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LEGAL AND PROCEDURAL TAX ISSUES IN MERGER AND ACQUISITION EXERCISE IN THE NIGERIAN BANKING SECTOR

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INTRODUCTION

In 2004, the Central Bank of Nigeria (CBN) in an aggressive manner, ordered for the reform of the Nigerian banking sector via consolidation, and recapitalization. According to the Apex bank guidelines and incentives on consolidation in Nigerian banking industry¹, the only legal modes of consolidation allowed are mergers and outright acquisition/takeover. A mere group arrangement is not acceptable for the purpose of meeting the #25 billion capital base. Therefore, all banks that have other banks as subsidiaries or have common ownership are encouraged to merge. Out of this merger exercise came about 25 banks which emerged as mega banks because they were able to fulfill the CBN guidelines for consolidation, merger and acquisition especially the meeting of #25 billion capital base target.

Unfortunately however, despite the laudable takeoff of this exercise, much success has not been recorded. Six years after, apart from several banks that merged together and those that were outrightly taken over, recently, due to non performing and non viability of some banks, the apex bank was forced to take over the running of some other banks. Their management was changed and their names also changed². All these happenings clearly signify the unending ends to the merger and acquisition exercise in the Nigerian banking sectors.

Globally, it is practically impossible to have a successful banking merger and acquisition without satisfying the legal as well as the procedural requirement especially the tax aspect of the exercise; unfortunately, in the Nigerian banking merger and acquisitions exercise, it was discovered that, some of the banks that merged together actually failed in meeting the legal obligation as to tax requirements in merger and acquisition. In other words, some of them neglected their legal obligation to the tax authorities; 19 of such banks were later discovered to have completely neglected the execution of the tax aspect of the merger exercise³.

Premised on this finding, this paper examines the tax requirements in banking merger and acquisition. Both legal and procedural tax issues are examined, viability of the Nigerian law in ensuring tax compliance in the merger and acquisition exercise tested

¹ As released on the 5th of August, 2004

² Bank PHB, changed to Keystone bank, AFRIBANK, now Mainstream bank, Spring bank, now, Enterprises Bank

³ Akintunde O, "Tax: FIRS probes 19 banks" The Punch Newspaper, February 16, 2006.

and recommendations proffer for the conformity with both legal as well as procedural tax aspects of merger and acquisition in the Nigerian banking sectors.,

MEANING OF MERGER AND ACQUISITION

Mergers and acquisitions are global business terms used in achieving business growth and survival. Merger entails the coming together of two or more firms to become one big firm, while acquisition is the takeover or purchase of a small firm, by a big firm, which are both pursuing similar motives.⁴

However, unlike the term acquisition which has more definite definition of the purchase of one company by another with neither the shareholders nor directors of the purchased companies retaining any continuing interest in the enlarged company,⁵ the term merger appears to be one of imprecise definition⁶. The term merger... has variously been described as a situation where two or more companies of approximately equal size come together with the shareholders and directors of both/all the companies supporting the combination and continuing to have an interest in the combined business.⁷ Merger in some other instances is when firms of equal size combine with the smallest one normally being absorbed.⁸ Merger can also be described as the amalgamation of the undertakings or any part thereof, of two or more companies.⁹

Invariably therefore, merger and acquisition could be said to be a process whereby two or more companies who are interested in carrying on a business that is either facing problem of liquidation or intend to improve on their capital base came together to further their business interest while abandoning one name for the other.

BRIEF HISTORY OF MERGER AND ACQUISITION IN NIGERIA

Historically, the 1930's and 1940's pioneering bank failures brought about the enactment of banking ordinance of 1952 which prescribed an operating license and emphasised on minimum equity capital for all banks in Nigeria. Since then, rising of bank

⁴ Okpanach J. "Comparative analysis of the impact of Mergers and acquisitions on financial efficiency of banks in Nigeria" *Journal of Accounting and Taxation* vol 3 (1) may 2011 also at <<http://www.academicjournals.org/JAT>> assessed on 13th September, 2011. see also, Amedu S. "Corporate takeover, Acquisition and Merger, the Nigerian stockbroker" *The official Journal, chartered institute of stockbrokers* Jan-March, 2004. see also, Bello M.S "Mergers and Acquisitions as strategies for Business Growth in Nigeria" *Nig. J. Acct. Res* 1 (1) 2004. Also see Gaughan P.A, *mergers and Acquisition* (New York, Harper Collins, 1999).

