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ABSTRACT

This article delves into the complexities of dividend taxation in Nigeria, focusing on the impact of recent legislative amendments and administrative interpretations. Specifically, it examines the historical application of Excess Dividend Tax (EDT) and the subsequent changes introduced by the Finance Act 2019. The article critically analyses the Federal Inland Revenue Service's interpretation of these amendments as outlined in the FIRS Information Circular 2020/04. By comparing the legislative intent with the FIRS's administrative stance, the article highlights potential inconsistencies and the resulting uncertainty for taxpayers. It further explores the implications of recent Tax Appeal Tribunal decisions, which have introduced new interpretations of the law. The article concludes by providing recommendations for taxpayers and policymakers to navigate this evolving landscape and ensure compliance with the evolving tax laws.

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1.0 INTRODUCTION

Dividends are a proportion of the distributed profits of a company which may be a fixed annual percentage, as in the case of preference shares, or a variable percentage according to the fortunes or other circumstances of the company, as in the case of equity shares.[1] By law, dividends are payable to shareholders only out of the distributable profits of a company.[2] Therefore, where a company makes a profit in an accounting year for which tax has been paid, the company may elect to declare and distribute profits to its shareholders as dividends.

A company earning profit in an accounting year may resolve to retain its profits in its retained earnings account depending on the needs of its business. This retained sum may then be reinvested in the business of the company or distributed in another year as dividends to shareholders. Because dividends can only be distributed out of the profits of a company, many companies distribute dividends out of their retained earnings in a year in which the company generated no profit. In other cases, companies pay dividends out of their retained earnings in addition to dividends payable out of a company's profits for the current year where the profit of the current year is insufficient to cater to the declared dividends.

The Companies Income Tax Act (CITA)[3] has rules governing the taxation of dividends paid out of retained earnings. Specifically, prior to the amendment of section 19 of the CITA, where a company pays dividends in any year and such dividends exceed the

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[1] Section 868, Companies and Allied Matters Act (CAMA) 2020 Cap. A18, Laws of the Federation of Nigeria, 2004.
[2] Section 426 (5), CAMA 2020.
[3] The Companies Income Tax Act (CITA), 1977 Cap C 21, Laws of the Federation of Nigeria, 2004.

company's taxable profits for the same year or the company has no taxable profits in the year that it declared the dividends, the dividends to be distributed will be subject to tax as though it is the actual profits of the company for the relevant year of assessment. This is known as Excess Dividend Tax (EDT). This effectively created a situation of double taxation of dividends distributed from retained earnings of a company given that such income which has been taxed in the previous year is further subjected to EDT. This effect, it appears, is contrary to the intent of section 19 of CITA. The policy and legal thrust of section 19 of the CITA was to institute an anti-avoidance mechanism, preventing situations where a company claims to have made no profit to avoid tax but declares dividends. To remedy the unintended consequences of section 19 of the CITA, the Finance Act 2019 amended section 19 of the CITA and exempted, amongst others, dividends paid out of retained earnings which have already been subject to companies' income tax, dividends paid out of tax-exempt income, dividend paid out of franked investment income, and distributions made by a real estate investment company to its shareholders from rental income and dividend income received on behalf of those shareholders.[4]

Despite the legislative effort to address the implication of Section 19 of the CITA, the Federal Inland Revenue Service (FIRS) while intending to clarify the amendment introduced by the FA 2019 issued information circular no: 2020/04 - "Clarification on Sundry Provisions of the Finance Act 2019 as it Relates to the Companies Income Tax Act"[5] (the "FIRS Circular") giving a divergent interpretation. In the FIRS Circular, the

[4] Section 7, Finance Act 2019.
[5] Federal Inland Revenue Service, "Clarification on Sundry Provisions of the Finance Act 2019 as it Relates to the Companies Income Tax Act" available at https://old.firs.gov.ng/wp-

FIRS stated that “in determining whether a dividend has been paid out of retained earnings for the purposes of section 19(1) exemption, profits of the current year disclosed in the financial statements shall be considered first.” Thus, where a company pays dividends out of its retained earnings, the FIRS will levy tax on that income if the company did not pay the dividends first, out of the profits of the current year before taking from the retained earnings.

