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Pioneer Status & the Return of the 3-Year Rule: Weep Not Taxpayer

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No doubt, the most omnibus incentive regime in Nigeria is the Pioneer Status certification, which until recently had granted a tax holiday to a successful applicant for straight 5 years. It has also come to gain the reputation of being the most abused in certain quarters. Nigerian Investment Promotion Commission (NIPC) is the agency which administers the grant of Pioneer Status in Nigeria.

By virtue of the express provisions of the Industrial Development (Income Tax Relief) Act ("IDITRA"), the Pioneer Status is to be granted for an initial period of 3 years with a possibility of an extension for another 2-year period. However, in practice, NIPC had in the last 14 years, granted pioneer status to successful applicants for a straight period of 5 years. This practice was not the result of arbitrariness but in consideration of the need to eliminate a renewal/extension process that had become a maze of bureaucratic bottlenecks and constraints with such concomitant effects as:

- increase in the cost of doing business;
- exposure of sincere investors to a difficult investment experience; and
- poor competitiveness of Nigeria relative to major countries in Africa as an investment destination.

The crash in crude oil prices 'unanticipated' by the then Federal Government resulting in significant cashflow challenge and the desire to address this challenge, brought under review the administration of pioneer status by NIPC. Naturally, a tax relief granted for any period will impact government take from those operations or sectors negatively by reducing the feasible quantum of revenue that is accruable.

NIPC felt the heat due to the following concerns, which were brought into sharp relief, around its administration of pioneer status:

- grant of straight 5 years instead of 3 years in the first instance and extension for a further 2 years subject to clear justification;
- rampant cases of incentive shopping arising from the activities of serial applicants vide replicating same businesses many times through set up of new entities; and
- grant to undeserving applicants e.g. certain exploration and production companies

Recently, NIPC issued letters to some corporate taxpayers who have enjoyed or are enjoying pioneer status to "restrict" previously granted relief period of straight 5 years to 3 years. These letters were no more than attempts at redress by NIPC to "restrict" pioneer status to 3 years whether or not the beneficiaries have exhausted the pioneer period. Some letters were written (curiously) to beneficiary companies who had completed the pioneer period or were already out of pioneer. Other letters to those who are still within the pioneer period – and this could be further broken down to those who are below three years or beyond three years but who have not completed the 5 years. Given the revenue recovery intent of these letters, Federal Inland Revenue Service (FIRS) wasted no further time to issue appropriate notices of assessment to claw back unpaid taxes for the balance of two years after the 3rd year.

That the Federal Government or any of its parastatals and/or agencies reserve the right to review the operation of any scheme for better administration cannot be questioned. However, the modalities for that review can be questioned or become a subject of judicial review in appropriate forum.

In returning to the original 3-year rule in the first instance for pioneer status, NIPC, FIRS, Ministry of Finance (MoF) and ultimately, the Federal Government must bear the following in mind:

(i) This step should rather be prospective than retroactive (that is, the rule should only apply to fresh or new applications and not to expired or current certificates). A retroactive application of this rule exposes these agencies to potential litigation as one of the options available to the affected beneficiaries.

(ii) Tax recovery via notices of assessment is not an automatic process. A taxpayer who feels hard done by a policy reversal or somersault will not hand over unforeseen or unforeseeable significant tax liability just because FIRS has served on it relevant notices of assessment. Given the impact for the economics of its operations, cashflow, returns to shareholders, lenders and other stakeholders in the business, it will object in writing to the assessment notices and be prepared to explore all available options for resolution within its rights under the law. The target of recovering an estimated ₦36 billion from this process may therefore be highly desperate.

(iii) The situations in (i) and (ii) increase the specter of significant revenue potentially due to government that is trapped at different levels of the judicial system. For instance, there were matters pending with the defunct Body of Appeal Commissioners (BAC) which originated since 1999 and could only be progressed when the Tax Appeal Tribunal (TAT) panels were constituted in 2010. Some of these cases have not been fully determined when the TAT was thrown into legal and judicial morass as to its constitutionality. It is undeniable that these unresolved cases hold significant tax revenue that have remained trapped for more than 15 years! This makes it imperative to consider alternative options to resolve such aged disputes and collect the tax payments due to the Federation without opening up new theatres of disputes that may take as long to resolve and adding to the present challenge. There is need to consider the increasingly significant loss in time value of money and the possibility of bankruptcy or exit of these debtors from the Nigerian market during the intervening period.

(iv) Whether NIPC is prepared to refund excess of the 2% of the estimated tax savings collected from the beneficiaries as one of the requirements for granting the incentive on the chance that one of the affected taxpayers happen to have obtained its pioneer status under the 2% estimated tax saving regime. Given that the estimated tax savings would have been calculated for 5 years, the affected taxpayer would have paid the 2% of the tax savings for 5 years to NIPC. Therefore, where the tax holiday period is reduced to 3 years, it would be reasonable to expect that NIPC would refund any excess payments.

(v) Appropriate intervention is still required in the case of Marginal Field Operators (MFOs) in the Oil and Gas industry. Since the conclusion of the first round of licensing, the regime under which marginal field operations/operators (MFOs) will be taxed is far from certain. Part of the incentives that Government leveraged to secure indigenous participation for its marginal field program were that MFOs will enjoy preferential royalty and tax rates.

Till date, the promised preferential 55% tax rate has not been codified within any instrument which has the same legislative effect as the principal legislation that sets out the normal framework for the taxation of oil and gas operations in Nigeria. The grant of pioneer status to MFOs is probably an attempt by the Federal Government not to fail this group of investors totally. It is very easy to shout "controversial" or sneer at the grant of pioneer status to the MFOs when you have no investment in those operations. Obviously, the gazetted list of 44 industries and products that are eligible for pioneer status in Nigeria, which excludes marginal field operations in the oil and gas industry, provides no comfort. To the extent that the gazette dated 27 May 2015 signed by Mr. Olusegun Aganga on 25 May, 2015, replicated the list of industries and products previously approved by the National Council of Ministers in 1989 and excludes all the industries and products subsequently added to the list and which have enjoyed pioneer relief,

provides no comfort.

Clearly, the process of returning to the 3 year rule must be managed properly. Relevant agencies NIPC, FIRS and Industrial Inspectorate Division (IID) of the Ministry of Industry, Trade & Investment must collaborate better in the grant of pioneer status to deserving applicants. In the meantime, regulatory integrity or bonafide would dictate revocation of letters to all those beneficiaries to which the 3-year rule is intended to apply retroactively. Assessment notices from FIRS riding on such letters should also be withdrawn and suits already instituted in any judicial forum should be terminated. Furthermore, return to the 3 year rule must not be the return to the wilderness of administrative bottlenecks to secure a further extension where appropriate justification is duly established.

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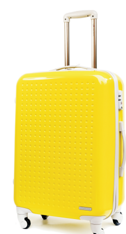

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