⁵ Banwo I "Tax Considerations in mergers & Acquisitions" <[www.banwo-igbodalo.com/-resources/Tax considerations in mergers & Acquisitions. pdf](http://www.banwo-igbodalo.com/-resources/Tax%20considerations%20in%20mergers%20&%20Acquisitions.pdf)> assessed on the 13th September, 2011

⁶ Ibid

⁷ Balogun B. "Tax considerations for merger and acquisitions" (unpublished) paper presented at the workshop on merger and acquisition, organized by the Nigerian insurers association, Tuesday, December, 14, 1999, see also Banwo

⁸ Lusting P. et al *Managerial Finance in a Canadian setting* (5th Edition Toronto, John Wiley & Sons, 1994) P:1, see also Banwo

⁹ Section 5 of Companies and Allied Matters Act (CAMA) 1990 now repealed by section 261 of the investment and securities Act (ISA) 1999 as cited in Banwo

capital has become the hallmark response policy of the Nigerian monetary authorities.¹⁰ The major concept of merger and acquisition is basically a capitalisation exercise which involves the gathering together of resources of different banks in a bid to merged together to form a new bank.

Capitalization is an important component of reforms in the banking industry, owing to the fact that a bank with a strong capital base has the ability to absorb losses arising from non-performing liabilities. Attaining capitalization requirement is achieved through consolidation, convergence as well as the capital market. Thus, banking reforms are primarily driven by the need to achieve the objectives of consolidation, competition and convergence in the financial architecture.¹¹

Prior to the onset of the reforms, there were 89 banks with 3,382 branches concentrated in the urban areas. The overall banking system was weak, with very low capitalization base, illiquidity, poor asset quality, weak corporate governance, dominance of a few large banks, and over-dependence on public sector assets, low depositor confidence, and low rate of credit therefore, the CBN stepped in and in 2005 and banks were recapitalized, merged or liquidated.¹²

On 3rd January 2005, the CBN announced that 25 banks or banking groups comprising 75 out of the original 89 banks and accounting for 94% of the deposit share of the market had met the new capital requirement [of Naira 25 billion shareholder's fund] by end of December 2005, and that the remaining 14 failed Banks were to be liquidated. The resultant effect of this exercise were that 12 Nigerian banks joined the elite groups of 1000 banks in the world, and one bank is listed on the London stock exchange. Liquidity, private sector lending, and access to overseas credit lines increased, while interest rates were driven down. Total banking sector capitalization jumped from less than \$3 billion to over \$8 billion. The share of the banking sector at the Nigeria Stock Exchange [NSE] reached 50% in 2006 and the sector contributed 75% of all new issues on the Nigeria Stock Exchange.¹³

CONCEPTS OF AND REASONS FOR MERGER AND ACQUISITIONS

Nigerian financial sector has long been experiencing distress and various calamities all at the detriment of the customers. It was in a bid to save this situation that prompted Sanusi Lamido Sanusi, the Central Bank of Nigeria Governor to sack five managing

¹⁰ Call Option Trading, 'Effect of Bank Consolidation on the performance of Banks in Nigeria' <<http://www.calloptointrading.com>> assessed on 10th April, 2010.

¹¹ Bond Multi Media Mart, 'Banking in Nigeria' <<http://www.bondman.com>> assessed on 10th April, 2010.

¹² Estandards Forum, 'Core principles for Effective Banking Supervision' <www.estandardsforum.org/> assessed on 17th April, 2010.

¹³ Abimbola Bukola, 'Bank Merger: in Recapitalization and Consolidation of Nigeria's Banking Sector' <<http://www.ebcoll.org>> assessed on 17th April, 2010.

directors of Nigerian banks that were found wanting on August 14, 2009.¹⁴ The action plan of the then governor that best fit to save the situation was to launch the banking sector consolidation exercise on July 6, 2004 which reduced the number of banks from 89 in 2004 to 25 in 2006¹⁵.

