COMPANIES INCOME TAX COMPUTATION AND TREATMENT IN FINANCIAL STATEMENTS

PRESENTED BY

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PEAK PROFESSIONAL SERVICES
(CHARTERED ACCOUNTANTS)
NIGERIA

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INTRODUCTION

Taxation is defined from elementary economics as the act of imposing a compulsory levy by the government or its agency on individuals or firms or goods and services. Taxes imposed on Individuals is known as Personal Income Tax while those imposed on Companies could take various forms like Companies Income Tax, Education Tax, Petroleum Profit Tax, or Capital Gains Tax. Value Added Tax is imposed on Goods and Services.

The amount and time of tax to be paid by an Individual or business organization is guided by the enabling act governing the type of tax. For example, the amount of tax payable by an individual is governed by the personal income tax act, while the income tax payable by a company is regulated by the Company’s Income Tax Act.

The aim of this paper is to explain how the various taxes can be calculated within the framework of the enabling act. The paper also presents the accounting treatment of the computed tax to ensure that it is in accordance with relevant accounting standards.

SESSION OBJECTIVE

At the end of this session, members of staff will be able to compute the following taxes for companies.

1. Income Tax.
2. Withholding Tax
3. Education Tax
4. Deferred Tax
5. Value Added Tax
6. Capital Gains Tax

In addition to the computation, members of staff will also be able to give the computed tax appropriate treatment in the accounts.

This paper does not cover Personal Income Tax and Petroleum Profits Tax. They will be dealt with under a separate cover.

This paper is very important because all our clients are required to pay one form of tax or the other. Since we also handle their tax engagements, the knowledge is important because it will help us to protect the interest of our clients.

To facilitate ease of understanding, the paper is divided into two major sessions. Section one deals with tax computations while section two is the accounting treatment of the computed tax.
SECTION 1

TAX COMPUTATIONS

The taxes covered in this section are as follows:

1. Value Added Tax
2. Withholding Tax
3. Capital Gains Tax
4. Education Tax
5. Companies’ Income Tax and
6. Deferred Tax.

VALUE ADDED TAX

Value Added Tax is the tax payable on supply of taxable goods and services. Businesses (even individuals) usually pay VAT when they buy goods and services and charge VAT on goods and services they sell.

At the end of a given period (usually monthly) businesses will be required to file their VAT returns to the Federal Inland Revenue Service. This is done by comparing the amount of VAT paid on goods and services purchased (known as input VAT) with the amount charged on goods and services sold (known as output VAT). The net amount in the period is the amount to be remitted to the Revenue.

ILLUSTRATION:

ABC limited paid 5,000 as VAT for items purchased in the production process in January, 2013 and made VATable supplies of N100,000 during the same month. With a VAT rate of 5%, you are required to calculate the company’s output VAT and the amount of VAT that should be remitted to the Revenue.

CAUTION ON INPUT VAT

1) Input VAT is only recoverable from Output VAT if the input relates to goods and services purchased directly for resale or manufacture of a product
2) Certain goods and services are VAT exempt. E.g, Basic food items, medical supplies and exported goods and services

Members of staff are required to familiarize themselves with the VAT act as it is essential for their professional practice and development.
WITHHOLDING TAX

Withholding tax otherwise known as advance corporation tax is an advance tax on income deducted at source. Under the Nigerian Tax laws, the payers of sums due to another person are required to withhold certain amount from such sums as tax and pay the net amount to the payee. The amount withheld is known as withholding tax and it is payable to the relevant tax authority.

The applicable rates depend on the nature of transaction and are briefly summarized in the following table:

<table>
<thead>
<tr>
<th>NATURE OF SERVICE OR ACTIVITY</th>
<th>RATE COMPANY</th>
<th>RATE INDIVIDUAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building, Construction and related activity</td>
<td>2.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Consultancy and professional services</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>Management Services</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>Technical Services</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>Commissions</td>
<td>10%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Computation of withholding tax payable is very simple. We are simply required to apply the relevant rate on the amount payable to the payee and remit to the relevant tax authority. Please note that the relevant tax authority for company is the Federal Inland Revenue Service while for individual or enterprise is the State Internal Revenue Service where the person is resident.

