TAX CONSIDERATIONS IN MERGERS AND ACQUISITIONS

Owing to changes in government policies and the current business climate in Nigeria, companies are required to be strategic in order to remain competitive, while also enhancing growth and profitability. Corporate restructuring or reorganisation is a critical tool required to achieve business efficiency and optimisation.

Corporate restructuring refers to any transaction whereby all or substantially all of the undertaking, property and assets of an entity becomes the property of another whether by way of arrangement, reorganization, consolidation, amalgamation, merger, continuance under any other jurisdiction of incorporation or otherwise for the purpose of earning higher profits, meeting business needs and remaining competitive.

In Nigeria, common forms of corporate restructuring range from capital reorganisations, business combinations, sale or purchase of assets and usually involves the use of legal structures, contractual agreements and statutory provisions.

While there are several reasons which may trigger a restructuring exercise, there are certain tax considerations which must be evaluated for an efficient restructuring exercise irrespective of the form of the said restructuring. In this article, the focus shall be on Mergers & Acquisitions being the most common form of restructuring in Nigeria.

MERGERS AND ACQUISITIONS

A merger is a voluntary consolidation of two or more entities into one new entity with a new ownership and management structure. A merger could be horizontal or vertical in nature. A vertical merger is achieved by the integration of two or more companies who are in different stages of a supply chain process for a common good or service in order to increase efficiency and gain business. A typical example will be an integration between a manufacturer of leather handbags and a supplier of leather used in creating handbags. Horizontal mergers are achieved by the integration of companies selling similar products/services with the aim of reducing competition while also increasing the product range and revenue of the newly formed entity.

An acquisition on the other hand, involves a company absorbing another company into itself such that the latter ceases to exist. The shareholders of the ceasing company are either paid off or issued shares in the acquiring company. An acquisition could also be horizontal or vertical in nature.

TAX CONSIDERATIONS

The approach to adopt in a Merger & Acquisition (M & A) largely depends on the legal status of the company. As such, there shall be references to several statutory and regulatory requirement as provided in the Companies and Allied Matters Act, Investment and Securities Act, Securities and Exchange Commission Rules amongst others.

However, we shall be enumerating the tax implications to consider before the implementation of an M & A which include the following:

1) APPROVAL FROM THE TAX AUTHORITY

Section 29 (12) of the ***Companies Income Tax Act*** provides that

"No merger, take-over, transfer or restructuring of the trade or business carried on by a company shall take place without having obtained the Board's direction under subsection (9) of this section and clearance with respect to any tax that may be due and payable under the Capital Gains Tax Act."

The import of the above provision is that the Federal Inland Revenue Service must be informed of all M & A transactions prior to commencement and the FIRS shall typically issue an approval-in-principle upon being satisfied with a proposed M & A arrangement.

2) APPLICATION OF COMMENCEMENT AND CESSATION RULES

UNRELATED PARTIES

In an M & A arrangement involving unrelated parties, the old and new businesses are regarded as distinct and as such, the commencement and cessation rules under ***Section 29 (9)*** of ***CITA*** becomes applicable to the surviving and ceasing company respectively.

Similarly, in an acquisition arrangement, cessation rules shall apply to the acquired entity which ceases to exist and cessation tax returns shall be filed in this regard.

It is worthy to note that the commencement and cessation rules as provided for in Section ***29 (3) & (4)*** of ***CITA*** was modified by the ***Finance Act 2019*** as they often resulted in double taxation of profits earned in one or more financial years of a company. The implication of the modification is that companies will now be able to prepare and file tax returns in their first, second and third years of assessment based on their first, second and third sets of financial statements i.e. according to their accounting periods. Assessable profits of a company for the purpose of cessation taxes shall now be the amount of profits from the beginning of the accounting period to the date of cessation.