Not only that, the CBN governor also ordered for the diversifying of the shareholding structure of the bank and instituted a tight code of corporate governance in the industry, with the goal of stemming the tide of banks distress in the industry.¹⁶ Therefore, according to him, the consolidating exercise was to achieve cost efficiency through economies of scale, and to diversity and expand on the range of business activities for improved performance is one of the major reasons for mergers.¹⁷ Apart from this, profit potential, risk reduction, tax and market positioning motives, growth-induced merger motives¹⁸ are also some other reasons, for merger and acquisition processes. Invariably therefore, mergers and acquisition are expected to address the problem of distress among insolvent banks without an initial resort to liquidation.¹⁹

Many studies²⁰ have suggested that mergers and acquisitions in the financial system could impact positively on the efficiency of most banks. Some other studies posited that mergers and acquisition actually enhanced ability to attract loans to the merged firms²¹ and that it also increased employee productivity and net asset growth²²

Similarly, some studies have argued that mergers and acquisitions, made Nigerian

¹⁴ Dike Nwuamaeze *Banking crisis in Nigeria* <<http://www.Find a Job In Africa.com>> accessed on 21 October, 2008, see also The Nigeria Tribune Newspaper Nigeria 16 November 2009 and The Nigerian Tribune Newspaper Nigeria 5 October 2009

¹⁵ For series of other issues on merger and acquisitions, and consequences of the exercise, see, Call option Trading Effect of bank Consolidation on the performance of banks in Nigeria <<http://www.calloptiontrading.com>> assessed on 10th May, 2010, Estandardsforum, 'Core principles of Effective Banking Supervision' <<http://www.estandardsforum.org/>> accessed on 17th March, 2010. Abimbola B, 'Bank Merger: Recapitalization and consolidation of Nigeria's banking sector' <<http://www.ebcoll.org/>> accessed on 12 April, 2010. See also, Emma Ujah and Tina Onah, 'CBN orders Bank MDs of 10yrs to quit' <<http://www.allafrica.com>> assessed on 10th February, 2010.

¹⁶ *ibid*

¹⁷ Soludo C. "Consolidating the Banking Industry to meet Development Challenges" Discussion Paper <<http://www.This day online. Com/business>> as cited in Okpanachi J. P: 003.

¹⁸ As outlined by Mr. Muyiwa Osho "consolidation through mergers and Acquisition: The African Experience" in the conference proceedings on consolidation of Nigeria's Banking Industry, CBN Fourth Annual monetary policy conference, 18th – 19th November, 2004, pp:49-50

¹⁹ Umoh PN "Capital Restructuring of Banks: Conceptual Framework, conference proceedings on consolidation of Nigeria's Banking Industry, CBN, Abuja.

²⁰ Amongst which are Calomiris et al, *The Bank Merger wave of the 19902: The Nine case studies* (Universities of Illinois, 1996), De-Nicolo "Bank Consolidation, Internationalization and conglomeration: Trends and Implications for Financial Risks. IMF work Pap. 03/158, 2003, Caprion L "The Long term performance of Horizontal Acquisitions. INSEAD work pap. 99/24/SM, Apal, 1999 as cited in Okpanachi J.

²¹ Cornett et al "changes in corporate performance Associated with bank Acquisitions" Journal of finance & Economics, April, 1992, Kay J.A Foundation of Corporate success (Oxford University Press) 1993).

²² Okpanachi J, "Effects of Financial products marketing management on profitability of some Banks in Nigeria" ABU J. Mark manage; 1 (II) June, 2006

banks more efficient²³ post as consolidation exercise has ensured customers confidence in the Nigerian banking industry in term of high profit.²⁴ Globally, merger and acquisitions has also been discovered to lead to high rate of economic activities and substantial scale efficiency.²⁵

To be more specific, merger and acquisition was undertaken in the Nigerian banking sector

*---in order to arrest systems decay, restoration of public confidence, building of strong competent and competitive player in the global arena, ensuring longevity and higher returns to investors --- creating a sound and more secure banking system that depositors can trust through mergers and acquisitions which enhanced operational capital base ---*²⁶

Similarly, the merger and acquisition drive in the Nigerian banking sector was anchored on two critical pillars, firstly, to provide effective protection against systematic financial crises in the interest of the depositors, and secondly, to fast track the growth and development of the national economy.²⁷

LEGAL AND PROCEDURAL TAX ISSUES IN BANKING MERGERS AND ACQUISITIONS

Since merger and acquisition basically revolves round the pooling of many companies resources together in order to assume new identity and secure a greater protection against liquidation, the merger exercise may weep up issues like reduction or increase of taxable entities in the revenue drive of the new emerging bank. This is in addition to the issue of profit and losses carried forward and the tendency to reconcile accounting date. Expectedly therefore, tax implication of the exercise may include series of VAT related issue in both pre and post merger exercise in the banking sector.

