



## FEDERAL INLAND REVENUE SERVICE

INFORMATION  
CIRCULAR

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### **SUBJECT: TAX IMPLICATION OF MERGERS AND ACQUISITION**

*This Information Circular is published to properly inform and enlighten Taxpayers, Tax Consultants and the general public on relevant tax issues involved in mergers and acquisitions process and to draw attention to the requirements that must be fulfilled before such a bid could be approved by the Board. It is hoped that Tax Consultants and Revenue officials will find this Circular very useful and informative in the course of their work.*

#### **1.0 Definition**

Merger is defined as “any amalgamation of the undertakings or any part of the undertakings or interest of two or more companies or the undertakings or part of the undertakings of one or more companies and one or more body corporates”. Simply put, a merger is a combination or integration of existing companies to form a single company.

Acquisition on the other hand, is known as take-over. It is the take-over by one company of sufficient share in another company to give the acquiring company control over that other company.

#### **2.0 Statutory Requirement under Companies Income Tax Act (CITA)**

The CITA in Section 29(12) CapC21, LFN, 2004 (as amended) provides that “no merger, take-over, transfer or restructuring of the trade or business carried on by a company shall take place without having obtained the Board’s direction under subsection 9 of this section and clearance with respect to any tax that may be due and payable under the Capital Gains Tax Act”. The implication of this provision is that the approval of the Federal Inland Revenue Service is a necessary condition for the completion of the process in a merger or acquisition bid. Therefore, no merger or acquisition bid would be fully consummated without the companies involved having obtained the consent of the FIRS.

#### **3.0 Procedure for Obtaining the Board’s Approval**

From the start, the merging companies are required to submit to the Board, copies of the scheme of merger and scheme of arrangement on the consolidation request as well as the due diligence report covering aspect of taxes of the integrating entities, for proper study and evaluation in order to ensure that taxes which may result from the companies’ transactions are correctly assessed and collected. Herein lies the relevance of the Board’s powers under section 29(9)(c)(i) to require either of the companies directly affected by any direction which is under the consideration of the Board to guarantee or give security to its satisfaction for payment in full of all tax

due or to become due by the company which is selling or transferring such asset or business.

#### **4.0 Tax Issues in Mergers and Acquisitions**

4.1 A merger may result in any of the following situations:

- \* Formation of a new company
- \* Continuation of the consolidated business by one of the merging parties, in its name or under a new name
- \* Cessation of business by the other merging parties

4.2 In acquisition, there is only an acquiring company and the company(ies) being acquired.

#### **4.3 Emergence of a New Company**

##### **4.3.1 Rendition of Annual Returns**

Where a new company emerges from a merger process, then, the new company is expected to file its returns, in line with the provisions of Section 55(2)(b) of CITA, CAP 21, LFN 2004 (as amended). The section provides that every new company shall file with the Board, its audited accounts and returns within eighteen (18) months from the date of its incorporation or not later than six (6) months after the end of its first accounting period as defined in Section 29(3) of CITA, CAP 21, LFN 2004 (as amended), whichever is earlier.

It should however be understood that a mere change of name does not make an existing business entity a new company. Such companies will continue to be treated as old business on going concern basis.

##### **4.3.2 Basis of Assessment**

Commencement rule as provided under Section 29(3) will apply to the new company. However, where the merging parties are connected parties (Section 29(10) of CITA) or the new business is a reconstituted company (under Part II of the Companies and Allied Matters Act Cap.C20 LFN 2004) taking over the trade or business formerly run by its foreign parent company (Section 29(10) of CITA), then the Service may direct that commencement rule be set aside, in which case, the new company will file its returns as a going concern and its assessment will be determined on preceding year basis.

### **4.3.3 Claim of Allowances**

Companies Income Tax Act (CITA) did not categorically address the value at which assets may be transferred for the purpose of capital allowances claim. However, International Accounting Standard 22 prescribes that in merger accounting, the assets, liabilities and reserves must be recorded at their carrying balances, implying that merger process does not permit the recording of assets at their fair value in the event of consolidation. The new company will therefore not be entitled to any investment allowance claim or initial allowance on the transferred assets; it will only be entitled to claim annual allowance on the Tax Written Down Values (TWDV) of the transferred assets.

### **4.3.4 Unabsorbed Losses and Un-Utilized Capital Allowances Brought Forward**

The new company may also not be permitted to inherit the unabsorbed losses and capital allowances of the absorbed companies, except where a reconstituted company under Part II of the Companies and Allied Matters Act Cap.C20 LFN 2004 is carrying on the same business previously carried on by this company and it is proved that the losses have not been allowed against any assessable profits or income of that company for any such year; in that case the amount of unabsorbed losses shall be deemed to be a loss incurred by the re-constituted company in its trade or business during the year of assessment in which the business commenced.

