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CHAPTER FOURTEEN

X-RAYING THE TAX TREATMENT OF PROFIT, LOSS AND BAD DEBT IN THE NIGERIAN BANKING SECTOR

Abstract

This paper appraises the tax treatment of profit, deductibility of loss, and bad debts in the Nigerian Banking Sector. The paper argues that despite the provisions of section 29(1) & 31(2) Companies Income Tax Act (CITA) which borders on the constituents of Company profits and tax treatment of loss deduction, the industry is still experiencing some challenges. In order to guard against this, the paper recommends among others for the use of Tax Information Circulars which can aid the process, enactment of clearer rule for the determination of the taxable bank profits as well as the amendment of 29(1) & 31(2) of Companies Income Tax Act.

1.0 INTRODUCTION

There are varieties of way by which countries engage the tax treatment of loan losses in the banking institution. In some advanced countries, charge-off method is used, while in some, reserve method is in vogue. By charge-off method, it means a method under which loan losses are mainly recognised by the time loans become worthless. In determining whether a loan is worthless, all pertinent evidence, including continual non-performance, adequacy of collateral and the financial condition of the debtor is considered.

Under the charge-off method, if an amount previously

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¹ Like United States of America, Australia, Korea.

charged off as uncollectible is later recovered or the loan again becomes performing, the amount previously written off is brought back and restored to income. Reserve method on the other hand is when there is a provision for accounting for loan losses for tax purpose in addition to requiring it for regulatory purposes. One certain fact concerning the charge-off and reserve methods is that, both recognise the fact that bad debts are costs of earning income, and for that their cost should be deductible expense for financial and tax purposes².

Unfortunately, in the Nigerian banking sector, the measurement of taxable annual profits before loss or bad debt are determined is not a straight jacket thing. This is because, in banking business, due to the unpredictable and precarious nature of the business, profits and losses cannot be anticipated; and the Companies Income Tax Act did not define what 'profit' is.³ Instead of defining what profit is, the Companies Income Tax Act only outlines which revenue of the company a tax is payable. According to the Act, a tax shall be payable '...upon the profits of any company accruing in, derived from, brought into, or receive in, Nigeria....'⁴

One of the major aims and objectives of establishing a bank and other Financial Institutions is profit making. And, to achieve this, it is expected of the service buyer or benefactor to pay for services received promptly. However, sometimes, Financial institutions supplying goods and services do it on credit; and delay in payment

² For comparative analysis of tax treatment of loan losses in developed countries, see Escolano Julio, 'Tax Treatment of Loan Losses of Banks' in E.A. William, et al. (Eds.) *Systemic Bank Restructuring and Macroeconomic Policy*, (International Monetary Fund, 1997), pp. 144-176. See also V. Beattie, et al. *Banks and Bad Debts: Accounting for Loan Losses in International Banking*, (John Wiley & Sons, 1995), pp. 148-151 & 156-159

³ Though there are judicial pronouncements on what constitutes profit in *Mersey Docks and Harbour Board v Lucas* (1883) & AC. 891, 2 TC 25 wherein the House of Lords held per Lord Selbourne LC that the word 'profit' as here used means the incoming (of fund) before their application or use. See also, Lord Herchell's definition of profit in *Russel v Town & Country Bank* (1888) 13 AC 418.

⁴ See, Companies Income Tax Act, Cap C 21, Laws of the Federation on Nigerian (LFN) 2004, s.9(1)

or outright refusal to pay by debtors, an action which may result into occasional loss and collapse under certain circumstances. In order to guard against the negative effect and to check further spread of effect on the economy, government most of the time devise a way by which bad loan are mopped up in the banking sector.

In Nigeria, loan losses are allowed to be written off by the bank with the approval of the Central Bank of Nigeria when such loans have been confirmed worthless and uncollectible and have been charged off the books of account of the bank as of the end of the taxable year. This is clearly in contrast with some countries where limits on the tax deduction for losses are set off.⁵ In some countries, however, loan losses may be written off for tax purposes only due to bankruptcy or death of debtor or declaration by a competent court of law, or in form of civil judgment in favour of a debtor.

