

Share Buyback Scheme and Contemporary Tax Treatment: An Overview

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ABSTRACT

This paper briefly examines the concept of sharebuy back scheme in Nigeria and the extant position of the Nigerian Law as regards the transaction. The present writer essentially places emphasis on an in depth analysis and examination of the tax implications of the transaction from the perspectives of the tax treatment models in other jurisdictions, particularly the United States, United Kingdom and Canada. From the comparative analysis from the above mentioned jurisdictions, the writer further analyses the present position of the extant Nigerian tax statutes on the possible tax treatment of share buyback in Nigeria. It then finally recommended the possible incorporation and adoption of the tax treatment models from other similar jurisdictions examined to the Nigerian tax environment.

1.0 INTRODUCTION

Share buyback¹ has, over the years, been recognised as a viable and legitimate corporate management tool adopted by the directors and managers of a company to return substantial value to its shareholders. In this light, the essence of the share buyback scheme is succinctly exemplified by Warren Buffet in the following words;

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¹ otherwise referred to as Share repurchase or Stock buyback

When companies with outstanding businesses and comfortable financial positions find their shares selling far below intrinsic value in the market place, no alternative action can benefit shareholders as surely as repurchases²

Thus, it is increasingly adopted by companies as a standard means of returning value to its shareholders in the stead of making direct payment of dividends to its shareholders.³ Though the practice of share repurchase appears novel in the Nigerian capital market, it has been widely practised in more advanced economies⁴. The first reported share buyback programme in Nigeria was that undertaken by the Custodian and Allied Insurance Plc.⁵

Essentially, corporate managers and directors are usually confronted with the vexed question of what they should use an excess cash that accrues to the company in an accounting year to

² Barkshire Hartworth 1984 Annual Report cited in Anthony Idigbe “ Legal Implications of Share Buyback” *Being a Paper prepared jointly with Okorie Kalu Esq., Senior Associate PUNUKA Attorneys & Solicitors and delivered at CAMCAN 2008 Training Programme, Conference Hotel, Ijebu-Ode, Ogun State on the 16th November, 2008*

³ The usual method adopted by firms to pay cash to its shareholders is to declare a cash dividend to its shareholders. However, an alternative and increasingly popular method is to repurchase its own stock or shares. In the United States, during the period of 1973-1974, the government imposed a limit on dividends but it forgot to impose a limit on share repurchase. Thus, many firms discovered share repurchase for the first time and the total value of repurchases swelled to about a fifth of the value of dividend payments. See Richard A. Brealey and Stewart C. Myers “*Principles of Corporate Finance*” 5th ed., (The MacGraw Hill Company Inc), p.419.

⁴ In some countries, including the United States and the United Kingdom, corporations can buy back their own stock in a share repurchase or share buyback. There has been a meteoric rise in the use of share repurchases in the U.S in the past twenty years, from \$5b in 1980 to approximately \$349b in 2005. See also Proshare, “Sharebuyback! Is it a viable option for companies?” available at <https://www.proshareng.com/articles/Archives/share-buyback!-is-it-a-viable-option-for-companies/1805>, (accessed 11 December 2016).

⁵ See Proshare “Custodian Announces Nigeria’s first sharebuy buy-back”, <https://www.proshareng.com/Custodian-announces-Nigeria-s-first-share-buy-back/9279>, (accessed 11 December 2016)

do. Faced with this situation, there are basically two capital allocation or deployment options open to them, namely capital budgeting or investment decision,⁶ on the one hand, and return of cash to their investors on the other.⁷ Share Buyback thus represents one of the many viable options of returning cash and value to the shareholders by the company.

In light of the above background fact that share buyback is a viable profit-distribution scheme and the increasing preference for the programme by many a company, this paper focuses on the analysis of the concept in light of the existing position of the Nigerian law; specifically reviewing tax treatment models of such transactions by way of a comparative analysis with other jurisdictions particularly the United States and United Kingdom. Understanding the tax treatment models in these jurisdictions will greatly assist in proposing a model to be adopted in the Nigerian tax environment.