RELATED PARTIES

Section 29(9) of ***CITA*** contemplates corporate reorganisation between related parties. It provides to the effect that where a trade or business carried on by a company is sold or transferred to a Nigerian company for the purpose of better organisation of that trade or business or in the transfer of its management to Nigeria and any asset employed in such trade or business is sold or transferred, tax exemptions such as exemption from the application of the commencement and cessation rules will be granted provided that one of the companies has control over the other or both companies are controlled by some other person or are members of a recognized group of companies.

In its to bid to reduce tax risks associated with corporate reorganisations, ***the Finance Act 2019*** modified ***Section 29((9)*** of ***CITA*** by providing that tax exemptions will be applicable on corporate reorganisations between related parties subject to a new condition called the "minimum holding period". This means that related parties must have been so related for a consecutive period of at least 365 days prior to the date of the reorganisation and an acquiring company cannot make a subsequent disposal of assets acquired within the succeeding 365 days after the date of the transaction. In the event that this occurs, any tax concession applicable under ***Section 29*** of ***CITA*** shall be rescinded and the companies shall be treated as if they did not qualify for the concession ab initio.

Section 17 of the ***Petroleum Profits Tax Act*** (PPT) also contemplates corporate restructuring between companies engaged in petroleum operations. The provision of this section is similar to that contained in Section 29 (9) of the CIT Act.

Under the PPT Act, business reorganizations between related parties enjoy certain reliefs including the transfer of assets at no risk of balancing charge exposure. Furthermore, where the transferee company (only) has yet to commence sale of oil in commercial quantity, the first accounting period of the combined entity would be deemed to commence on the transaction date or any day in the month of the transaction. This is subject to the approval of the tax authorities.

3) UNUTILISED CAPITAL ALLOWANCE, TAX LOSSES AND WITHHOLDING TAX CREDIT

UNRELATED PARTIES

Considering that the surviving entity in an M & A arrangement involving related parties will be said to have commenced a new business, the company will be entitled to claim all capital allowances (initial, annual and investment allowances). This also implies that any unutilised capital allowances, tax losses or withholding tax credit of the former entities cannot be taken over by the new company.

RELATED PARTIES

Where the M & A arrangement involves related parties, in which the commencement and cessation rules are not applicable, the surviving entity, in terms of capital allowance, shall only be entitled to annual allowance based on the tax written down value of the assets taken over. This is in line with the provisions of ***Section 29 (9) (b) & (c)*** of ***CITA***. This further implies that since a new company is not formed, all relevant outstanding tax assets such as unutilised capital allowance, unrelieved tax losses, unutilised withholding tax credit of the acquired or merging entities will be transferred to the surviving entity for subsequent usage.

4) CAPITAL GAINS TAX IMPLICATIONS

Typically, In an M & A arrangement, the shareholders of the acquired/merging entities are settled with the issue of shares in the surviving entity or payment of cash or a combination of both. Upon disposal of their shares by the shareholders, capital gains tax naturally arises. However, ***Section 30*** of the ***Capital Gains Tax Act*** provides that

"*Gains accruing to a person from disposal by him of Nigeria Government securities, stocks and shares shall not be chargeable gain under the Act*."

Section 32 of the ***Capital Gains Tax Act*** prior to amendment provided that

"*A person shall not be chargeable to tax under this Act, in respect of any gains arising from the acquisition of the share of a company taken over or absorbed or merged by another company as a result of which the acquired company loses its identity as a limited liability company, provided that no cash payment is made in respect of the shares acquired.*"

A combined reading of these provisions provides that the disposal of shares by shareholders arising as a result of an M & A shall be exempt from capital gains tax however ***Section 32,*** as it then was, included a proviso to the effect that for the exemption to be applicable, there must have been no cash payment in respect of the shares acquired. This is contradictory to the provision of ***Section 30*** of the Act.

In resolving this contradiction, the Finance Act 2019 deletes the entirety of ***Section 32*** of the ***Capital Gains Tax Act*** not only for being contradictory but also for being redundant in nature. Shareholders of acquired/merged entities who receive settlement for their shares should not be subjected to capital gains tax simply on the grounds that the means of settlement is cash. This could easily lead to a witch hunt or targeting of shareholders by the tax authorities for disposal of shares resulting in cash.