²³ Walter C.N and Uche U "New Capitalization for Banks: Implication for the Nigerian Economy." (Adamawa State Univ. Bus. J. 1 (1) January, 2005

²⁴ Akpan AB "Effectiveness of Bank Capitalization and Consolidation in Building Market Confidence: An Assessment of Customers Perception in Nigeria" Abuja Journal of Bus. Admin 1 (2) December, 2007

²⁵ See Berger AN; Mester LJ; "Banking consolidation: What is a small Business to do?" Bus. Rev. January/February 1997, Karim U. "Bank Post Consolidation, issues and challenges in Malaysia & India: Lesson of Experience. Bullion, CBN Abuja, 31 (4) 2007, Kwan S.H. "Operational Performance of Banks among Asian Economies: An International and Time series Comparison. AKIMR work paper, 13 June, 2002; Stiroh K "Diversification in Banking: is Non-interest Income the Answer?" Staff Reports, Federal Reserve Bank of New York (154) September, 2002, Uchendu O.A "Banking Sector Reforms and bank Consolidation: the Malaysian Experience. Bullion. Central Bank of Nigeria, Abuja 29 (2) April/June, 2005

²⁶ Okpanachi, pp:1-2

²⁷ Ibid, P:2

LEGAL ISSUES

The Legal Framework

Apart from section 100-123 of the Investment and Securities Act No. 45, 1999, section 29 (3), (4) and (9) Companies Income Tax Act could be said to be the Nigerian tax laws which has direct bearing on the regulatory issues in Mergers and Acquisitions in Nigerian. Section 29 (3) CITA, provide for the companies prerequisite when entering to merger. Section 29 (4) CITA, is on Cessation of Trade or Business and section 29(9) is basically on Trade or Businesses sold or transferred. One way or the other the referred sections are talking about new identity for companies.

A merger may result in either the formation of a new company, continuation of the consolidated business by one of the merging parties, in its name or under a new name and in Cessation of Business by the other merging parties. Where merger results in acquisition of a company, there is only an acquiring company and the company being acquired. However, where the process results in the emergence of a new company, then the new company is expected to file its returns, in line with the provisions of Section 55(3) of CITA. According to the Section,

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 this Act, 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 businesses on on-going concern basis.²⁸

b) Status of a Surviving Company as to Tax

It is a possibility that one of the merging companies survives and retains 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(3)(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 not claim initial allowance on 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

²⁸ Abdulrazaq, M.T. 'Taxation Issues Arising from Mergers and Acquisitions in Nigeria', Unpublished Working Paper.

- a reconstituted company.
- (vi) all expenses paid by the surviving company in connection with the merger or consolidation exercise are to be regarded as capital in nature and non-deductible for the purpose of tax.
 - (vii) 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 and the company will have to obtain its own staff pension scheme approval from the Joint Tax Board (JTB).

(c) Basis of Assessment (Commencement and Cessation Rule)

i) Commencement

Commencement rule as provided under Section 29(3) will apply to the new company, except where any of the under-listed circumstances arise:

- (i) where the merging parties are connected parties, the Board may direct that commencement rule be set aside, in which case, the new company will file its returns as an on-going concern and its assessment will be determined on preceding year basis.
- (ii) where the new business is a reconstituted company, taking over the trade or business formerly run by its foreign parent company²⁹.

ii) 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)³⁰.

In essence, a company is assessed to tax based on either normal basis period of assessment or abnormal basis period of assessment. But in the case of merger and acquisition, special rule exists; the exercise usually involves the cessation of a company and commencement of a new one. The cessation rules are, to a certain extent, compensatory³¹. While under the commencement rules, the profit of the 1st year taxed two or three times, in cessation, the profit of another period will escape assessment. And for this, if companies with varying accounting years end dates wish to merge, they will generally have to adopt a uniform date for the merged entity. The normal rules under

²⁹ Abdulrazaq, M.T. 'Taxation Issues Arising from Mergers and Acquisitions in Nigeria'.

³⁰ Ibid.

³¹ 'Tax Considerations in Mergers & Acquisitions' <www.banwo-igbodalo.com/-resources/Tax_Considerations_in_Mergers_Acquisitions.pdf> assessed on the 13th September, 2011

CITA allow companies to elect which accounting dates to make up accounts to. The FBIR, however, has a right of election to charge tax on the higher chargeable profits based on either the old accounting date or the new one³².

