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Nigeria imposes income tax on forex gains of banks

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The Federal Government of Nigeria is seeking to tax the realised profits from all foreign exchange transactions of banks in the 2023 financial year. This measure is contained in the Finance (Amendment) Bill 2024. The Bill provides for a one-off tax of 50% on such realised profits. The Federal Inland Revenue Service (FIRS) will assess and collect the amount due, though the banks have the option to settle the windfall tax in instalments. However, the FIRS must approve such instalment plan on or before 31 December 2024. Where a bank has not executed an instalment plan or paid the additional tax due, such bank will be guilty of an offense and shall, on conviction, be liable to pay the tax due plus a penalty of 10% per annum and interest at the prevailing Central Bank of Nigeria's minimum rediscount rate. The principal officers of such defaulting bank may also face imprisonment for a period of not more than 3 years.

Commentary

Undoubtedly, the current revenue challenge being experienced by government and the need to enhance debt sustainability have triggered this windfall tax response despite its initial commitment not to introduce new taxes. The question that has always arisen is how the Government would fund the initial projected deficit of N9 trillion (4% of GDP) considering the inability of government to even meet the specified minimum crude oil production of 1.78million barrels per day. As of June, the daily production was 1.5million barrels, inclusive of 220k condensates (which does not form part of OPEC quota).

The fact remains that Nigeria has not been able to meet its OPEC quota for a very long time, and it does not appear that we are close to this given the lack of investment in the oil sector. According to the Debt Management Office (DMO), the total public debt as of 31 March 2024 was $92 billion and this amount keeps increasing. The current debt to GDP is about 50%, which is higher than the government self-imposed limit of 40%.

It should be noted that Nigeria is not a stranger to excess profits tax. In fact, Nigerian banks were once subjected to excess profits tax before the provision was repealed. There are other countries that have implemented windfall taxes on excess corporate profits of energy companies triggered by the Covid-19 pandemic. These include the UK and the EU countries. In the UK, the initial duration of the windfall tax was for 2 years, starting from January 2023 before it was extended. Hopefully, Nigeria's case will remain a one -off.

Notwithstanding the above, there are many issues that the proposed implementation of the windfall tax will trigger, and these should be carefully examined before the enabling law is enacted. These include the following:

1. It is always important that any proposed change in tax law or policy be subjected to a period of technical consultation. This will provide government with the opportunity to obtain feedback from all stakeholders and timely address unintended consequences. We are not aware that any consultation of this nature has been held. We suggest that such consultation be carried out before the enactment of the proposed amendment.

2. Various reports have indicated that Government may realise about N6.2trillion from the windfall tax. However, there is no publicly available policy-costing document on this. This lack of transparency has been the bane of policy formulation in the country. It is always important that the public be presented with tax expenditure statement showing how much will be generated from the introduction of a new tax. It will also afford the public the opportunity to review the reasonableness of the assumptions underpinning

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the revenue target. Interestingly, available reporting also indicates that about 50% of the amount to be generated will be spent on recurrent expenditure! One would have expected that the money would be spent on a package of targeted measures to help support Nigerian households with the rising cost of living!

3. Nigeria's tax policy frowns at retroactive application of tax laws. It is, therefore, surprising, that the government has chosen to implement this windfall taxes retroactively. Moreover, many of these banks have submitted their tax returns for the 2023 financial years and have settled the resultant liability. The impact of this retroactive application may raise constitutional concerns as it may violate the principle of legitimate expectations. It will, therefore, not be surprising if the implementation leads to legal disputes and challenges. Retroactive tax laws can discourage investment as potential investors may perceive the Nigerian tax system as unpredictable. The uncertainty will make it challenging for businesses to anticipate their tax obligations and may be suspicious that the tax will be repeated in future. Today, it is the banking sector. Who says that it cannot be extended to other sectors tomorrow!

4. The proposed law imposes 50% tax on realised forex gains of banks. However, in their 2024 tax returns, these banks would have paid 30% income tax on such profits. The question, therefore, is whether such banks would only pay additional 20% on such profits. This needs to be clarified to avoid unnecessary disputes and double taxation; otherwise, the same income would be taxed twice.

5. Any business that holds monetary assets in foreign currency would have earned realised forex profits if such assets were settled during 2023. The question is why are only banks singled out for this treatment? One of the fundamental principles of the National Tax Policy is equity and fairness. The Tax Policy requires the Nigerian tax system to be fair and equitable and devoid of discrimination. Why would we need a tax policy that we cannot uphold?

6. Currently, banks are embarking on a recapitalisation drive to meet the minimum capital requirements stipulated by the Central Bank of Nigeria (CBN) in respect of the various banking licences. Given the strict definition of paid-up share capital, banks have very limited options for meeting the new capital requirements. Thus, the threat posed by the proposed windfall tax is an unnecessary distraction that the banks do not need at this time. It is, therefore, important that the Ministry of Finance engage with the CBN and the banks to critically evaluate the implications on the ability of the banks to raise capital. It is likely, that in the short term, the share price of these banks may be adversely affected.

7. One thing that is missing from the Amendment Bill is tax relief for the banks that will be subject to the windfall tax. Available evidence shows that anywhere a windfall tax has been introduced, it makes sense to introduce some form of tax relief, such as investment allowance, to cushion the impact. This will encourage the banks to spend and, in turn, accelerate economic growth. We, therefore, suggest that this be considered before the law is enacted.

8. It is important that there is proper monitoring and implementation of the windfall tax to ensure that the defined objectives are met. This will enable a review of the policy and necessary and timely adjustment when required. Otherwise, it will be business as usual.

While we may understand the reasons why the government has opted for the windfall tax on realised forex profits (which may be considered extraordinary and which are not due to any creative efforts but just unusual favourable market factors) of banks, we believe that it would have been able to secure the necessary buy-in of the banks if there had been adequate consultation from the outset. We do not think this is late though. We, therefore, recommend that Government engage with the CBN and the Bankers' Committee to agree possible changes as soon as possible. We suggest that the other issues highlighted above be taken into consideration before the Amendment bill is enacted.

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