Therefore, Part I of this paper introduces the concept, Part II analyses the different arguments for and against the concept. In Part III, the writer examines the various methods of share buyback, while Part IV looks into the position of the Nigerian Law on Share buyback under both the Companies and Allied Matters

⁶ The capital budgeting or investment decision involves investment via capital spending, working capital, mergers and acquisitions (i.e. re-injection of capital into the business for further growth);

⁷ Return of cash to stakeholders includes equity capital providers (dividends or share buyback), debt capital providers (secured and unsecured creditors through debt repayment) and other stakeholders such as management & employees (executive compensation, stock options or “golden parachutes”, employees’ stock options).

Act(CAMA)⁸ and the Consolidated Rules of the Securities and Exchange Commission 2013. Part V considers the tax treatment and implications of share buyback within the jurisdiction of United States, United Kingdom and Canada whilst Part VI examines the taxability of the Share buyback under the existing fiscal regime in Nigeria as well as incorporating the lessons from the tax treatment approaches in the jurisdictions examined. This paper concludes with the suggestion that the fiscal regime be amended to incorporate and align with the existing tax treatment models from the jurisdictions analysed

2.0 THE CONCEPT OF SHARE BUYBACK

The concept of share buyback is simply the acquisition by a company of its own shares from its shareholders.⁹ In other words, a share buyback refers to the repurchasing of shares by the company that issued them. Essentially, a buyback occurs when the issuing company pays a shareholder the market value per share and re-absorbs that portion of its ownership that was previously distributed among public and private investors.¹⁰

⁸ Cap 59 Laws of the Federation of Nigeria(LFN) 2004

⁹ Further to the above, A buyback evokes the idea of a company using its cash to buy its own shares, in other words, investing in itself. See Anthony Idigbe “ Legal Implications of Share Buyback” *Being a Paper prepared jointly with Okorie Kalu Esq., Senior Associate PUNUKA Attorneys & Solicitors and delivered at CAMCAN 2008 Training Programme, Conference Hotel, Ijebu-Ode, Ogun State on the 16th November, 2008,*

¹⁰ In specific terms, The Head, Investment Banking, Sub-saharan Africa and Financial Institutions- Africa for Merrill Lynch, Mr Michael Larbie, defined share buy-back as the repurchase by a company of its own shares in the market. The bought shares are either cancelled or retained as treasury shares in order to be able to re-sell them or allocate them to fulfill stock options or to otherwise avoid issuing new shares. See Omoh Gabriel and Peter Egwuatu “ Share

Generally, where a company buys back its own shares, it effectively shrinks its issued share capital¹¹ by reducing the number of shares held by the public, such that even if the profits of such company were to remain the same, the company's earnings per share would increase.

3.0 ARGUMENTS FOR AND AGAINST SHARE BUYBACK SCHEME

Several arguments and postulations have been proposed in favour of and against the sharebuyback scheme, by its proponents and antagonists, respectively.

Proponents of share buybacks have argued that there is a need for quoted companies to reduce their shares and create scarcity, revive the stock market and ensure that value is given to investors. Further to this, it has been argued that buy back of shares allows a company to return to shareholders surplus cash that the company itself is unable to invest efficiently in profitable

reconstruct and the shareholder- What next?" Proshare, June 30, 2008, available at <<https://www.proshareng.com/news/investors%20NewsBeat/Share-reconstruction-and-the-shareholder---What-next-/4447>>, (accessed 12 December 2016). see also "Why would a company buy back its own shares" available at <http://investopedia.com/ask/answers/042015/why-would-company-buyback-its-own-shares.asp>, (accessed 7 December 2016)

¹¹Issued Share Capital is the portion of the authorised share capital which has been subscribed or issued to shareholders and the expression "issued share capital" when used in relation to a reduction of share capital includes the share premium account and any capital redemption reserve account of a company; See Section 105(2) of CAMA. The issued share capital must not be less than twenty five percent of the authorised share capital see section 99 of CAMA; See generally, Hon. Dr. J. Olakunle Orojo "*Company Law and Practice in Nigeria*", LexisNexis, Fifth Edition, Pg. 116.

investment projects and also assists a company to bolster or stabilise the market price of its shares.¹²