On this, Adesola,³³ however, opines that, notwithstanding the right of election, it appears that the FBIR has no right to reject the adopted accounting date because doing so will amount to doing other thing inconsistent with the provision of the CITA which allows companies to elect which accounting dates to make up their accounts to. This, the writer agrees with, since it is the law that permits the company to elect accounting date, that should be respected by the FBIR without an interference in whatever form from any other authority.

d) Claim of Allowances

Companies Income Tax Act (CITA) does not categorically address the value, 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 assets³⁴.

e) Unabsorbed Losses and Unutilised 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 under the following circumstance: (i) where a reconstituted company 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.

(f) Issues of Interest Payment, Carried Forward, Assets and Shares

i) Interest Payment Forward

While undertaking merger, especially when same is financed with loan capital, the interest payment is treated as allowable deduction.³⁵ This classification may encourage the transferee to engage in tax planning by re-characterising some of

³² As outlined by Section 29 (2).

³³ Adesola, S.M. *Tax Laws & Administration Nigeria* (OAU, Ife, 1998) p.688.

³⁴ Ibid.

³⁵ See section 24 CITA, LFN, 2004.

the considerations for the merger as interest.³⁶

ii) Loss Carried Forward

On issue of loss carried forward in the process of merger and acquisition, the type of merger and what is transferred will determine its treatment to tax. Therefore, where the subject of the transfer is the assets of one company, both companies remain in existence³⁷. In such circumstances, as both parties remain in existence, each will be responsible for its own taxes and the transferee will generally not inherit the transferor's tax liabilities. It will, however, not be entitled to any of the transferor's losses carried forward³⁸. This is so because Nigerian law does not provide any form of loss reliefs for mergers³⁹.

In fact, this is also indirectly confirmed in the CITA,⁴⁰ and to provide a succor for this, the Revenue has developed a practice of treating the losses carried forward as part of the assets of the company, which may be transferred as a result of a merger or acquisition.⁴¹ Hence, the transferee company may enjoy the reliefs so long as he carries on business similar to that in respect of which the transferor became entitled to the reliefs.⁴²

iii) Issue of Shares or Cash Received

If it was shares that were the subject of transfer instead of assets, a share purchase will usually preserve the loss reliefs so that they can be utilized by the transferee after the merger⁴³. Tax consequences of a share transfer are generally more attractive to the transferor company and its shareholders. The reason for this is that, any gains arising from disposal of such share are exempt from CGT⁴⁴. Therefore, going by the provision in section 32A of Capital Gains Tax Act (CGTA) Cap. 121 LFN, 2004 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

³⁶ Tarr, A.J. 'Tax Considerations for Buyers and Sellers of Companies' (Metropolitan Corporate Counsel Magazine, 2002) also available at <www.loeb.com/CM/Articles?articles109.asj>

³⁷ 'Tax Considerations in Mergers & Acquisitions' <[www.banwo-igbodalo.com/-resources/Tax Considerations in Mergers & Acquisitions. pdf](http://www.banwo-igbodalo.com/-resources/Tax_Considerations_in_Mergers_Acquisitions.pdf)> assessed on the 13th September, 2011

³⁸ Chiltern, A. 'Assets or Shares-a Tax Conundrum' (M & A Tax Focus, 2005) p.1.

³⁹ Oyedunde, O. 'Consolidation Reform of the Banking Sector' (Journal of International Banking Law and Regulation) p.283.

⁴⁰ Section 33(2) CITA LFN, 2004.

⁴¹ 'Tax Considerations in Mergers & Acquisitions' <[www.banwo-igbodalo.com/-resources/Tax Considerations in Mergers & Acquisitions. pdf](http://www.banwo-igbodalo.com/-resources/Tax_Considerations_in_Mergers_Acquisitions.pdf)> assessed on the 13th September, 2011

⁴² 'Tax Consideration in Mergers and Acquisitions'

⁴³ Field, F.W. 'Company Acquisition in the UK: A Guide' (September, 2004) p.2.

⁴⁴ See Section 31 CGTA. See also Section 32A CGTA which provides additional merger reliefs in a situation where merger is by exchange of share devoid of any cash consideration.