### **4.3.5 Taxes and Deductibility of Related Expenses**

#### **(i) Stamp Duties**

Duty payment will arise on the share capital of the new company, subject to the provisions of Section 104 of the Stamp Duties Act, in relation to capital and duty relief.

#### **(ii) Consolidated Expenses**

Fees paid to statutory bodies such as SEC, NSE, CBN, Land Authorities etc, including professionals like Accountants, Stockbrokers, Issuing Houses, and Solicitors are regarded as capital in nature and will therefore not be allowed as deductible expenses by virtue of Section 27(a) of CITA.

#### **(iii) Taxation of Consolidation Fees:**

Fees paid to professionals for services rendered in connection with consolidation will be subject to VAT and WHT at the rates of 5% and 10% respectively.

#### **4.3.6 Tax Indemnification**

Section 29(9)(i) of CITA provides that the Board may require the new company to guarantee or give security for payment in full, for any tax due or that may become due by any of the ceased companies.

#### **4.4 Status of a Surviving Company in Relation to Taxation**

It is a possibility that one of the merging companies survives with its old name or a new name to inherit the assets, liabilities, reserves and entire operations of the merging parties. Where this happens, the following points must be noted:

- (i) the surviving company must file its returns in line with the provisions of section 55(2)(a) of CITA.
- (ii) Commencement rules under section 29(3) of CITA will **not** apply to the surviving company, as it will be regarded as an existing company.
- (iii) The surviving company will **not** be allowed to claim investment allowance on the assets which were transferred to it and will also not claim initial allowance on such assets.
- (iv) The surviving company may however claim annual allowance only on the Tax Written Down Values (TWDV) of the assets transferred to it.
- (v) The surviving company may **not** inherit the unabsorbed losses and capital allowances of the merging companies, except it is proved that the new business is a reconstituted company.
- (vi) All fees payable on merger bids or consolidation will be liable to VAT and WHT just like it is applicable on the emergence of a new company. Stamp duties will be paid on the increase in share capital..

#### **4.5 Ceased Businesses**

The merger or consolidation exercise may also result in cessation of business for any of the merging parties. In this case, cessation rule as applicable under section 29(4) of CITA will apply to any of the merging companies which have now ceased business permanently, except if any of the following circumstances occur:

- (i) where the merging companies are connected. Here, the Board may direct, in line with its discretionary powers, under section 29(9) of CITA that the cessation rule may not apply.
- (ii) Where a reconstituted company is formed to take over the trade or business formerly run by its foreign parent company. (see Section 29(10) of CITA.

#### **4.5.1 Capital Gains Tax on Shares or Cash Received**

Section 32 of Capital Gains Tax Act (CGTA) Cap C1 LFN 2004 provides that a person shall not be chargeable to tax under the Act, in respect of any gains arising from the acquisition of the shares of a company, either merged with, or taken over or absorbed by another company, as a result of which the acquired company has lost its identity. However, where shareholders are either wholly or partly paid in cash for surrendering their shares in the ceased business, the gains arising from the cash payment will be subject to CGT.

#### **4.6 Effect of Taxations on Acquiring/Acquired Companies**

The tax implications of consolidation on acquiring company or acquired companies are similar to those of mergers. Acquisition expenses are non-deductible while fees paid to professional bodies are equally subject to WHT and VAT.

#### **5.0. Conclusion**

The FIRS has made the clarification contained in this circular for the benefits of companies which may be considering merger options. The FIRS has no power under the Act to halt or prevent any merger proposal, once the steps are in line with the requirements of Companies and Allied Matters Act (CAMA). The Board's concern, however, lies with ensuring that all taxes due or may be payable by any of the merging companies are assessed and fully recovered. For this reason, companies intending to merge or consolidate are advised to promptly bring such proposal to the notice of the FIRS with copies of relevant schemes of Merger and Arrangement for evaluation. The benefit for the taxpayer is that the acquiring company enjoys the privilege of not having to pay taxes that could have arisen from the computation of taxes on the company that was acquired on cessation.

#### **6.0 Enquiries**

**All enquiries on any aspect of this publication are to be directed to:**

Office of the Executive Chairman,  
Federal Inland Revenue Service,

Revenue House,  
15 Sokode Crescent,  
Wuse Zone 5, Abuja.  
enquiries@firs.gov.ng

Director, Tax Policy and Legislation  
Department

Federal Inland Revenue Service,  
Revenue House,  
15 Sokode Crescent,  
Wuse Zone 5, Abuja.

Or

tpld@firs.gov.ng

Visit our website: [www.firs.gov.ng](http://www.firs.gov.ng)

Email: [enquiries@firs.gov.ng](mailto:enquiries@firs.gov.ng)

Telephones: 08159490002, 08159490001, 08159490000