Guarding against the accumulation of either non-performing or bad debt has been the major concern of the government and the Central Bank of Nigeria. In fact, the CBN was reported to have targeted maximum of 5% bad loan ratio for all the Nigerian banks in 2011/2012⁶. In order to achieve the fit, the CBN cleared all bad loans and was on track to recapitalize banks rescued in a \$ 4 billion bailout in 2011⁷. Furthermore, the Central Bank of Nigeria on Tuesday 5th April, 2011 said the Asset Management Corporation of Nigeria had bought all non-performing loans in about 22 banks in Nigeria⁸. All these are to protect the banking institution against liquidation and to strengthen their statutory functions toward the customers.

Banks, because of the scale and nature of their activities, are possibly more prone to the risk of default by *lender* than most

⁵ This is the practice in countries like Japan and Thailand

⁶ *The Nation Newspaper* (Nigeria) Wednesday, April 6, 2011, p.2.

⁷ *ibid.*

⁸ Ademola A., 'AMCON has bought all non-performing loans-CBN', *The Punch Newspaper*, Wednesday, 6th April, 2011, p.21, see also, Yemi K. 'AMCON buys extra N1Trn bad loans for N600bn', *The Punch Newspaper*, Thursday, March, 31st 2011, p.19. It was also reported in the *Nigerian Tribune* of 29th November, 2011, that the total bad loan so far acquired by CBN is now N3.14 trillion. See also *The Sun Newspaper* (Nigeria) November 29, 2011.

other enterprises. Under normal circumstances, while computing loans, debtors will be brought into account at their face value, however, if payment is delayed and the debt does not bear commercial rate of interest debt could be discounted. For tax purpose, debtors are generally included in the computation of profits and only limited classes of taxpayers⁹ are excluded. Statutorily, the rules applying to the deductibility for tax purpose of bad debt provisions are the same as those applying to any other business.¹⁰ The question now is, what is the applicable rule governing the tax aspect of the loss and bad debt in the Nigerian Banking sector? How is a profit computed to determine loss for tax purpose? What are the allowable losses and how is a loan proved to be bad?

Structured into five sections, the next section discusses the determination of Banks taxable profit. Section three focuses on the ascertainment of loss and deductibility of bad debt while section four is on the procedure for computation of profit, proof of bad debt and regulatory accounting for tax purpose. The final section concludes the paper with some practical recommendation to the clogs in the determination of banks taxable profit in order to reduce tax burden in the banking industry.

2.0 DETERMINATION OF BANKS' TAXABLE PROFITS

In Nigeria, despite the length of time over which the Companies Income Tax Act charge has existed in substantially unaltered form, there are still many areas where the rules for determining the taxable profits of a trade are anything but certain.¹¹ Many of the leading cases did not involve the CITA, 1990 charge but arose out of comments against accountants not disclosing full amount of profits¹². Even the leading cases on the matter¹³ have

⁹ For example, barristers, authors and some professional firms.

¹⁰ F. Christopher, and W. Miles, *Taxation and Banking* (London, Sweet & Maxwell, 1990), p.41.

¹¹ M.T. Abdulrazaq, *The Basis of Taxation for Nigerian Banks*, (Nigerian Tax Notes, 1995), p.1

¹² *Ibid*, p.78, See also Christopher and Miles, above note 10, p.12.

¹³ For example, the *Willingle v International Commercial Bank Ltd* (1978) STC 75, *Pattison v Manne Midland* (1984) STC 10 and *Symons v Weeks* (1983) STC 195.

not resulted in greater certainty in practice, but each has provoked a considerable amount of controversies. The major reason for these controversies was that, new accounting principles and more complex transactions do not always fit very aptly into rules developed to deal with more straightforward trades.¹⁴ Hence, different principles proposed for the determination of banks' taxable profit?