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.

g) 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. Effect of Taxation on Consolidation for 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 liable to WHT and VAT.

h) VAT Issue

Issue of Value Added Tax may also arise in merger and acquisition exercise. If this occurs, the input VAT on service and administration expenses and VAT expenses incurred, in connection with capital assets, are required to be expenses of capitalization in the taxpayers' financial statements. The essence of this is that, though the Nigerian VAT law has not been developed to adequately take care of merger and acquisition matter an analogical deduction of Section 7 VAT Act is adequate to provide for certain percentage relief in merger and acquisition exercise in the banking sector.

i) Tax Indemnification

On 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.

PROCEDURAL ISSUES

a) Issue of Permission

The FIRS has no power under the Act to halt or prevent any merger proposals, 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 a 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.

The CITA in Section 29(12) Cap 21 LFN, 2004 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 Sub-section 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 *sine qua non* for the completion of the process in a merger or acquisition bid. Therefore, no merger or acquisition bids would be fully consummated without the companies involved having obtained the consent from the FIRS.

b) 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 for its study and proper 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)(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.

After due consultation, consideration and determination to merge by banks, it is expected of them to seek direction from the FBIR. The reason for this is that, under the law,⁴⁵ no merger, take-over, transfer or restructuring of trade or business carried on by a company (in this case, bank), shall take place without getting adequate direction from the FBIR under Section (9) before the consummation of any form of merger and acquisition exercise. This is in addition to the applying and obtaining of clearance with respect to any tax that may be due and payable under the Capital Gains Tax Act.

In other words, the proposed merger banks must see that adequate permission is sought for the clearance and advice from the FBIR and same must be done with respect to knowing the status of the proposed bank as regards the tax that may be due for payment as required by the Capital Gains Tax Act.

⁴⁵ See Section 29 (12) CITA, LFN, 2004.

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Exercise in the Nigerian Banking Sector*

The direction of the FBIR is usually obtained pursuant to an application submitted to it which must be submitted with a number of documents, including the merger plans and audited accounts of the companies involved for the three years preceding the year of the consummation of the merger⁴⁶ and copies of the income tax computations based on these accounts⁴⁷.

Even though a clear sanction is not stated in either the CITA or FBIR Act as to the punishment for any company that fails to seek for direction, doing that clearly amounts to an incomplete merging exercise. This is so because clearly, the Nigerian Tax Regime makes adequate provision regarding procedural issues for merger and acquisitions. The prerequisite direction of the FBIR is to ensure that the Revenue is not sidelined in an arrangement, which will deprive it of a buoyant of truant tax payer.⁴⁸

OTHER TAX ISSUES

a) Effective Date of Trade

It is important to determine when a trade commences, because expenditure is only deductible if incurred after that time. If an expense is incurred in the twelve months before trading, the amount is treated as a loss incurred in the year of commencement. Therefore, preparing to commence a trade is not the same as commencing a trade. In other words, when considering a commencement date for tax purpose, mere formation of an intention to commence trading is not the moment of commencement, nor is the incurring of capital expenditure for the purpose of preparing to trade⁴⁹.

b) Commencement – New Trade or Development of Existing One

There is no rule of law that a person, whether or not a company, cannot carry on more than one business and it is immaterial that there is one consolidated balance sheet.

⁴⁶ FIRS, Notice to Bank and other Companies Involved in Recapitalisation, Merger & Acquisitions in Guardian Newspaper, February 6, 2006, also in Ibid

⁴⁷ Balogun, B. 'Tax Consideration for Mergers and Acquisitions' (Unpublished) Paper Presented at the Workshop on Mergers and Acquisition, Organized by the Nigerian Insurers Association, December 14, 1999.

⁴⁸ 'Tax Considerations in Mergers & Acquisitions' <www.banwo-igbodalo.com/-resources/Tax_Considerations_in_Mergers_and_Acquisitions.pdf> assessed on the 13th September, 2011

⁴⁹ See the case of *Birmingham and District Cattle By-Products Co Ltd. v IRC*, (1915) 12 TC 92. In that case, the appellant company was incorporated on 20th June 1913; its directors then arranged for the installation of plant and machinery and entered into agreements for the purchase of its raw materials and the sale of its products; the raw materials were received on 6th October. The company's trade began on 6th October when they began to take the raw materials and to turn out their product. However, this was not the case in *Cannop Coal Co Ltd. v IRC*, (1918) 12 TC 31, where the trade was to be the mining of coal by sinking pits in the Forest of Dean. The company had since 1909 extracted a certain amount of coal from a drift nearby for use in its machines and, finding it had extracted more than it needed, sold the excess to the public; the company was held to have commenced trading when it sold the excess coal to the public and not when in 1912 coal began to emerge from the pits. That the coal company was engaged in a trade in those three years seems beyond argument and it was too fine a point to say that the trade was different from the mining of coal from the pits. See also, Abdulrazaq, M.T. 'Taxation Issues Arising from Mergers and Acquisitions in Nigeria.'