In addition, Vice President, Financial Markets International Incorporated, United States, Mr Peter Levine noted that share repurchase can be used to increase financial leverage in particular by underleveraged companies. He further stated that companies buy back their shares to eliminate an undesirable major shareholder, to defend against an actual or threatened take-over proposal¹³, inhibit potential corporate raiders from accumulating shares in the open market, remove market overhang and increase the percentage of ownership of the remaining shareholders.¹⁴

On the other hand, the antagonists to the scheme have equally and vehemently argued that the scheme gives room for unscrupulous managers and promoters of companies to perpetrate fraud by creating an artificial buoyancy of the shares of companies, and ultimately fuels dangerous speculative trading of

¹² See Ellis Ferran & Look Chan Ho, *Corporate Finance Law*, 2nd ed., (Oxford University Press, Great Britain 2014), pp.179-183, Joseph Onele "What is Illegal about share buybacks in Nigeria", available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2731858, (accessed 12 December 2016).

¹³ This works in instances of greenmail transactions in which the target of a takeover attempt to buy off the hostile bidder by repurchasing shares that it has acquired. "Greenmail" means that these shares are repurchased by the target at a price which makes the bidder happy to agree to leave the target alone. This price does not always make the target's shareholders happy; See generally Richard A. Brealey and Stewart C. Myers "*Principles of Corporate Finance*" 5th ed., (The MacGraw Hill Companies Inc). p.420.

¹⁴ See Omoh Gabriel and Peter Ekwuatu "Share reconstruction and the shareholder- What next?" June 30 2008, Proshare, available at <https://www.proshareng.com/news/investors%20NewsBeat/Share-reconstruction-and-the-shareholder---What-next-/4447>, (accessed 12 December 2016)

shares by repurchasing those shares with loans.¹⁵ It is further argued that share buyback may result in a company becoming highly geared (a situation where amount of debt is much higher than equity), the immediate effects being insolvency risk and financial distress costs, which collectively undermine the shareholders value and interest in the company.¹⁶

In spite of the arguments for and against the share buyback scheme, it appears that the share buyback will enhance wealth creation and, in practical effect, broaden the Nigerian capital market. It is therefore worth adopting as a principal method of distributing excess cash back to the shareholders of the company.

4.0 METHODS OF SHAREBUYBACK TRANSACTION

Share buyback can be effectuated through the various methods accepted by clear economic standards and sanctioned by the provisions of the law over a long period of time. In this respect, the various methods of share buyback particularly adopted in the United States, include the following;

4.1 Open Market Programme:

This is the prominent method. It is a form of share buyback which is carried out on the open floor of the stock exchange at the prevailing or current price. The implementation of this form of share buybacks is subject to various rules and regulations of the

¹⁵ see Thisday “Endless Wait for Share Buy-back”, available at <<http://www.thisdaylive.com/endless-wait-for-sharebuyback>>”, (accessed 12 December 2016)

¹⁶ Supra note 14.

Securities and Exchange Commission which set limits on the time, price, volume and number of brokers on a daily basis.

4.2 Self Tender offer:

Self-tender offer is done with either fixed price or Dutch auction. In a self-tender, a company specifies a number of shares it is prepared to buy-back and specifies either a fixed price or a range of prices in Dutch auction that it is prepared to pay for the shares. In this case, the company usually engages the service of investment bankers or stockbrokers to manage the tender and pays a special commission to brokers who persuade shareholders to purchase them.

4.3 Private Transaction:

This method takes the form of a direct negotiation with a major shareholder of the company. Thus, the company buys back shares directly from a shareholder away from the Open Market at a negotiated fixed or formula price.

