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TAX UPDATE

Expiration of the 10-year Tax Exemption for Corporate and Supranational Bonds and Government Debt Securities

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Background

For the last couple of years, Nigerian issuers of bonds expected that the 10 year income tax exemption for certain classes of bonds which was granted in December 2011, would be renewed before its expiry date of 1st January 2022. That expectation did not, eventually, come true! The exemption, therefore, expired with effect from 2nd January 2022 as set out in the enabling order without any renewal or extension. The exemption was granted by the Federal Government of Nigeria ("**FGN**") pursuant to the Companies Income Tax (Exemption of Bonds and Short-Term Government Securities) Order, 2011 (the "**Order**"). It was aimed at boosting investment in debt instruments in the Nigerian capital market and bring the treatment of State Governments, corporate and supranational bonds on an equal tax footing as bonds issued by the FGN.

The Order exempted from Companies Income Tax ("**CIT**"): (a) short term FGN securities, such as treasury bills and promissory notes; (b) bonds issued by corporate bodies (including supranational bonds); (c) bonds issued by Federal, State and Local Governments and their agencies; and (d) interests earned by holders of the bonds and short-term securities listed in (a) to (c). Other than in relation to bonds issued by the FGN, the exemption was granted for a 10-year period from 2nd January 2012 to 1st January 2022.

Expiration of the Exemption

Based on the foregoing, with effect from 2nd January 2022, interest income earned by holders of bonds issued by corporates, supranationals, and State Governments will be liable to the tax. In relation to short-term securities issued by the FGN, such securities are usually issued at a discount and not liable to the withholding of tax ("**WHT**"). Consequently, interest income on existing and subsequent corporate, supranational, and State Government debt instruments due to corporate bondholders will now be subject to **WHT**. Consequently, such issuers now have an obligation to withhold tax on interest payments and remit to the Federal Inland Revenue Services except where specific exemptions exist in the case of supranational issuers.

Pension Funds Investments

Notwithstanding the expiration of the relevant Order, income on the investment made with pension funds/assets will continue to be exempt from tax. This is because pension funds invested in bonds and short-term government securities by Pension Fund Administrators ("PFA") are exempt from tax pursuant to the Pension Reform Act, 2014.

Individual Bond Holders

The expiration of the Order does not affect holders of the affected instruments who are individuals. This is because the exemption granted by the Personal Income Tax

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(Amendment) Act, 2011 to holders of the instruments who are individuals has no expiration date. Thus, investments made by individuals in the bonds and securities will continue to be exempted from personal income tax. Issuers will have no obligation to withhold tax on interest payments to individual holders of such instruments.

Value Added Tax on Debt Instruments

The Value Added Tax (Exemption of Proceeds of the Disposal of Government and Corporate Securities) Order, 2011 also exempts from Value Added Tax ("**VAT**") proceeds from the disposal of short-term securities and bonds issued by the Federal, State, and Local Governments as well as corporate bonds (including supranational bonds) for a period of 10 years, commencing from 2nd January 2012. The limited 10-year exemption period for VAT does not apply to bonds issued by the FGN. Notwithstanding that this order in respect of VAT has also expired, the exemption is effectively preserved as the Finance Act, 2020 expressly, through its definitions of vatable goods and services, excludes and exempts money and securities from VAT.

Impact on Existing Bonds.

The impact of this development on corporate holders of existing bonds should be fairly limited as issuers generally included gross-up provisions in the issuance documents. The effect of such provisions is that the issuers will have an obligation to gross-up interest payments to holders and to make such payments in full to the relevant holders as if no tax was withheld. These gross-up provisions will generally protect corporate bondholders in respect of instruments issued by corporates, supranationals, and State governments. Holders of such instruments that are individuals or PFAs will be able to rely on the exemptions that continue to apply to them pursuant to the enabling statutes and issuers will neither withhold tax on nor need to gross up, interest payments to such holders.

This update is for general information purposes only and does not constitute legal advice. If you have any questions or require any assistance or clarification on how this update could apply to you or your business or require litigation advice on any aspect of the Nigerian laws, please contact capitalmarketsteam@uubo.org or taxteam@uubo.org.