The Finance Act 2019 goes further to insert a new Section 32 which is in line with the provisions of Section 29 (9) of CITA as amended. The new Section 32 contemplates corporate reorganisation between related parties and provides that no tax shall apply under the Capital Gains Tax Act to such controlled transactions subject to satisfying the "minimum holding period" requirement.

5) APPLICABILITY OF TRANSACTION TAXES: STAMP DUTIES, WITHHOLDING TAX AND VALUE ADDED TAX

STAMP DUTY

Pursuant to ***Section 104*** of the ***Stamp Duties Act***, transfer of shares pursuant to an M & A is exempt from stamp duty. ***Section 105*** of the Act subsequently provides that the transfer of property between related parties will not be liable to stamp duty. However, stamp duty will be applicable on an increase in share capital with the Corporate Affairs Commission with respect to the M & A. Also, instruments such as agreements, documents, and stocks are liable to stamp duty at the rate prescribed in the Stamp Duty Act.

VALUE ADDED TAX

Prior to the Finance Act, there were no existing provisions in the VAT Act concerning the transfer of assets in an M & A arrangement. As such, taxpayers undergoing a reorganisation sought the approval of the tax authorities for an exemption from transaction tax – VAT in this case, on the basis of ***Section 2*** of the ***VAT Act*** which provides that VAT shall be chargeable on the supply of taxable goods and services. Considering that an M & A transfer/disposal does not constitute the supply of taxable goods and service, VAT should not be applicable on the purchase consideration.

The Finance Act 2019 provides for a new ***Section 42*** of the ***VAT Act*** which is in line with the provisions of Section 29 (9) of CITA as amended and Section 32 of the CGT Act as amended. The new Section 42 also contemplates corporate reorganisation between related parties and provides that no tax shall apply under the Value Added Tax Act to such controlled transactions subject to satisfying the "minimum holding period" requirement.

With respect to the application of VAT in M & A arrangements between unrelated parties, parties may still have to seek the approval of the tax authorities for an exemption in this regard as the tax authorities may take the view that the transaction is not specifically exempted by the VAT Act.

Payments made for professional services with respect to M & A arrangements are liable to VAT.

WITHHOLDING TAX

M & A arrangements constitute a capital transaction and as such, withholding tax shall not be applicable in this regard. However, payments made for professional services with respect to M & A arrangements are liable to WHT.

6) POST MERGER TAX LIABILITIES

Section 29 (9) (c) i of ***CITA*** provides that

"the board in its discretion may require either company directly affected by the any such direction which is under consideration by the board to guarantee or give security to the satisfaction of the board, for payment in full of all tax due or to become due by the company selling or transferring such asset or business."

It is of paramount importance to identify the party responsible for the outstanding tax liability of the acquired or merging entities. It is recommended that a tax due diligence is conducted to identify any potential tax exposure with respect to the M & A arrangement as this may have an effect on the purchase consideration.

CONCLUSION

Neglecting tax considerations in an M & A arrangement can significantly derail the benefits sought to be derived from the exercise as the emerging entity may be saddled with excessive tax exposures. As such, while it is important to pay attention to the corporate finance and legal aspects of an M & A, tax considerations should also be given commensurate attention.

The Finance Act has, to a large extent, changed the tax environment for corporate reorganizations as contemplated in Section 29 (9) of the CIT Act by its inclusion of provisions that recognise corporate reorganisations in the VAT and CGT Act subject to the principle of the minimum holding period. This in turn has reduced the uncertainty and tax risks associated with M & A arrangements as taxpayers are aware of the tax neutrality or otherwise of the different forms of corporate reorganisation. This portrays the Nigerian business environment as attractive to investors (both local and international).

In view of the continuous evolution of the Nigerian tax laws, taxpayers are advised to seek professional advice on the tax considerations in an M & A and other forms of corporate restructuring in order to make informed decisions in this regard.

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