In view of the provisions of the Finance Act 2019 vis-a-vis the FIRS Circular, it is doubtful whether the FIRS Circular is legal. On its part, the Tax Appeal Tribunal (TAT) has delivered decisions since the introduction of the amendment of Section 19, one of which appears to be a departure from previous decisions and the historical interpretation of Section 19 of the CITA. This article analyses the pre- and post-amendment implications of the Excess Dividend Tax, decisions of the TAT, and why the FIRS Circular may not represent the accurate position of the law.

2.0 EXCESS DIVIDEND TAX PRE-FINANCE ACT 2019 AND FINANCE ACT 2019

2.1 Pre-Finance Act 2019

The CITA regulates the taxation of profits of companies except companies engaged in petroleum operations. The corporate tax rate under the CITA is 30 percent. However, by the provisions of section 19 of the CITA, where a company pays dividends from retained earnings or tax-exempt income in a year that it had no taxable profits or the taxable profits are less than the dividends to be distributed, the company paying the dividends will be charged to tax as if the dividend is the total profits of the company

content/uploads/2021/06/CLARIFICATION-ON-SUNDRY-PROVISIONS-OF-THE-FINANCE.pdf (assessed 30 June 2024).

for the relevant year of assessment. This effectively created a situation of double taxation of the same income at the rate of 60 percent in the relevant year of assessment.

The above effect of Section 19 of the CITA before its amendment by the Finance Act 2019 was unintended especially because companies have various reasons for retaining profits and there are valid circumstances that could lead to a company distributing dividends out of retained earnings in a year that no taxable profit was generated. There are also other valid reasons that may give rise to a company not having taxable profits. For example, a company may have been granted pioneer status and exempted from payment of companies' income tax. Typically, companies upon expiration of their pioneer status, record zero taxable profits due to their claim of tax reliefs arising from deferred interest expense, tax loss relief, investment allowance, and claim of capital allowance on qualifying capital expenditure. However, the interpretation of Section 19 of the CITA does not spare even income exempted from tax as the courts and Tax Appeal Tribunal (TAT) have held time and again that where dividends are declared from exempted income and such dividends exceed the taxable profits of the company or the company has no taxable profits, the Excess Dividend Tax will apply.

Section 19 of the CITA is one of the most contentious provisions of the CITA, however, each presentation of the section for interpretation by the courts gave rise to the same unintended consequence of double taxation. The TAT and courts alike have upheld the assessment of companies to Excess Dividend Tax, where dividend is paid out of retained earnings, notwithstanding that the retained earnings had been subjected to tax in prior years or are exempt from tax. In *Actis Africa (Nigeria) Limited* v *Federal Inland Revenue*

Service,[6] following the decision of the company to declare dividends in 2014, an interim dividend of ₦49,095,020.00 was declared and paid from the company's retained earnings for 2013 as it made no profit in 2014.

Sequel to a tax audit of the company by the FIRS, additional tax assessments were issued to the company on the basis that the company did not comply with section 19 of the CITA. The company argued that it had paid tax on its profit in 2013 and it made no profit in 2014, hence, its payment of dividends from its retained earnings had already been subjected to tax. The company argued that if it was subjected to Excess Dividend Tax, it would amount to double taxation. On the other hand, the FIRS contended that the company had not complied with the provisions of section 19 of the CITA and was therefore liable to pay additional income tax. In its decision, the Tax Appeal Tribunal held that the company did not comply with the provision of section 19 of the CITA. This is similar to the holding of the Federal High Court in *Oando* v *FIRS*.[7]

Similarly, in *EcoBank Nigeria Limited (EcoBank)* v *Federal Inland Revenue Service,*[8] the FIRS issued an additional assessment on EcoBank on the basis that it declared losses for its 2009 to 2016 Years of Assessment. The FIRS further stated that within the period EcoBank declared losses, it distributed dividends to its shareholders amounting to ₦5,545,000,000.00. Consequently, the FIRS assessed EcoBank to additional income tax based on section 19 of CITA.