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Whether the particular change is the ceasing of one trade and the commencement of another or is simply a normal development of his previous trade. A trade does not cease if it is merely in abeyance. Thus, a mere interruption in production does not cause discontinuance nor does either a disposal of assets nor even the appointment of a liquidator. Business is not confined to being busy and long periods of inactivity may occur. It is, however, a question of fact whether a particular trade has lapsed into a period of quiescence or has ceased. A trade may be treated as permanently discontinued, notwithstanding that the former trade later commences a new trade which, in all respects, is identical with the previous ceased trade⁵⁴.

ISSUE OF CONTINGENCIES IN THE BANKING MERGER AND ACQUISITIONS

Part of the contingencies that may arise from merger and acquisition is the issue of job loss and executions of series of legal documents which may involve payment of gratuity and compensation for loss of office.⁵⁵

On the issue of the execution of legal document in merger and acquisition, such that will generally be necessary in respect of transferred properties and undertakings of the transferor company, stamp duties will be charged *ad valorem* on the instruments executed.⁵⁶

Further on stamp duties, under certain circumstances parties to merger and acquisition may be entitled to stamp duty exemptions⁵⁷. The duty reliefs cover exceptions with regards to conveyance and transfer of instruments as well as duties on increase of share capital.⁵⁸ Furthermore, the new company will need to obtain a Joint Tax Board

⁵⁴ In *Kirk and Randall Ltd v Dunn*, (1924) 8 TC 663 the new owners of a trading company obtained no new contracts and tried to sell the premises; they then had their works and plant requisitioned during the First World War. However, the Managing Director tried to obtain contracts overseas. Rowlatt, J. reversing the Commissioners, held that the company was still trading as there was evidence of business activity resulting in expenditure and loss. However, in *J.G. Ingram & Son Ltd. v Callaghan*, (1969) 45 TC 151, where the period was much shorter, the Court of Appeal upheld the Commissioners' finding that there was not just unprofitability but inactivity and so a discontinuance. In this case, the company had, by May 1961, ceased to produce rubber goods, had sold off its stock and dismissed its staff. The plan was to switch to the production of plastics. From September 1961 to June 1962, products were manufactured by another subsidiary of the owner and sold over the company's name. In this way, the goodwill was kept alive but the operations of the company were confined to little more than bookkeeping and perhaps debt collecting; the trade was not kept alive between those dates. See also, Abdulrazaq, M.T. 'Taxation Issues Arising from Mergers and Acquisitions in Nigeria.'

⁵⁵ See also Section 24 (g) CITA, 2004 which makes certain expenses an allowable deduction once approved by Joint Tax Board (JTB). See also *Nigerian Breweries Plc v FIR* (Appeal No. 342/2002. See also, 'Tax Considerations in Mergers & Acquisitions' <[www.banwo-igbodalo.com/-resources/Tax Considerations in Mergers & Acquisitions. pdf](http://www.banwo-igbodalo.com/-resources/Tax%20Considerations%20in%20Mergers%20&%20Acquisitions.pdf)> assessed on the 13th September, 2011

⁵⁶ Oyetunde, O. p.284.

⁵⁷ 'Tax Considerations in Mergers & Acquisitions' <[www.banwo-igbodalo.com/-resources/Tax Considerations in Mergers & Acquisitions. pdf](http://www.banwo-igbodalo.com/-resources/Tax%20Considerations%20in%20Mergers%20&%20Acquisitions.pdf)> assessed on the 13th September, 2011. See also Section 104 (1) C Stamp Duties Act which provides duty reliefs where at least 90% of the consideration for the transfer must consist in the issue of shares.

⁵⁸ Section 104 (3) SDA.

approval for its staff pension scheme⁵⁹.