QUESTION

PPS is a firm of accountants with very smart people. They are about signing a consulting agreement with TNL who insists on doing things correctly by deducting appropriate WHT.

If the objective of PPS is to minimize exposure to WHT, which platform should they use? Peak Professional Services or Peak Professional Services Limited? Please give reasons

CAPITAL GAINS TAX (CGT)

Capital Gains is chargeable at 10% on capital gains arising from disposal of assets. Section 3 of CGT Act defines Capital Assets as meaning all forms of property including:

- Options, debts and incorporeal property
- Any currency other than Nigerian Currency
- Any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired.

Stocks and shares are exempted from Capital Gains Tax.
**Question**

XYX Limited bought a house in 2009 at 50 Million Naira and sold it at 200 Million in 2013. What is the capital gains tax payable by XYZ?

If the house is the only asset owned by XYZ limited and the shareholders of the company decides to sell their shares, valued at 200 Million at the date of disposal what will be the capital gain tax on the transaction?

**POINT TO NOTE ABOUT CAPITAL GAINS**

Capital gains arising from the disposal of fixed assets may be deferred by the application of roll over relief. Roll over relief occurs if the proceeds of the disposal are reinvested on a qualifying replacement asset.

**COMPANIES’ INCOME TAX AND EDUCATION TAX**

Company’s Income Tax and Education Tax are chargeable on the income of all companies operating in Nigeria except those that are specifically exempted by the enabling act. Company taxation is administered by the Federal Inland Revenue Service using the Company’s Income Tax Act (CITA).

The relevant section of CITA provides that company income tax shall be levied and payable for each year of assessment at the rate of thirty kobo for every Naira in respect of a company’s total profits. For the purpose of calculating the amount of tax payable by a company, the Revenue will normally make use of the audited accounts of the Company. The audited accounts will be adjusted to arrive at a taxable profit to which a tax rate of 30% will be applied for Income Tax and 2% will be applied for Education Tax.

**ADJUSTMENTS TO AUDITED ACCOUNTS PROFITS**

In order to convert the audited accounts profits to taxable profit, certain adjustments will have to be made in the light of the tax laws. Such adjustments will take the form of

I. Expenditure charged in the accounts but not allowable for tax purposes (known as disallowable expenses)
II. Items chargeable to tax but not credited to profit and loss account
III. Items credited to profit and loss account but not taxable and
IV. Expenditure not charged to profit and loss account but allowable.

The guiding principles for determining what to include in the tax computation are the rules of allowable and disallowable expenses.
ALLOWABLE EXPENSES

Allowable expenses are expenses of a company that are wholly, exclusively, necessarily and reasonably incurred in the production of the profits of a company. Examples of expenses that will be allowed by the Revenue in a Company’s Tax Computation are as follows:

I. Interest on borrowed money
II. Rent on office
III. Repairs and maintenance
IV. Contribution to approved pension fund
V. Salaries and Wages

VIII.
IX. Members of staff should give more examples.

DISALLOWABLE EXPENSES

Expenses that are not allowed for tax purposes should be added back to accounting profit (even when they have been charged in the profit and loss account) to arrive at the taxable profit.

Examples of expenses that are not allowed for tax purposes are as follows:

- Capital Withdrawn or repaid or any expenditure of a capital nature
- Depreciation of assets (Capital allowances are granted instead)
- All appropriation of profits such as dividends, share issue expenses, formation expenses etc
- Payment to unapproved pension scheme
- All other expenditure that are not incurred to earn the taxable profit.

Illustration

Funke Limited is a company engaged in the sale of computer hardware.

Its results for the year ended 30 June 2012 revealed the following:

Profit or Loss Account

<table>
<thead>
<tr>
<th></th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>23,000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>7,820</td>
</tr>
<tr>
<td>Overhead Expenses</td>
<td>4,950</td>
</tr>
<tr>
<td>Net Profit</td>
<td>2,870</td>
</tr>
</tbody>
</table>

Notes
The overhead expenses include:
You are required to calculate the adjusted profit for tax purposes.