[6] Appeal No: TAT/LZ/EDT/014/2017.
[7] [2009] 1 TLRN 61.
[8] Appeal No: TAT/LZ/CIT/024/2018.

Upon appeal to the Tax Appeal Tribunal, EcoBank contended that a significant portion of the income distributed as dividends were profits earned from short government securities such as treasury bills and bonds, which are income exempt from tax under CITA and the Companies Income Tax (Exemption Order of Bonds and Short-term Government Securities) Order 2011. The other component of the dividends was paid out of the bank's trading profit which the bank treated as undisputed tax liability and paid the tax due from trading profit.

The FIRS, however, contended that the application of section 19 of CITA does not take into account the Companies Income Tax (Exemption Order of Bonds and Short-term Government Securities) Order 2011 and cannot be impeded by it. The FIRS further contended that in applying section 19 of the CITA it is not required to consider the source of the dividend income.

In its judgement, the Tribunal agreed with the FIRS and held as follows:

> It must be stated that companies that invest in bonds will by virtue of the tax exemptions become liable to pay excess dividend tax on their profits. A liability to pay tax arises when a company that seeks to pay dividends has either no taxable profits or has a distributable profit that is higher than the taxable profits. If the tax exemption granted by the order creates an excess dividend situation, the company should be liable to pay excess dividend tax on the same income that otherwise would have been exempted from tax. A liability to pay excess dividend tax arises where a company that seeks to pay dividends has no taxable profit as in the instant case but has distributable profit that is higher than the taxable profit.

2.1 Finance Act 2019 Amendment

To cure the defect of double taxation occasioned by section 19 of the CITA, section 7 of the Finance Act 2019 amended section 19 of the CITA, by introducing a new subsection (2) which exempts certain distributions from the application of section 19 of CITA. The amendment is reproduced below:

> The provisions of subsection (I) shall not apply to—
>
> (a) dividends paid out of the retained earnings of a company, provided that the dividends are paid out of profits that have been subjected to tax under this Act, the Petroleum Profits Tax Act, or the Capital Gains Tax Act;
>
> (b) dividends paid out of profits that are exempted from income tax by any provision of this Act, the Industrial Development (Income Tax Relief) Act, the Petroleum Profits Tax Act, or the Capital Gains Tax Act or any other legislation.
>
> (c) profits or income of a company that are regarded as franked investment income and under this Act; and
>
> (d) distributions made by a real estate investment company to its shareholders from rental income and dividend income received on behalf of those shareholders,
>
> Whether such dividends are paid out of profits of the year in which the dividend is declared or out of profits of previous reporting periods.

By virtue of section 19 (2)(a) and (b) above, dividends paid out of the retained earnings of a company which has been previously subjected to tax as well as dividends paid out of tax-exempt profits will not be subjected to Excess Dividend Tax. The provision of the Finance Act 2019 was clear and unambiguous in exempting the listed distributions from the application of section 19(1) without any conditions. It was believed that the Finance Act 2019 laid to rest the issue of Excess Dividend Tax in Nigeria.

3.0 RECENT DECISIONS OF THE TAX APPEAL TRIBUNAL SINCE FINANCE ACT 2019

3.1 *Dangote Industries Limited* v *FIRS*[9]

The FIRS audited Dangote Industries Limited (DIL) and raised additional companies' income tax, Withholding tax, education tax, and VAT assessments for the years 2013-

[9] Appeal No: TAT/LZ/CIT/011/2019.

2015. DIL objected to the assessments and challenged same at the Tribunal on the basis that the dividends distributed consisted of tax-exempt income under the pioneer status regime of the Industrial Development (Income Tax Relief) Act (IDITRA) 2004 and franked investment income which had been taxed in previous years.