4.4 Exchange Offer:

Here, a company offers shares its ownshares in another public company or offers another class of its own securities in exchange for common shares of company.¹⁷

It is noteworthy to state at this juncture that the Consolidated Rules and Regulations of the Securities and Exchange Commission (SEC) 2013 applicable in Nigeria only recognise two methods of a

¹⁷ Supra note 13, and Supra note 3, p.420

sharebuyback transaction which are Self-tender Offer and Open-market Programme.¹⁸

5.0 SHARE BUYBACK AND THE NIGERIAN LAW

5.1 Position Under the Companies and Allied Matters Act

There is popular misconception that share repurchase is absolutely prohibited by the Nigerian law. The popular misconception arose from the wordings of the provisions of s. 160(1) of the *Companies and Allied Matters Act*¹⁹ which states that “subject to the provisions of subsection (2) of this section and its articles, a company may not purchase or otherwise acquire shares issued by it.”²⁰

An analysis of the entire provisions of the Companies and Allied Matters Act would suggest otherwise. As it stands today, the Nigerian law is quite liberal on repurchase of its own shares by a company. This is borne out of the expediency of modern business

¹⁸ See Rule 398(3) of the SEC rules 2013

¹⁹ Cap C21, Laws of the Federation of Nigeria, 2004. It is the current operative corporation law legislation in Nigeria which regulate the formation, incorporation, management, administration, winding-up and dissolution of companies in Nigeria. For ease of reference, (Hereinafter referred to as CAMA).

²⁰ This statutory position is a direct directive of the common law position as laid down in the celebrated case of *Trevor and Anor v. Whitworth and Anor* (1887) 12 App Cas 409. Here, a limited liability company was incorporated with the objects of acquiring and carrying on a manufacturing business, and any other businesses and transactions which the company might consider to be in any way conducive or auxiliary thereto or in any way connected therewith. The articles authorised the company for the balance of the price of his shares sold by him to the company before the liquidation and not wholly paid for. The House of Lords, in reversing the decision of the Court of Appeal held that such a company had no power under the Companies Act to purchase its own shares and that the claim must fail.

practices which dictates that absolute prohibition of share buy-back by companies will do more harm than good. Hence, government intervened through the enactment of comprehensive rules and regulations. As a result, section 160(2) of CAMA provides for the exceptional circumstances in which a buyback by a company will be permissible. Under this section, a company whose articles of Association allow it to buyback its own shares, shall only execute such buyback under any one of the following prescribed situations;

- a) Settling or compromising a debt or claim asserted by or against the company
- b) Eliminating fractional shares²¹
- c) Fulfilling the terms of a non-assignable agreement under which the company has an option or is obliged to purchase shares owned by an officer or an employee of the company
- d) Satisfying the claim of a dissenting shareholder
- e) Complying with a court order

In the same vein, **S.158** of **CAMA** provides that a company shall buy back its own shares for the purpose of redemption of redeemable preference shares.²²

The Act specifically set outs conditions to be fulfilled by the company before it can purchase its own shares. S.161 of CAMA accordingly provides that, notwithstanding any provision in the

²¹ Fractional shares are shares of equity that is less than one full share. Fractional shares usually come about from stock splits, dividend reinvestment plans(DRIPS) and similar corporate actions. Normally, fractional shares cannot be acquired from the market, and while they have value to the investor, they can be difficult to sell.

²² Redeemable preference shares are shares which can be redeemed at the option of the company either at a fixed rate on a specified date or over a certain period of time

articles, a company shall not purchase any of its own shares, except on compliance with the following conditions, that is:

- a) Shares shall only be purchased out of the profits of the company which would otherwise be available for dividends or the proceeds of a fresh issue of shares made for the purpose of the purchase.
- b) Redeemable shares shall not be purchased at a price greater than the lowest price at which they are redeemable or shall be redeemable at the next date thereafter at which they are due or liable to be redeemed;
- c) No purchase shall be made in breach of section 162 of this Act.²³

Furthermore, the Act set limits on the number of shares that can be acquired. Thus, no transaction shall be entered into by or on behalf of a company whereby the total number of its shares of any one class, held by persons other than the company or its nominees becomes less than eighty-five percent (85%) of the total number of shares, or of shares of that class which have been issued provided that:

- a) Redeemable shares shall be disregarded for the purpose of this section; and
- b) Where, after shares of any class have been issued, the number of such shares has been reduced, this section shall apply as if the number originally issued (including

²³ S.161 of the Companies and Allied Matters Act LFN ,CAP 21, Laws of the Federation of Nigeria ,2004

share of that class cancelled before the reduction took effect) had been the number as so reduced.²⁴

Any contract with a company providing for the acquisition by the company of shares in the company is specifically enforceable against the company, except to the extent that the company cannot perform the contract without thereby being a breach of the provisions of section 160 of this Act.²⁵ In any action brought on a contract referred to above, the company shall have the burden of proving that performance of the contract is prevented by the provisions of section 160 of this Act.²⁶

5.2 Position Under the Consolidated Rules of the Securities and Exchange Commission 2013

As a necessary supplement to the provisions of CAMA and in view of its overall regulatory and oversight functions in the Nigerian Capital market, the Securities and Exchange Commission (SEC) has enacted comprehensive provisions detailing the various rules guiding share buyback in the Nigerian Capital Market.

