CITA) on Dividends

✓ When certain Profits will be treated as distributed – Section 9 of CITA
Section 17 Rules

(1) Wherever any amount of profits of a pioneer company is exempt from tax under section 16 of this Act, that amount shall immediately be credited by the pioneer company to an account to be kept by it for the purposes of this section.

(2) Where at the date of payment of any dividends by the pioneer company the said account is in credit, the dividends, or so much of the dividends where (after the end of its tax relief period) that amount thereof exceeds such credit, as equal the amount of such credit, shall be debited to the account.

(3) So much of the amount of any dividends so debited to the account as are received by a shareholder in the pioneer company shall, if the Board is satisfied with the entries in the account, be exempt from tax in the hands of that shareholder and shall for the purposes of the principal Act and the Personal Income Tax Act, be deemed to be paid out of profits on which tax is not paid or payable.

(4) Any dividend so debited to the account shall be treated as having been distributed to the shareholders or any particular class of shareholders of the pioneer company, in the same proportions as those shareholders were entitled to payments of the dividends giving rise to the debit.

(5) Whenever called upon so to do by notice in writing sent by the Board to the registered office of a pioneer company, the company shall, until such time as the Board is satisfied that there is no further need for maintaining the account, deliver to the Board a copy of the account made up to a date specified by the Board in the notice.

(6) Notwithstanding the provisions of section 16 of this Act and of this section, where it appears to the relevant tax authority that any amount of exempted profits of a pioneer company, or any dividend exempted in the hands of a shareholder, ought not to have been exempted by reasons of -

(a) a direction under section 13 of this Act having been made with respect to a pioneer company, after any profits of that company has been exempted under the provisions of section 16 of this Act; or

(b) the cancellation of a pioneer certificate, the relevant tax authority may at any time within six years of the direction or cancellation make such additional assessment upon the pioneer company or shareholder as may appear to the relevant tax authority necessary in order to counteract any benefit obtained from the amount which ought not to have been exempted.

(7) For the purpose of subsection (6) of this section, “relevant tax authority” has the same meaning as in section 100 of the Personal Income Tax Act, and in relation to any additional assessment to be made on a company under the said subsection (6), it means the Board.
Section 19 Rules

Section 19 - Payment of Dividend by Nigeria Company No 30 1996

No. 18 of 1998 where a dividend is paid out of profit on which no tax is payable due to -

(a) to no total profit; or

(b) to total profit which are less than the amount of dividend which is paid, whether or not the recipient of the dividend is a Nigerian company, the company paying the dividend shall be charged to tax at a rate prescribed in section 40(1) of this Act, as if the dividend is the total profits of the company for the year of assessment to which the accounts, out of which the dividends is deducted relates.

Oando Vs FIRS
Section 9 Rules

(3) In this section “Dividend” means -
(a) In relation to a company not being in the process of being wound up or liquidated, any profits distributed whether such profit are a capital nature or not, including an amount equal to the nominal value of bonus shares, debentures or securities awarded to the shareholders; and
(b) In relation to a company that is being wound up or liquidated, any profit distributed whether in money or monies worth or otherwise, other than those of a capital nature earned before or during the winding up or liquidation.
Dividends exempted from taxes

✓ Oil & gas free trade zones
✓ Pioneer profits
✓ Upstream oil profits
✓ Repatriated Dividends [through government approved channels?]
Next Steps

Consideration should be given to:

- Fact that dividend policy is of strategic importance
- The theories and practical approach to dividend policies
- Business arrangements to control future dividend
- Expenditure profiles to avoid as much transaction taxes as possible [reimbursables?]
- Manage profits
- Declaration of Dividend in Pioneer periods
- Generating Tax free Dividend Investments.

Thanks.