DIL argued that since its dividends were paid out of franked investment income, any further attempt by the FIRS to tax it again would amount to double taxation. It maintained that assuming without conceding that Section 19 of CITA applied to its case, the pioneer profits and franked investment income of the company are already protected from taxation by the combined effect of the IDITRA which exempts pioneer profits from tax and Section 18 of CITA. DIL further stated that Section 19 of CITA seeks to ensure that the government has a fair share of tax, where shareholders are entitled to dividends in a reasonable proportion and that it was in no way enacted to perpetrate double taxation on the profits of a company. Therefore, the section neither exposes it to Excess Dividend Tax if all sources of income are considered nor will it apply in any way to its retained earnings from which it declared dividends.

In delivering its decision, the Tribunal held that section 19 of the CITA is an anti-avoidance provision in the tax statute which seeks to limit the opportunities of taxpayers to engage in tax avoidance schemes and the source of the profit out of which the dividend is paid is not relevant as long as the dividend exceeds the taxable profit of the company and that it will only amount to double taxation if the same income is taxed more than once in the hand of a single/or the same taxpayer.

The Tribunal, however, stated by sections 80(1) and (3) of the CITA, that franked investment income cannot be further subjected to tax. In addition, section 14 of IDITRA exempts returns of profit from pioneer companies while section 16 of the IDITRA exempts the profit of pioneer companies from income tax. Thus, the dividends should not be subjected to Excess Dividend Tax if DIL can substantiate its claims.

While the Tribunal held that Excess Dividend Tax does not apply to DIL, the Tribunal did not rely on the amendments introduced by the Finance Act 2019. The Tribunal could not have relied on the Finance Act 2019 given that the dividends in question were distributed before the enactment of the Finance Act 2019, as such the Finance Act 2019 will not apply. The Tribunal, however, departed from the precedent set by previous decisions reached on the issue prior to FA 2019. Although not relied upon by the Tribunal, the decision aligns with the changes introduced by the Finance Act 2019. While the decision is laudable, it blurs the certainty of taxpayers and calls to question whether the decision can stand a challenge in appellate courts.

3.1 *FBN Insurance* v *FIRS*[10]

The FIRS imposed Excess Dividend Tax on the dividends distributed by FBN Insurance (FBNI) on the basis that the dividends exceeded the company's taxable profits. FBNI however objected to the assessment stating that the dividends were paid out of tax-exempt income.

The Tribunal in its decision upheld FIRS' additional assessments on the basis that section 19 does not take into account the source of income from which the dividends were paid. The Tribunal averred its mind to the amendments introduced by the Finance Act 2019. However, it held that the Finance Act 2019 was not in force at the time FBNI

[10] Appeal No: TAT/LZ/CIT/030/2022.

distributed the dividends on which the Excess Dividend Tax was applied. The above appears to represent the view of the courts and the Tribunal on the treatment of dividends paid out of retained earnings prior to the enactment of the Finance Act 2019.

4.0 RETROSPECTIVE APPLICATION OF SECTION 19(1) CITA (AS AMENDED BY THE FINANCE ACT 2019) TO PRE-FINANCE ACT RETAINED EARNINGS AND EXEMPT INCOME

An important issue that agitates the mind and has attracted inquiry is whether retained earnings from periods before the enactment of the Finance Act 2019 will fall within the scope of section 19(2) of the CITA and whether companies can distribute dividends from such retained earnings without setting off the Excess Dividend Tax provisions.

The proviso to section 19(2) of the CITA expressly provides that the exception to the Excess Dividends Tax remains even if the dividends are paid out of profits of that year in which the dividend is declared or out of profits of previous reporting periods. The wording of the subsection is clear enough and supports a retrospective application to retained earnings carried forward from the pre-Finance Act periods.