**BASIS PERIOD**

The basis period for tax purposes is the period covered by a company’s returns. It normally runs from January to December of the year.

The general rule for deciding the basis period of assessment is contained in Section 25 of CITA. The Section states that the assessable profit of a company shall be the profits of the year immediately preceding the assessment year. This is what is referred to as the preceding year basis.

For example, if we are to calculate the profit of a company for 2013 year of assessment, we will make use of the accounting results for 2012.

However, this general rule will not be used under the following circumstances.

Commencement of Business
Change in Accounting Date
Cessation of business

Members of staff are advised to consult relevant literatures for a better understanding of these circumstances.

**TOTAL PROFITS OF A COMPANY**

Section 27 of CITA defines total profits of any year of assessment as the amount of any assessable profits from all sources for that year, together with any additions for balancing charge that may be applicable, less deductions for loss relief and capital allowance.

Though this definition may seem complex, it could be better appreciated with the following table showing the structure of a typical tax computation.
XYZ LIMITED. INCOME TAX COMPUTATION FOR THE 201X YEAR OF ASSESSMENT

<table>
<thead>
<tr>
<th>NET PROFIT PER ACCOUNTS</th>
<th>Naira</th>
<th>6,413</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ADD BACK DISALLOWABLE DEDUCTIONS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>1,170</td>
<td></td>
</tr>
<tr>
<td>Amortisation OF Intangible Assets</td>
<td>1,683</td>
<td></td>
</tr>
<tr>
<td>Gain / Loss on sale of Fixed Asset</td>
<td>3,569</td>
<td>6,422</td>
</tr>
<tr>
<td><strong>Adjusted/ Assessable Profit</strong></td>
<td></td>
<td>12,835</td>
</tr>
<tr>
<td>Education Tax @ 2%</td>
<td>256.7</td>
<td></td>
</tr>
<tr>
<td>Less Balancing Allowance</td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td>Add Balancing Charge</td>
<td>14,189</td>
<td></td>
</tr>
<tr>
<td><strong>STATUTORY TOTAL INCOME</strong></td>
<td></td>
<td>22,024</td>
</tr>
<tr>
<td><strong>LESS CAPITAL ALLOWANCES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unutilised Brought Forward</td>
<td>29,123</td>
<td></td>
</tr>
<tr>
<td>Capital Allowance (Initial+Annual)</td>
<td>66,171</td>
<td>95,294</td>
</tr>
<tr>
<td>Relieved</td>
<td>14,683</td>
<td>14,683</td>
</tr>
<tr>
<td>Capital Allowance carried forward</td>
<td>80,611</td>
<td></td>
</tr>
<tr>
<td><strong>Chargeable Profit</strong></td>
<td>7,341</td>
<td></td>
</tr>
<tr>
<td><strong>Company Income Tax @ 30%</strong></td>
<td>2,202.30</td>
<td></td>
</tr>
</tbody>
</table>

From the above table we should note the following:

Education tax is chargeable on Assessable profit at 2%. Assessable profit is the profit arrived at after adjusting for allowable and disallowable expenses but before giving effect to balancing charge, loss relief and capital allowances.
OTHER BASES OF COMPUTING INCOME TAX PAYABLE

- Minimum Tax basis – Section 33 CITA
- Turnover basis – Section 30 CITA
- Dividend basis – Section 19 CITA

Minimum Tax is paid by a company which has (1) no total profit, (2) whose total profits results in no tax payable or (3) tax payable is less than minimum tax.

If the turnover of the company is N500, 000 or below and the company has been in business for at least 4 calendar years.

Minimum Tax basis is levied and payable by a company for any year of assessment where:

1. In ascertainment of total assessable profits from all sources a loss occurs, or
2. Tax on total profits is less than the minimum tax as determined below;
3. Where turnover is N500,000 or below, minimum tax payable shall be the highest of:
   - 0.5% of gross profits
   - 0.5% of net assets
   - 0.25% of paid-up capital, or
   - 0.25% of Turnover for the year.

