

TAXATION ISSUES IN LEASING

IN

**ACCOUNTING, TAXATION & LEGAL ISSUES
(EQUIPMENT LEASING)**

ORGANISED BY

EQUIPMENT LEASING ASSOCIATION OF NIGERIA (ELAN)

AT

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August 24, 2006

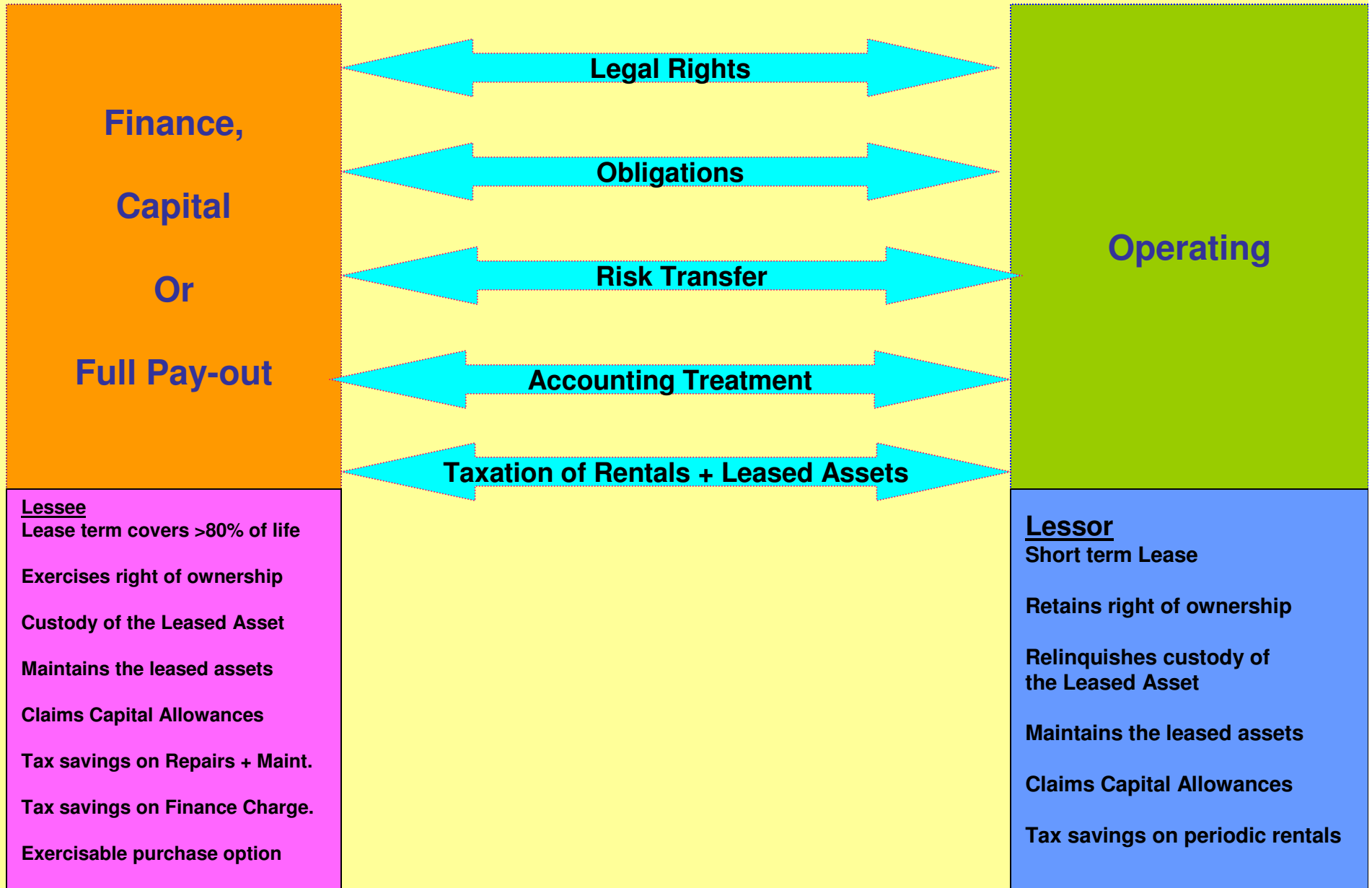
Synopsis

- Introduction
- Lease – definition variants
- Types of Lease
- Finance Lease Vs Operating Lease
- Taxation, a fiscal concept
- Relevant Tax Authority
- The incidence of tax
- Basis of Assessment
- Capital Allowance an Lease Assets
- Withholding Tax on Lease-income
- Value Added Tax (VAT) on Lease-income
- Conclusion
- Illustration