Thus, every public quoted company acquiring its own shares is required to file an application with SEC for the approval of such acquisition accompanied with detailed information about the

²⁴ S.162 of the CAMA, *ibid.*

²⁵ S.163(1) of the CAMA

²⁶ SI 63(2) of the CAMA

transaction including the company's latest audited financial statements.²⁷

Pursuant to Rule 398(3) SEC Rules 2013, every publicly quoted company acquiring its own shares is expected to comply with the following –

- a) The aggregate number of shares to be bought back shall not exceed 15% of its existing issued and paid-up equity capital in any given financial year
- b) An undertaking that no voting rights shall be exercised by the company or its nominee or trustee in respect of the acquired shares
- c) The Company and/or directors shall file details of the director's shareholding before and after the acquisition
- d) The resolution of the company authorising the share buy-back shall be special resolution as provided in the CAMA
- e) The notice of the general meeting to authorise the share buy-back shall be published in at least two national daily newspapers and evidence of publication shall be filed with SEC
- f) Shares shall only be purchased out of the profit of the company which would otherwise be available for dividends or the proceeds of a fresh issue of shares made for the purpose of the purchase. These shall be reflected in the latest audited accounts which shall not be more than nine(9) months old.
- g) The buy-back shall be either through the Open Market or through Self-Tender Offer
- h) The residual debt equity ratio shall not exceed 2:1 after the buy-back, the equity for this purpose is the shareholder's fund
- i) The buyback shall be a direct purchase made only by the company and the beneficiary shall be the company.

²⁷ Rule 398(1) and (2) of the Consolidated Rules of the Securities and Exchange Commission 2013

- j) The shares bought back shall be cancelled in accordance with the procedures set out in CAMA
- k) The maximum time allowed for the completion of the buy-back process shall not be more than twelve months from the date of the shareholder's resolution
- l) A declaration of solvency shall be filed with SEC by the Board of Directors of the company that they believe that the company would remain solvent in the foreseeable future.
- m) The buy-back shall not be made if the company is illiquid, that is, a company defaulting in payments of its obligations including dividend payment. A letter from the Auditors on the going concern status of the company shall be filed with SEC.
- n) For open market buy-back, the price of the shares to be bought back shall be at the current market price and for self-tenders offer, the price shall be determined by the Board of Directors and shall not be more than 5% above the average calculated market price over the last five(5) days.
- o) The company shall make a public announcement in at least two national daily newspapers, at least five days to the commencement of the program, disclosing relevant information to the public, such as proposed size, nature, duration and the potential impact on the company's financial position. A similar announcement shall also be made at the conclusion of the exercise.
- p) The company and the financial adviser shall file a monthly report not later than five(5) working days after the end of each month indicating the number of shares bought, the total amount paid, minimum and maximum price, and the number of shares cancelled
- q) Redeemable shares shall not be purchased greater than the lowest price at which they are redeemable or shall be redeemable at the next date thereafter at which they are due or liable to be redeemed.
- r) Any two buy-back programs shall be separated by a minimum of 365 days after the end of the preceding buy-back even where they are of different classes.
- s) The source of funding the buyback shall be disclosed

- t) After any buyback, the shareholders' funds of the company shall not fall below any legally prescribed minimum for the line of business
- u) For the purpose of the buy-back through open market, the company shall not use more than two stockbroking companies for each programme. The stock broking firm shall not be a subsidiary of the company
- v) The company shall file quarterly returns in respect of the acquisition and the disposal of same. Where the shares are held by nominees or trustees of the company, the particulars of the nominees or trustees shall be provided.²⁸

From the above reproduced provisions, it is crystal clear that only publicly quoted companies can buy back its own shares in the legitimate circumstances sanctioned by CAMA and in full compliance with all the conditions appropriately laid down therein. Once the above outlined conditions are complied with by the company, then it can engage in the repurchase of its own shares from its shareholders. It therefore goes to show that private companies can not engage in a share repurchase transactions.