   Where turnover is above N500,000, minimum tax payable shall be the sum of
   - Highest factor in (1) above; plus
   - 0.125% of turnover in excess of N500, 000

1. Exception to Minimum Tax
   - The minimum tax is not applicable to a company during the first four years of its commencement of business;
   - It is also not applicable to agricultural trade or business as defined in Section 9 (8) of Companies Income Tax Act: and
   - It is not applicable to any company with at least 25 per cent imported equity capital.

POINTS TO NOTE

Members of staff are strongly advised to read relevant books on company’s income tax. The presentation is just a summary to stimulate your interest on the subject.

DEFERRED TAXATION

Perhaps it may be useful to start this topic with the often quoted phrase that deferred tax is the only tax that is computed which is not paid to any tax authority. That is why it is sometimes referred to as Tax Equalization Account.
It was pointed out in the earlier section that the profits according to the financial statements or audited account are often different from the profits for tax purposes. The main reason for this difference is as follows:

I. The figure of depreciation shown in the profit and loss account may be different from the capital allowances figures used in tax computation. This is common because depreciation is based on the company’s judgment of how long the asset would serve while the rate of capital allowance is as advised by the Revenue.

II. Some items of expenditure will not be allowed by the Revenue even if they are charged in the profit and loss account. For example, political donations.

Deferred tax seeks to address this mismatch. It is inherent in the recognition of an asset or liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability and the recovery or settlement of that carrying amount will make future tax payments larger (or smaller) than they would be if such recovery or settlement were to have no tax consequences. Therefore, recognizing the tax effects of temporary differences resulting from the difference between tax and accounting rules, ensures that the correct tax expense is recognized in the financial statements. The recognition of this additional amount gives rise to deferred taxation either payable or recoverable in a subsequent accounting period. Therefore, the tax charge in the financial statements comprises deferred tax as well as current tax.

**HOW DEFERRED TAX ARISES**

**DEFERRED TAX ASSET:** This is tax that is paid or payable in the present which is likely to be recovered in the near future. Example

<table>
<thead>
<tr>
<th></th>
<th>Accounting</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Provisions already charged</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Specific</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>General</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-----------</td>
<td>------</td>
</tr>
<tr>
<td></td>
<td>100,000</td>
<td>130,000</td>
</tr>
<tr>
<td></td>
<td>-----------</td>
<td>------</td>
</tr>
</tbody>
</table>

**DEFERRED TAX LIABILITY:** This is a tax that is not payable in the present but in the near future and it is being recognized as a liability in the present.

<table>
<thead>
<tr>
<th></th>
<th>Accounting</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Asset</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>(25,000)</td>
<td>IA/AA (62,500)</td>
</tr>
<tr>
<td></td>
<td>-----------</td>
<td>-----</td>
</tr>
<tr>
<td>NBV</td>
<td>75,000</td>
<td>TWDV 37,500</td>
</tr>
<tr>
<td></td>
<td>-----------</td>
<td>-----</td>
</tr>
</tbody>
</table>

From the above figures we can easily calculate the deferred tax asset and liability;
ACCOUNTING FOR TAXES

As earlier stated in the opening paragraphs, taxes are not only computed using the rules in the enabling laws, their treatment in the financial statements of a company are also guided by relevant accounting standards.

It is therefore important to note that we as professionals are not only required to know the rules governing the computations, we must also be familiar with the accounting treatment of the computed tax in the financial statements of our clients.

In Nigeria, the relevant standard guiding the treatment of taxation in financial statements is SAS 19: ACCOUNTING FOR TAXES. This standard accords substantially with IFRS 12 on accounting for Taxes. We shall therefore be using our local SAS 19 as a guide in our presentation. We shall however highlight any area of significant difference.

In line with our presentation format, the section will be structured as follows:

- Accounting for VAT
- Accounting for WHT
- Accounting for CGT
- Accounting for Education Tax
- Accounting for Company Income Tax
- Accounting for Deferred Tax

ACCOUNTING FOR VAT

In accounting for VAT, we must be careful to understand what the transaction relates to.