Our courts have held in a line of cases that although the legislature is empowered to make retrospective laws, such retrospective intention must be expressly stated in the law. This is in line with the findings of our courts including the Supreme Court.[11] There is a clear and manifest intention in the proviso to section 19 that the exceptions to its application should apply retrospectively.

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[11] *SPDC* v *Anaro & Ors* [2015] LPELR-24750 (SC); Toyin v *People's Democratic Party (PDP)* [2019] 9 NWLR (Part 1676) pp 50 - 64, paras. G-H; *Adesanya* v. *Adewole* [2006] 14 NWLR (Part 1000) p. 242; *Osakwe* v *Federal College of Education (Tech) Asaba* [2002] 7 NWLR (Part 765) pp 222 - 238, paras. B-C; and *Njokanma* v *Mowete* [2001] 6 NWLR (Part 709) p. 315.

In view of the foregoing, the exceptions to section 19(1) of the CITA will have a retrospective effect, thus permitting taxpayers to distribute dividends from retained earnings that were carried forward into the Finance Act era.

It is important to note that the retrospective application only applies when a company distributes retained earnings from pre-Finance Act periods after the enactment of the Finance Act. Thus, where a company distributed dividends in 2018 from retained earnings that have already suffered tax, which dividends exceed its total profits in 2018 and were assessed to Excess Dividend Tax by the FIRS in 2020, the tribunal and courts will likely hold that EDT was rightly applied. This was the reasoning of the Tribunal in the case of *First Bank Nigeria Insurance Limited (FBNI)* v *FIRS.*[12] However, where the company distributes retained earnings from 2018 in 2020, it will be exempt from Excess Dividend Tax.

5.0 FIRS' LAST-IN-FIRST-OUT PRINCIPLE: LEGALITY OR OTHERWISE

In a bid to provide clarification on the amendments made by the Finance Act 2019 to the new Excess Dividend Tax provision in section 19(2) of the CITA, the FIRS issued information circular no. 2020/04 - Clarification on Sundry Provisions of the Finance Act 2019 as it relates to the Companies Income Tax Act.

The Circular introduced the Last-In-First-Out Principle (LIFO Principle) in para. 3.1. The LIFO principle is a method of valuation where it is assumed that a business entity sold the most recent/current inventory first. On the other hand, the first-in-first-out (FIFO)

[12] Appeal No: TAT/LZ/CIT/030/2022.

principle is a valuation method that assumes that a business entity sells the oldest/inventory first.[13] Paragraph 3.1 of the Circular provides that:

> In determining whether a dividend has been paid out of retained earnings for the purposes of section 19(1) of CITA, profits of the current year disclosed in the financial statements shall be considered first.

In addition to the above, the Circular also stated that where the profits reported for an accounting period are sufficient to cover the dividend declared for that year, such dividend will not be treated as having been paid from retained earnings, even if so, and will be subject to tax under section 19(1) of the CITA. This reinforces the LIFO approach adopted by the FIRS in its interpretation of section 19(2) of CITA.

The implication of the foregoing is that if a company makes a profit in the same year, it declares dividends, the profits of that year will be considered first in determining whether or not the dividends were paid out of retained earnings. In other words, dividends should first be paid out of the profit of the current year before retained earnings of prior years can be utilised for the payment of dividends, otherwise, it will not be considered as being paid out of the retained earnings and will suffer Excess Dividend Tax.

The position of the FIRS is a clear departure from the clear and unambiguous provision of the Finance Act 2019. It is evident that the amendment by the Finance Act 2019, expressly exempts dividends paid from retained earnings on which tax has already been

[13] Tim Smith, "Last In, First Out (LIFO): The Inventory Cost Method Explained," *Investopedia* 4 June 2024, available at https://www.investopedia.com/terms/l/lifo.asp (assessed 30 June 2024).

paid from the application of section 19 of the CITA, and gives no condition or qualifier to the exemption.