CONCLUSION AND RECOMMENDATIONS

Merger and acquisition is a very important exercise that requires the conformity with both legal as well as procedural tax aspects of the exercise, failure of this makes such exercise inconclusive. Therefore, from the proposal stage to the completion stage, the affected companies needs to adhere and satisfy the tax aspect of the exercise. Apart from the fact that banks should comply with the legal requirements in mergers and acquisition as contained in section 100-123 of the Investment and Securities Act No. 45, 1999, they should also obtain the approval of the Governor of the Central Bank of Nigeria as required under the BOFIA as amended⁶⁰ and other tax laws that has to do with the exercise.

Unfortunately, the ongoing merger and acquisition exercise in Nigeria is facing challenges. Banks are merging without conforming to the tax aspect of the exercise, and some of those that conformed were later discovered to have done so via fraud.

In conclusion, the weakness and lack of specific and clear provision on merger and acquisition in the Companies Income Tax Act is humbly submitted to be a great minus for the viability of the Nigerian law on merger and acquisition and a clog to the realization of accurate revenue by FIRS through merger and acquisition in the Nigerian banking sector.

RECOMMENDATIONS

In view of the above findings, this paper recommends:

- **Amendment of the Companies Income Tax Act towards the expansion of the provision in Section 48 and enactment of clearer and workable guidelines for all the partakers in the merger and acquisition exercise.**

Due to non availability of a clear and specific provision in the Companies Income Tax Act on do's and don'ts compliance on the merger and acquisition, some banks seized that opportunity not strictly conforming with the legal as well as procedural requirements of the exercise. This has ridiculed and made nonsense of the exercise so far and same has resulted in to unending problems and continue failure in the banking sector. To halt this, the paper humbly recommends an amendment of the CITA to expand the provision of Section 48 to include what the managers or officers of the banks are expected to do while undertaking merging and acquisition exercise in addition to an enactment of clearer and workable guidelines for all the partaker in the exercise.

⁵⁹ However, This is no longer required in view of the Pensions Reform Act which is a cross legislation provision. See also, Abdulrazaq, M..T. 'Taxation Issues Arising from Mergers and Acquisitions in Nigeria'.

⁶⁰ See clause 6.1 & 6.2 of the CBN Guidelines and incentives on consolidation in the Nigerian Banking Industry (August 5th, 2004) also at <www.cenbank.org/out/publications/bsd/2004/consolidation.pdf>assessed on 15/9/11.

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- There should be a proper overhauling of the Nigerian tax legislation, especially as it has to do with the on-going recapitalization exercise in Nigeria

The researcher observed that in the recent past, Nigeria has made a lot of efforts to ensure the viability of the Nigerian tax system. Apart from the general effort in the direction of the establishment and reorganisation of the tax authorities, especially the Federal Board of Internal Revenue and the Federal Inland Revenue Service, a lot of efforts have also been put in the mode and manner of collecting tax in the country. However, even with this, there is still a long way to go. Nigeria seems to be reforming slowly in a fast-changing world that is becoming increasingly competitive, with tax playing a major role⁶¹. In order to achieve proper taxation of the banking business and to guide against the slow mode and manner tax reforming and collection is in Nigeria, it is humbly suggested that there should be a proper overhauling of the Nigerian tax legislation, especially as it has to do with the on-going recapitalisation exercise

- **Training of tax officers and collaboration within various government agencies**

For an effective taxation of banking business in Nigeria, the tax authorities should take training very seriously and collaborate with other government agencies such as the Corporate Affairs Commission, Land Registry, EFCC etc to reduce the incidence of tax evasion and cultivate voluntary tax compliance culture.

- **Improved and advanced technology**

Improved technology will also aid the actualization of proper taxation of banking business in Nigeria. Therefore, online filing of tax, online payment and filing of returns should be introduced to reduce the compliance time and the associated cost. This will also help in reducing human interaction between the taxpayers and the tax officials which will ultimately lead to reduction in tax fraud.

⁶¹ Mr. Taiwo Michael Oyedele made this observation in 2010, in one of his papers, 'Contentious Issues in Nigerian Income Tax Laws and Its Effects on the Citizenry' *Nigerians Speak Tax @ 50* (The Chartered Institute of Taxation of Nigeria (CITN)) Tuesday, 28 September 2010. Unfortunately, the situation remains the same till today which confirms that the reform efforts in the Nigerian tax sector is yet to have any possible effect on the Nigerian economy as far as taxation is concerned.