Amongst the principle used in determining banks taxable profit are the normal commercial principle,¹⁵ which basically emphasised the interpretation of the word, 'profit' literally, the concept of accruing profit and expenses rather than setting out receipts and payment¹⁶. Possibly, the definition of taxable profits, which is most often quoted, is that of Lord President Clyde in *Whimster & Co. v. IRC*¹⁷

In computing the balance of profits and gains for the purposes of income tax, two general and fundamental common places have always to be kept in mind. In the first place, the profits, any particular year or accounting period, must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and expenditure laid out to earn those receipts. In the second place, the account of profit and loss to be made up for the purpose of ascertaining that difference must be framed consistently with the ordinary principles of commercial accounting, so far as applicable-and in conformity with the rules of the Income Tax Act¹⁸.

¹⁴ Abdulrazaq above note 11, p.79.

¹⁵ This was the principle laid down in the cases of *Sun Insurance Office v. Clark* (1912)AC 443 at 455 per Lord Halden, *Gresham Life Assurance Society v. Styles* 3 TC 188, per lord Halsbury.

¹⁶ See *Viscount Simon in IRC v. Gardner Mountain and D'Ambrunnil Ltd* 29 TC 69.

¹⁷ 12 TC 813 at 823.

¹⁸ See Abdulrazaq above, note 11, p.80. See also Christopher and Miles above, note 10, p.13.

Debts due and owing, in addition to opening and closing work in progress or stock in trade, must, accordingly, be brought into account for tax purposes so that profits are not distorted by any build up or reduction in the closing balances.¹⁹ As a company's account would naturally include debts, work in progress and stock in trade, taxation adjustments to accountancy profits are only required when the way in which these are calculated for accounting purposes fails to satisfy taxation requirements.²⁰

The rule that taxable profits are determined according to normal commercial principles may be qualified by the specific requirements of CITA²¹ which provide for numerous adjustments to be made to accounting profits in order to determine the taxable profits for the period. Subject to such adjustments as are demanded by legislation or case law, however, a company's accounts will determine its taxable profits provided that these are prepared in accordance with these normal accounting principles²²

Contemporarily, expert evidence of accountancy practice appears to be growing in importance in determining whether or not a particular item is to be subject to tax during a particular period. This may be in part because, since the early cases, company law requirements and accountancy principles have increased the technical requirements for companies in drawing up their accounts. Ordinary commercial accounting practice now has to be determined in accordance with accounting standards set out by the accountancy bodies from time to time. The principle remains, however, that although accountancy practice is important, it is not decisive²³.

¹⁹ *John v W. S. Try Ltd* 27 TC 167.

²⁰ See *Duple Motor Bodies Ltd. v Ostone* 39 TC 537.

²¹ 2004

²² in accordance with normal accounting principles, see *Western Sudan Exporters v FBIR* 1 MTC p. 239.

²³ See Lord Radcliffe's views in *Owen (HM. Inspector of Taxes) v Southern Railway of Peru* 36 TC 602 at 646.

3.0 ASCERTAINMENT OF LOSS AND DEDUCTIBILITY OF BAD DEBT

3.1 Allowable Losses

In ascertaining profit, there are some deductions statutorily allowed²⁴ and the whole process begins with the preparation of financial statements or accounts in accordance with general acceptable accounting principles and the provisions of CAMA.²⁵

Even though a deduction is allowed under the legislation, and that general bad debt provision may be set up by the bank, this is not in itself totally sufficient. The common practices and procedure adopted by most of the commercial enterprises is to provide against specific debts where the personal circumstances of the debtors or other external factors make it unlikely that the debt be fully recovered.²⁶

In the banking business a deduction for bad debts is not just ordinarily available but only when each debt had been looked at specifically and assessed according to its particular circumstances. In that circumstances the Federal Board of Inland Revenue may nevertheless give a deduction for provisions which are calculated on a reliable and scientific basis.²⁷

However, in the case of individual account, where assessments are on earnings basis, money owed to the business must be brought into account. A deduction is, however, allowed for debts proved to be bad and for those properly estimated to be