In *Attorney General of the Federation* v *Attorney G*eneral of *Abia State,*[14] the Supreme Court stated that:

> It is a fundamental and cardinal principle of interpretation of statutes that where in its ordinary meaning a provision is clear and unambiguous, effect should be given to it without resorting to external aid.

Similarly, the Court of Appeal stated in *Stanbic IBTC Holdings* v *FRCN,*[15] that where the language of a statute is plain, clear and unambiguous, the task of interpretation hardly arises because there is nothing to interpret or construe. In such a case, the court is duty-bound to give the words used in the provisions their ordinary, plain, natural, and grammatical meanings. Therefore, the attempt by the FIRS to import a LIFO principle in interpreting a clear provision is an aberration.

Besides, if the legislature had intended that the exemption of dividends paid from retained earnings under section 19(2)(a) of the CITA be made, by applying the LIFO principle as described by the FIRS, they would have expressly stated this in the Finance Act 2019 amendment. In *Oni* v *Gov. Ekiti State*,[16] the Supreme Court held that:

> One of the maxims of statutory interpretation is *expressio unius est exclusio*, which means the express mention of one thing excludes others, that is, although there is no express exclusion, exclusion is implied. **An implied exclusion argument lies whenever there is reason to believe that if the legislature meant to include a particular thing within the ambit of a statute, it would have referred to that thing and because of the expectation, its failure to mention that thing becomes ground for inferring that it was deliberately excluded**. In other words, the express mention of one thing in any statutory provision automatically excludes any

[14] [2002] 6 NWLR (Part 764) 542 SC.
[15] [2020] 5 NWLR (Part 1716) 110 CA.
[16] [2019] 5 NWLR (Part 1664) 1 SC.

> other, which otherwise, would have applied by implication with regard to the same issue.

Further, the introduction of the LIFO principle by the FIRS amounts to an amendment of the provision of section 19 of CITA, a task which the FIRS cannot undertake. In *Koninklijke Luchtvaart Maatschappij N.V. (KLM) Airlines* v *Kumzhi*,[17] the court held that where there is a gap in a legislation, the remedy is to amend the legislation by a subsequent legislation. The competent legislative authority vested with the powers to amend the CITA is the National Assembly, not the FIRS and the manner is by legislation as done with the various Finance Acts and not by a circular as attempted by the FIRS. The implication of this is that the action of the FIRS in amending section 19(2) of the CITA by introducing the LIFO principle and the use of a Circular in doing so is without a legal basis.

Finally, it is without doubt that FIRS circulars are the opinion of the tax authority and as such subject to the provisions of tax laws. In *Global International Drilling Corporation* v *FIRS*,[18] the court held that the FIRS information circulars are merely explanatory notes and cannot by any stretch of imagination supersede or override the provisions of a tax statute. Thus, where a circular provision is inconsistent with the law, the provision of the law supersedes it. Therefore, the authors are of the opinion that the aspect of the Circular which introduced the LIFO principle, being inconsistent with the provision of section 19 (2) of CITA, contradicts the law and is thus inapplicable.

[17] [2004] 8 NWLR (Part 875) 231 CA.

[18] [2013] 12 TLRN 1.

5.0 CONCLUSION

It would appear that the controversy surrounding the application of Excess Dividend Tax under section 19 of the CITA prior to the Finance Act 2019 is yet to be conclusively decided at the level of the Tax Appeal Tribunal. We note, however, that the decision of the FHC in *Oando* v *FIRS*[19] remains the applicable decision prior to the Finance Act 2019.

While we are yet to see an express challenge of the FIRS Circular in court, it is clear that there is no legal basis for the introduction of the LIFO principle. As is evident in the Finance Act 2019 amendment, section 19(2)(a) expressly excludes dividends paid out of retained earnings from Excess Dividend Tax under section 19(1) without more, hence questioning the LIFO principle introduced by the FIRS. Nonetheless, it is believed that a challenge of the Circular in court will reinforce the position of the law as stated in the Finance Act 2019.

[19] [2009] 1 TLRN 61.