6.0 SHARE BUYBACK TRANSACTION AND TAX TREATMENT

Generally, where there are buyback of shares by the company, there are specific tax consequences for shareholders but generally not so much for the company. On the part of the company, it is so because the company would neither realise gain nor loss, since

²⁸ Rule 398(3) SEC Rules 2013

the share buyback would not amount to either a sale or exchange but rather be very similar to a partial liquidation of the company.²⁹

Ideally, companies are only liable to pay corporation tax at the effective rate of 30% on any profits accruing to them in a particular accounting year. But it does not pay any tax where it merely distributes cash to the shareholders by way of share buyback otherwise than by dividends distribution.³⁰

Here, I examine the various tax treatment approach for share buyback from other jurisdictions, particularly the United States, United Kingdom and Canada.

6.1 The American Approach on the Tax Treatment of Share Buyback

As part of the Tax Treatment approach for share buyback in the United States from the shareholder's standpoint, the shareholder may be liable to pay capital gains tax on any profits accruing to him in situations where he sells the shares back to the company at a profit. Such profit is usually the difference between the cost of reselling the shares back to the company and the original issue price of the shares. Further, the amount of the tax payable and the

²⁹ Olumide K. Obayemi "Contemporary Tax Treatment of Redemption of Preference Shares" *This Day Lawyer* (2015), Page 6

³⁰ Noteworthy to state here that the issue of excess dividend tax rule still continues to rage on after the decision of the Tax Appeal Tribunal in the case of *Oando Plc v FIRS (Oando IV)* (2014) 16 TLRN 99 which overall implications amounts effectively to a taxation of the corporate income at the rate of 60%. This is due to the fact that the company pays tax of any dividend paid out of its retained earnings which has been previously taxed. For detailed analysis of the EDT rule, see generally, Dr Olumide K Obayemi "A Critical Analysis of the Excess Dividend Rule in Nigeria: *Oando Plc v Firs (Oando IV)* Revisited, *Gravitas Review of Business and Property Law*, March 2015, Vol 6 No. 1.

applicable tax rate depends on the shareholders income tax bracket and the length of time the shares were held. If less than 12 months, the short-term capital gains tax applies, and the shareholder will be taxed on any profits at ordinary income tax rates. If more than 12 months, the favourable long term rates would apply.³¹

From the company's perspective, share buyback is generally not a taxable event. Thus, the corporation pays no tax on any gains nor may it deduct any losses.³² This general rule is however subject to exceptions. Thus, if the company buys back shares with appreciated non-cash property (such as securities, real estate inventory, livestock), the Internal Revenue Service (IRS) may assess capital gains taxes on the transaction. The tax applies to any profits on the property or assets sold. From the service perspective, such transaction is equivalent to the company selling their assets for cash and then using the cash to buy back the shares. However, if the assets have declined in value, rather than appreciated, the company is not generally entitled to claim a capital loss on assets other than cash used to buy back the shares.³³

6.2 The United Kingdom Approach on the Tax Treatment of Share Buyback

³¹ As of July 2012, the maximum long-term gains rate is 15 percent, though the top rate was increased to 20 percent as of 2013 in the United States See Zacks Finance "How to treat Income from a Stock Buyback", available online at <http://finance.zacks.com/treat-income-stock-buyback-1460.html> (accessed 8 July 2017).