²⁴ See Companies Income Tax Act, *Cap 60 Laws of the Federation of Nigeria 1990*, s.20, now Companies Income Tax Act, *Cap C21 Laws of the Federation of Nigeria 2004*, s.24

²⁵ On the preparation of Financial Statement and Accounting Records, see Companies and Allied Matters Act, *Cap C20 LFN 2004*, SS 331 and 332. Also see S. Lekan, & O. Sunday, O. *Taxation Principles and Practice in Nigeria*, (Silicon Publishing Company, Ibadan, 2006) p.290. See also, E.A. Ogundele, *Element of Taxation*, (Libri service Nig. Ltd., Lagos, 1999), p.373.

²⁶ M.T. Abdulrazaq, "Tax Implications of Provision for Bad Debts by Nigerian Banks", (unpublished working paper) p.57.

²⁷ Christopher and Miles, above note 10, p.42.

doubtful or are defaulted.²⁸ Therefore, if taxed on an earnings basis, an apportioned amount of money owed may be allowed as a deduction for tax purposes, provided that it is a revenue expense incurred wholly, exclusively, necessarily and reasonably for the purpose of earning profits.

Going by the provision of section 29(2) of the Companies Income Tax Act, the amount of the loss to be allowed for tax purpose in a company should be that which the Board is satisfied as having been incurred by the company in a trade or business during a preceding year of assessment.²⁹ The meaning of this is that in the banking business, the loss that would be relieved for tax purpose should be the one that occurred the year ended before the assessment period. And in no circumstances shall the amount to be relieved exceed the total amount of the loss.³⁰

However, for an individual, if a loss occurred as a result of bad debts, relief is available either against any assessable income of the taxpayer for the year of assessment in which the loss was incurred³¹ or by way of "carry forward" against future assessable income from the particular trade in which the loss was incurred³².

Even though losses can be carried forward for a maximum of four years following that in which they are incurred, but a relief can only be given against profit from same trade or business in which the loss was incurred. However, losses incurred by any company that is engaging in agricultural trade or business can be carried forward with no time limit. The loss available for relief should

²⁸ Going by the provision in Personal Income Tax Act, Cap P8 LFN, 2004, s. 20 (1) (c), this adjustment is for debtors,

²⁹ but if the assessment is made on a cash basis, no deduction can be allowed until the payment is made and the expense incurred.

³⁰ Companies Income Tax Act, Cap C21 Laws of the Federation of Nigeria 2004, s.29 (2).

³¹ A.A. James, *Companies Taxation in Nigeria*, (3rd edn. JAA Nig. Ltd, 2000), pp.67-68.

³² See Personal Income Tax Decree, 1993 s.36(2)(a)(ii) and Companies Income Tax Act (CITA), Cap 60, Laws of the Federation of Nigeria, 1990, s.27 (2)(a)(ii) now Companies Income Tax (CITA), Cap C21 Laws of the Federation of Nigeria 2004, s. 29(1)(a)(2) Abdulrazaq, above, note 25, p.1.

be computed on the same basis as is the computation of assessable profit for a year of assessment. Imperatively, however, where a relief is sought the whole amount of loss must be set off so far as it is possible and any balance may be carried forward.³³

In a nutshell, no sum shall be deducted in respect of any debts, except bad debts proved to be such, and doubtful debts to the extent that they are respectively estimated to be bad, and in the case of bankruptcy or insolvency or a debtor, the amount which may reasonably be expected to be received on any such debt shall be deemed to be the value thereof.

Furthermore, the Federal Board of Inland Revenue is also allowed³⁴ to examine the specific bad debt provision made by the taxpayer (bank) and look at the consideration of factors leading to that provision being made and that in appropriate cases it may challenge same.³⁵ The major thing to note in the effort of knowing which of the activities of the loan will qualify for loss or bad debt arising out of trade which will qualify for relief and the one that will not qualify is that the loss must be directly arisen from the banking trade and not any attached circumstances thereto.