Introduction

- All undertakings - business, social, religious and not-for-profit – creates wealth for sustenance
- Wealth creation
 - own resources
 - resource optimisation
 - measured in money terms
- Leasing is a significant creative financing tool:
 - Acquisition of capital assets
 - Release scarce fund to meet 'more' worthwhile project
 - Ease entry into huge-capital oriented ventures
- Leasing, an alternative to outright purchase of capital assets.
- Biting economy of the nineties increased the level of embrace it enjoyed in business

Types of Lease



Concept of Taxation

- **All income generated by animate and inanimate persons attract income tax.**
- **Tax is levied by local, state or federal government of the residence of the taxpayer.**
- **Related taxation to leases are covered under the following tax instruments:**
 - **Personal Income Tax Act, 1993**
 - **Companies Income Tax Act, 1979**
 - **Value Added Tax Act, 1992**
 - **Industrial Development (Income Tax Relief) Act, 1971**

Relevant Tax Authority

- These are the agencies of government having responsibility for:
 - assessment;
 - collection; and
 - administration of tax
- Incomes or Savings of both the Lessor and Lessee on lease transaction are taxable, depending on their nature of persons.
 - Animate Persons - Personal Income Tax, 1993
 - Inanimate Persons - Companies Income Tax, 1979 (Limited Coys)
 - Partnership - Personal Income Tax, 1993
- In case of partnership, it is income or saving derived from the partnership that is taxed in the hands of the individual partners.
- Tax Authorities, in Nigeria, are:
 - Federal Board of Inland Revenue - administers companies income tax and taxes of members of the armed forces and individuals resident in the FCT + Value Added Tax of all persons.
 - State Board of Internal Revenue - administers personal income tax + state sales tax of all persons.

Incidence of Tax

- **The bearer of tax arising from lease-transaction depends on:**
 - The type of lease; and
 - The position of each party (whether a Lessor or Lessee)
- **Treatment of Tax and effects on both the Lessor and Lessee will be reviewed under the two major types of lease, viz:**
 - Operating; and
 - Finance Leases.
- **Essentially, tax charge remains a function of the income or savings arising from the leased transaction.**
- **However, income or saving that is taxable must concurrently respect the four-pronged principles of (WREN):**
 - Wholly;
 - Reasonable;
 - Exclusive; and
 - necessarily

Incidence of Tax and Finance Lease

Lessee	Lessor
<u>Tax Benefits (tax savings) on:</u> <ul style="list-style-type: none">▪finance charge▪capital allowances▪balancing allowance▪repairs + maintenance	<u>Tax Benefits (tax savings on):</u>
<u>Tax Charge</u> <ul style="list-style-type: none">▪VAT on Periodic Rentals▪balancing charge	<u>Tax Charge</u> <ul style="list-style-type: none">▪finance income.▪Withholding Tax on Rentals (advanced taxation) but loses are measured on the time-value of the advanced tax.▪Forfeits the hitherto enjoyed tax savings on capital allowances

Incidence of Tax and Operating Lease

Lessee	Lessor
<u>Tax Benefits (tax savings) on:</u> <ul style="list-style-type: none">▪ Periodic rentals (allowable deduction)	<u>Tax Benefits (tax savings on):</u> <ul style="list-style-type: none">▪ Repairs and maintenance▪ Capital allowances▪ Balancing allowance
<u>Tax Charge</u> <ul style="list-style-type: none">▪ VAT on Periodic Rentals	<u>Tax Charge</u> <ul style="list-style-type: none">▪ Withholding Tax on Rentals (advanced taxation) but losses are measured on the time-value of the advanced tax.▪ Balancing charge

Basis of Assessment

- **General Rule : Preceding Year Basis (PYB) – sec 25(1) of CITA**
- **Exemptions to the PYB rule:**
 - **Income from employment (based on actual year basis)**
 - **Commencement Rule**
 - **Change of Accounting Date**
 - **Cessation Rule**

Commencement Rule Provisions

- With effect from 1980 year of assessment (YOA), fiscal year ends on December 31.
- In the first year of commencement:
 - The basis period is from the date of commencement of business to the end of the fiscal year (YOA). Sec 25(2)(a) of CITA, 1979
- Second YOA:
 - The basis period is the first twelve months of commencement of business.
- Third YOA and future YOA:
 - The basis period is the 'preceding year basis' i.e. the accounting year (period of twelve months) ending in the fiscal year immediately preceding the relevant YOA.
- It is the profit of the business for the basis period that is assessed for the relevant YOA.