³² Section C032, Internal Revenue Service Code, United States, *ibid.* 30

³³ *Ibid.* 30

Though slightly similar to the position in the United States, the default position in the United Kingdom is that a buyback is taxed as a distribution to the extent that the price exceeds the original share subscription amount. If the shareholder is not the original owner of the shares, the distribution is still calculated by reference to the subscription price not the amount the current shareholder paid for the shares.³⁴

However, the buyback will automatically be taxed as a CGT event not an income distribution if a number of conditions are fulfilled. The conditions, in brief, are

- a) The company is an unquoted trading company or holding company of a trading group
- b) The shareholder is UK tax resident
- c) They have held their shares for at least 5 years
- d) They are not connected with the company after the buyback (more than a 30% interest)
- e) They reduce their interest in the company by at least 25% as a result of the buyback and
- f) The buyback is to benefit the trade. The test is subjective.³⁵

The tax treatment of sharebuyback in the United Kingdom is rather complicated and has been changed at various points in time. The complication arises from the fact that the United Kingdom has an imputation system, which is meant to reduce the double taxation of dividend. Under this system, shareholders receive credit for taxes paid by the company on earnings distributed as dividends and on the “distribution element” of

³⁴ Holly Bedford “Share Buybacks-Income Tax or Capital Gain?”, available at <http://share-buybacks-income-tax-or-capital-gain/> (accessed 22 July 2017).

³⁵ *Ibid.* 34

share buybacks. The distribution element is defined as the difference between the market value of the repurchased shares and the book value of the corresponding paid-in capital.³⁶

Considering the fact that there are more tax implications for individual shareholders in instances of share repurchases, the calculation of the taxes is thus dependent on the distinction between between an off-market repurchase (such as a repurchase tender offer or a private repurchase) and an on-market repurchase (or open market repurchase). The difference between the repurchase price and the original subscription price is defined as the distribution element. Thus, where the shareholder purchases the shares above the original subscription price, he would be subject to capital gains taxes.³⁷

In the case of on-market repurchase wherein the shareholder knows that the ultimate purchaser of the shares is the company itself. As he is selling to a market maker, his profit will be taxed as a capital gain, as no tax credit can be claimed.³⁸

6.3 The Canadian Tax Treatment Model

In Canada, the tax implications of sharebuyback scheme are quite similar to that of the United states. Thus, where a shareholder has his or her shares repurchased by the corporation in which such shares are held, the shareholder is deemed to have received a dividend equal to the amount by which the amount paid by the

³⁶ P. Raghavendra Rau, "Regulation, Taxes and Share Repurchases in the United Kingdom" *Journal Of Business*, p. 253

³⁷ *Ibid.* 36

³⁸ P. Raghavendra Rau, *ibid*, page 255 and 256.

corporation to repurchase the shares exceeds the paid-up capital of the shares repurchased. If the shareholder is a connected corporation, as that term defined in the ITA, the dividend may be received by the shareholder tax-free.

In certain circumstances, in particular in the context of a sale transaction, a repurchase of shares that would otherwise have resulted in a tax-free intercorporate dividend, as described above, may be recharacterised as a taxable capital gain.³⁹

7.0 EXISTING FISCAL REGIME IN NIGERIA: ANY NEW LESSONS .

As has been seen from the comparative analysis, it is crystal clear that the company may generally not be subject to tax in the event of a share buyback transaction except in certain exceptional circumstances. However, the tax consequences for the shareholders are always interspersed between the capital gains tax and the income tax (i.e., Personal Income Tax or Companies' Income Tax).

As pointed out in the United States tax treatment approach, the writer hereby suggests that the company should be ordinarily made subject to capital gains tax treatment under the Nigerian tax environment in instances where the company buys back the

³⁹ William Fowles, Ilam Braude, Brendo Ho, Regan O'Neil, Graham Purse and Stephen Rukavian, Miller Thompson "Tax on corporate transactions in Canada: Overview" Practical Law, A Thomson Reuters Lega Solution 2015, available at <<http://ca.practicallaw.com/5-503-2395?source=relatedcontent>> , (accessed 16 December 2016)

shares from the shareholders by an appreciated non-cash property.

The United Kingdom often treat sharebuyback as a distribution and thus subject the distribution to income tax except upon fulfillment of certain conditions wherein the tax treatment is assessed under the Capital Gains Tax. Thus, the Nigerian Fiscal environment can also take a cue from this position by treating any share buyback as a distribution provided that the amount of the repurchase exceeds the original subscription price notwithstanding the fact that the selling shareholder was not the original purchaser of the shares.