This qualification was further clarified in the case of *Curtis v Oldfield*,³⁶ where the Managing Director of a company had used the company's bank account to pay his own private bills. It was held that the loss so incurred by the company was not deductible. In the words of Rowlatt J,

If you have a business... in the course of which you have to employ subordinates and owing to the negligence or the dishonesty of the subordinates, some of the receipts of

³³ See Personal Income Tax Decree, 1993, s.36 (2) (b) (iv) and Companies Income Tax Act (CITA), Cap 60, Laws of the Federation of Nigeria, 1990, s. 27 (2) (a) (11) now Companies Income Tax Act (CITA), Cap 21, Laws of the Federation of Nigeria 2004, s. 29(1)(a)(2).

³⁴ Abdulrazaq above, note 25, p.56.

³⁵ By Companies Income Tax (CITA), Cap C21 Laws of the Federation of Nigeria 2004, s.24

³⁶ Abdulrazaq above, note 25, p.59.

the business do not find their way into the till, or some of the bills are not collected at all, or something of that sort, that may be an expense connected with and arising out of the trade in the most complete sense of the word.

The implication of the above statement is that, to qualify for a loss or bad debt in banking industries, such loss must have arisen directly from the banking business or trade and not any attached circumstances thereto. In simple term, a loss incurred on structural facilities like building and advert cannot qualify for loss, but any loss incur in account making, service payment that direct arisen from banking business qualifies. In nut shell, the use of trading loss to reduce tax can be considered in two ways to wit: the use of losses incurred by the trade itself, and the use of losses incurred by someone else.³⁷

3.2 Loan Losses

In March 2010, in a bid to solve the issue of bad loan in the Nigerian banking sector, the Asset Management Corporation of Nigeria bought extra #1 trillion bad loans for N600 billion. According to the Managing Director of the Asset Management Corporation of Nigeria³⁸ this was done so that;

...the banks, instead of being stuck with liquid non-performing assets have bonds that they will cash as they make new loans, and use the proceeds to fund new loans.

They can create new portfolio of loans in line with the CBN's prudential guidelines. And as they make loans they will be able to fund them.

In ascertaining the assessable income of a taxpayer for a year of assessment, relief is given for the amount of any loss incurred

³⁷ (1925) 9 T.e 319.

³⁸ M.T. Abdulrazaq. *Principles and Practice of Nigerian Tax Planning and Management*, (Batey Law Publication Ltd, 1993), p.62.

by or in a trade, business, profession or vocation carried on by the taxpayer.³⁹ Any amount recovered with respect to debts written off previously is treated as profit of the year in which such amount was recovered and written back to profit and loss account.⁴⁰

Given the importance of loans in bank assets and the cost of bad debts, the treatment of losses is one of the central tax policy issues relating to the taxation of banking. Losses are an inevitable cost that is incurred in order to earn income and these losses should be recognized as an expense for both financial and tax purposes.⁴¹ On a bank's financial statement, the values of loans are often shown on a net basis (that is, the face value of the loans corrected by the estimated loss).⁴²

In nut shell, order not to under-provide for loan losses and to benefit maximally from loss provisioning; banks significantly want the tax rules for recognising loan losses to conform closely to regulating accounting standard, even though this may reduce income taxes paid by banks. This, the tax officials often are wary of⁴³.

3.3 Issue of Sovereign Bad Debts

A sovereign debt is a debt incurred by a government or government agency or guaranteed by a government or government agency.⁴⁴ The common belief that sovereign entities may not likely go broke which may mean that bad debt may not crystalise, gave rise to some doubt on whether the tax authorities would agree to any provision made against debts due by sovereign entities. In

³⁹ In *The Punch* Newspaper (Nigeria), March, 31, 2011, p 19, however, as at November 2011, the total bad loans bought by AMCON has risen to N3.14 trillion. See *Nigerian Tribune* (Nigeria) and *The Sun* Newspapers (Nigeria) of November 29, 2011.