Right of Election Vs Commencement Rule

- **Sec. 25 (3)(d) of CITA, 1979:**
 - **A taxpayer may elect to have the assessable profits of both its 2nd and 3rd years computed on the actual year basis**
 - **It cannot opt to have one of both years i.e. 2nd and 3rd years are mutually dependent at election.**
 - **Right of election exercisable only if the company had given notice in writing.**
 - **Notice is valid if given within two years following the end of the 2nd YOA.**
 - **The company may within 12 months following the 3rd YOA revoke the notice earlier given.**

Change Of Accounting Date

- A taxpayer is allowed to change its accounting date (period) if it so desires.
- Selection of the basis for computation of tax liability is at the instance of the tax authority.
- The Revenue (Tax Authority) will select the basis that gives the higher tax liability, thus:
 - Compute, on PYB, the assessable profit for the three (3) assessment years, beginning from the year of change;
 - Computation will be based on both the old and new accounting dates for the three years;
 - It will then select the basis that gives, in aggregate, higher assessable profit.
- Subsequent assessment will be based on the new accounting date, and computed on PYB.

Cessation Rule

- This rule applies when the business of a company ceases permanently.
- Focus is on the last two YOA
- For the year of permanent cessation
 - Actual year basis
- YOA preceding year of permanent cessation (Penultimate Year), the higher of:
 - Assessable profit computed on PYB; and
 - Assessable profit based on actual year basis
- Computation of the assessable profit for the penultimate years of assessment is not a matter of choice but the rule.

Capital Allowances and Leases

- It is given on qualifying (capital) expenditure, for the use of leased assets in generating business income.
- Given in lieu of accounting depreciation. Note depreciation charge is a disallowable expense.
- The type of lease determines the beneficiary of capital allowances.

Finance Lease	Operating Lease
Lessee	Lessor

- Investment Allowance
- Rural Investment Allowance
- Initial Allowance
- Annual Allowance
- Balancing Allowance.

How to Claim Capital Allowance

For capital allowances to be claimed on any qualifying expenditures, the following applies :

- a written application has been made;
- it is granted on assets owned on the last date of the basis period of a year of assessment;
- ownership and usage on the last date of the relevant basis period must be attributable to the taxpayer;
- it is not granted on the cost of Land, but claimable on the cost of the Building;
- Relieve is granted as a deduction in arriving at the assessable income of the taxpayer
- Note that it is not granted during the year of disposal, in which case it is either the balancing allowance or balancing charge that becomes relevant.

Basis of Assessment

- The basis of assessment of taxable income or profit is basically the same as for ascertaining capital expenditures on which capital allowances are computed.
- Second Schedule of CITA, 1979 resolves gap, coincide and interval periods that may arise when ascertaining the basis period.
- Where two basis periods overlap:
 - the period to the two shall be deemed, except for the purpose of making an annual allowance, to fall in the basis period ending at the earlier date, and in no other basis period.

Basis of Assessment (cont'd)

- Where two basis periods coincide, they shall be treated as overlapping:
 - the basis period for the earlier year of assessment shall be treated as ending before the end of the basis period for the later year of assessment.
- Where there is an interval between two bases periods of two consecutive years of assessment:
 - unless the second mention year of assessment is the year, in which the company permanently ceases to carry on the trade or business, the interval shall be deemed to be part of the second basis period

Conclusion

- it is the amount of savings or additional wealth created that should interest all parties to a lease in deciding on this form of asset acquisition or financing decision
- Savings from this appraisal
 - product of capital allowance, allowable rentals or the interest element of rentals and the companies' income tax rate.
- The cash or liquidity effect is the increase in wealth of owners of business
 - the discounted value of the amount of resultant savings.

Thank you all