The tax consequences of share buyback can also be assessed from the perspective of the transaction structure adopted. Share buyback could be effectuated through self-tender offer, open market programme, private transaction or exchange offer. However, Rule 398(3) of the SEC rules 2013 recognises just self-tender offer and open-market programme. In the case of the self-tender offer, it is carried out as an off-market repurchase and the shareholder is aware that he is selling to the company. On the other hand, the open market programme is a form of an on-market repurchase and the shareholder is not aware that he is selling to the company as he would be selling to an intermediary who is acting as a principal.

In the case of an off-market repurchase, individuals may likely not be liable to capital gains tax as long as the individual's cost base is significantly below the paid-in capital per share. Where the

shareholder sells on market-it is deemed that he does not know he is selling to the company itself-to the market maker, his profit will be taxed as a capital gain, and no tax credit can be claimed. This position can also be made applicable to the Nigerian tax environment considering the two acceptable methods of effectuating the share buyback transaction and should be taxed accordingly in the manner stated above.

As stated above in Part V of this paper, a share buyback could also be effectuated through redemption of redeemable preference shares by the company under the provisions of CAMA in so far as the applicable conditions are accordingly complied with. Where such redemption has been consummated by the company, it would ordinarily be subject to Income tax, Value Added Tax and withholding tax at the applicable tax rates under the Nigerian Tax system.

Further, every consumer is mandatorily obliged to pay Value Added Tax (VAT) on services rendered to it.⁴⁰ Thus, fees paid to professionals for services rendered in connection with the share buyback (most especially in connection with the open-market repurchase) will be subject to value added tax and withholding tax

⁴⁰ Section 2 of the Value Added Tax Act states that “The Tax shall be charged and payable on the supply of all goods and services (In this Act referred to as “taxable goods and services”) other than goods and services listed in the First Schedule to this Act” .S.3 of the Value Added Tax Act Cap VI LFN 2004 further states that “There shall be exempt from the tax the goods and services listed listed in the First Schedule to this Act”. A careful read of the first schedule does not include fees paid for professional services as exempt from the chargeability to the Value Added Tax in Nigeria.

at the rate of 5% and 10% respectively under the applicable extant laws.

In also determining whether to subject the buyback of the shares to tax, it is vital to consider the location of the shares. The test for determining the location of the shares is set out in section 24(e) of the Capital Gains Tax Act⁴¹ which is to the effect that, in the case of shares, registered shares or securities are situated where they are registered and, if registered in more than one register, where the principal register is situated; the shares would be said to be situate in Nigeria if the shares are registered in Nigeria or the principal register in which the shares are registered is situate in Nigeria. In this sense, if it is accepted that the shares are situate in Nigeria, then any such share buyback would be subject to taxes under the Nigerian tax laws

In computing the appropriate tax payable on any share buyback transaction, it is apt to consider the exemption applicable to the securities to be disposed by the shareholder. Where the shares to be re-acquired by the company are tax-exempt, then they would ordinarily not be subject to capital gains tax. For instance, section 30 of the Capital Gains Tax Act provides that gains accruing from a disposal by him of Nigerian government securities shall not be chargeable to capital gains under this Act. Thus, where the shares to be acquired are that of government securities, they may likely not be subject to capital gains tax.

8.0 CONCLUSION

⁴¹ Cap C1, LFN 2004

We must note that share buyback transaction is not a frequent business activity in Nigeria. It has become a subject of intense debate on whether it is illegal or not, whether it is permitted or prohibited by our laws or not, it is nevertheless important to examine, in clear terms, the various existing rules for its tax treatment or implications to provide a relevant and practical guide for companies and professionals interested in exploring the concept as a viable corporate management tool to deliver more value to their shareholders with a view to planning adequately for the tax consequences. It is also evident that there have not been clear guidelines by the relevant tax authority on the tax treatment in its various circulars for the contemporary tax treatment of a share buyback transaction. The comparative analysis undertaken in this paper should provide a reliable guide in formulating the right tax treatment principles. It is expected that relevant guidelines and rules would be issued and published by the relevant tax authorities in the near future.

On a final note, it is hereby proposed that the tax treatment models analysed from other jurisdictions be adopted and aligned alongside the existing fiscal regime for share buyback in Nigeria.