VAT paid on items purchased should be treated in any of the following ways:

- If it is on allowed input into the production process, it should be debited to input VAT account.
- If it is VAT paid on the purchase of fixed asset, it should be capitalized as part of the fixed asset
- If it is paid on a non allowable expense, then it should be expensed alongside the amount.

Example:

Our client PDL purchased the following items:

Motor vehicle 500,000
Spare parts for construction 60,000
Tissue papers 20,000

If they were charged VAT at 5% on the items, explain how each VAT element will be treated in their financial statements.
Output VAT should be excluded from the turnover of the company.

Example: One of our clients reported a Turnover of 10,000,000 which includes VAT at 5%. As the auditor to the company, you are required to compute the VAT element and state the Turnover correctly bearing in mind that VAT rate is 5%

At the end of an accounting period, the net amount owing as VAT or recoverable as VAT should be stated as Creditors or Debtors in the balance sheet.

**WITHHOLDING TAX**

There are two aspects in the accounting treatment of withholding tax.

1) A company is required to deduct withholding tax from payments to third parties
2) The company also suffers withholding tax from its own receipts from its customers.

The first aspect is known as withholding tax payable, while the second aspect is known as withholding tax receivable

**WITHHOLDING TAX PAYABLE**

When a company deducts withholding tax from payment due to a supplier, withholding tax payable is credited, while the suppliers account is debited.

On payment of the amount deducted, cash/bank is credited while the withholding tax payable account is debited.

At the end of the accounting period, the withholding tax payable is regarded as part of creditors and accruals in the balance sheet.

Example: TNL is due to pay the audit fee of their auditor PPS. If the fee is 400,000 and PPS as a law abiding business entity charged VAT at 5%, you are required to calculate the amount of Withholding tax that TNL will deduct and how the amount will be recorded in their books.

**WITHHOLDING TAX RECEIVABLE**

Withholding tax receivable is regarded as an advance payment of tax. Therefore the tax credit should be used to set-off against the income tax payable. If the tax Credit is more than the computed tax, it is regarded as asset, while if it is less, the balance of tax payable is paid by cash.

Example: ABC limited tax liability for 201X YOA is 50,000 while it has tax credit notes of 60,000. How much tax will the company pay by cash?
The taxes listed above will be treated together in Accounting for taxes because they have one peculiar element.

These taxes are regarded as an appropriation of profit rather than as an expenditure of a company.

Therefore these taxes can only be presented after the profit for the year in the financial statements of a company. (ie below the line items).

There are two aspects in the treatment of taxation in a company’s financial statement.

A) Profit and Loss account
B) Balance Sheet.

We shall now look at the components.

**PROFIT AND LOSS ACCOUNT**

The tax on the profit of a company is to be disclosed in the Profit and Loss account is calculated by aggregating the following:

Income tax payable on the profit for the year
Transfers to/ from deferred tax account
Any under provision or overprovision of income tax on profits for previous years

Example:

INL limited has the following figures in respect of their 201x accounts:

Education tax liability 20m
Income Tax: 50m
Capital Gains Tax 5m
Deferred Tax Charge 10m

A tax audit has just been concluded, an additional assessments where raised in respect of past three years amount to 40m Income Tax and 3M Education Tax.

Calculate how much tax should be carried in the profit and loss account for the year 201X.
TAXATION IN THE BALANCE SHEET

From our above explanations, it is clear that the tax in the profit and loss account need not be the same as the profit in the balance sheet.

The tax account in the balance sheet is divided into two components. The Current Tax and Deferred Tax

Current Tax: Current Tax consists of

Tax charge in the profit and loss account (omitting deferred tax)
Plus unpaid balance brought forward less
Payment in the year

For example: If the company in our example above had current tax outstanding of 300M at the beginning of the year and paid 150M in the year, what will be the current tax balance in their financial statement?

Deferred Tax

Deferred Tax is shown as non current liability in the balance sheet (also known as statement of financial position). The balance on the deferred tax account is the opening balance plus current year charge (less current year transfer).

CONCLUSION
I thank you for your time while hoping that the presentation will spur us to do some further reading and improve our performance on the job.