⁴⁰ P.G.W. Willoughby & H.A. Brian *Guide to Income Tax and Capital Gain Tax* (Sweet & Maxwell, 1969), pp.34-35. See also, Abdulrazaq, above note 25, p.1.

⁴¹ Lekan, & Sunday, above note 24, 291.

⁴² M.S. Emil, "The Tax Treatment of Bank Loan Losses". <http://siteresources.worldbank.org/INTFR/Resources/Sunley_BadDebts.pdf> accessed on March 16, 2011, p.1

⁴³ *Ibid.* p.2.

⁴⁴ *Ibid.* p.1

consequence thereof, there are some general principles applicable in determining the extent to which specific provisions for sovereign risk debt can properly be allowed for tax purpose in Nigeria. The general principles are:

- a. It is for each individual bank to decide on the amount of any specific provision which it regards as appropriate and to justify such provisions for tax purposes.
- b. Whether a specific provision can properly be allowed for any debt can only be determined in accordance with the relevant tax law in the light of the particular circumstances at that date, including, as regards a sovereign debt, the present and prospective ability of the debtor sovereign to service its debt
- c. Subject to all other circumstances, the rescheduling of a debt, or of the interest thereon, does not of itself necessarily preclude the allowance of specific provision in respect of that debt.
- d. Where interest is overdue on a debt and the bank is taxable on an accruals basis, a provision may be allowed against that interest until such times as it is paid.
- e. Any specific provision allowed for tax is subject to annual review, even if during the year, there has been no recovery of the debt; this review will have regard, amongst other things, to any changes in the economy of the sovereign debtor which might have a bearing on the prospects of recovery of the debt.
- f. In the case of an overseas commercial debt, account is taken of any overseas government intervention (e.g., exchange control) which may prevent or render doubtful payment of interest or repayment of the debt.

- g. Inspectors of taxes should apply tax principles in a consistent way. They should recognize that the treatment of sovereign risk debt may involve special or unusual factors, and they are to be ready therefore, to consider any particular difficulties which may occur⁴⁵.

The use of the above outlined general principles is not without some problems. Amongst such problems is the considerable uncertainty as to the level of provision which the FBIR would allow. The reasons being that, the nature of these debts coupled with their size meant that provision were more likely to be challenged than provision on normal commercial debts.

Furthermore, since it is possible for sovereign to secure debt in many banks, the opportunity for comparison by the FBIR between the treatments by various creditor banks of debt due by the same sovereign entity are also enormous. However, since the soundness of the debt is measured on an objective basis, the allowable provision given to different banks in respect of the same sovereign debt would not vary greatly, if at all.

In a nutshell, even though there exists the general principle in providing for sovereign bad debt, the actualization of same is not without problems, and majorly amongst the problems is the size of such debt which may constitute a challenge to the tax authority coupled with the problem of lack of certainty or clarity of mode of treatment by various creditor banks of the said sovereign bad debt.

3.4 Tax Treatment of Loan Losses: A Jurisdictional Juxtaposition

Given the wide diversity in tax treatment, there clearly is no generally accepted international standard as to the appropriate tax treatment of loan losses⁴⁶. Different countries after using different guide-lines device and enact a suitable rules for tax treatment of

⁴⁵ Abdulrazaq, above note 26, p.60.

⁴⁶ Abdulrazaq, above, note 25, p.60. See also, Christopher and Miles, above note 10, p.44.

loan losses. Therefore, rules and method of deductibility in a developed economy may divers from the developing economy. According to Emil,⁴⁷ in country like United States with large banks that worth more than \$500 million in assets, Australia, Korea, Malaysia, and, Philippines their law only allow the charge-off method, under which loan losses are recognized only when loans become worthless. She argued further that, in determining whether a loan is worthless, all pertinent evidence, including continual non-performance, adequacy of collateral and the financial condition of the debtor should be considered

In the Philippines, loan losses are allowed only for worthless and uncollectible loans that have been charged off the books of account of a bank as of the end of the taxable year. The tax authority allows a debt to be written off for tax purposes once it has been written off by the bank with the approval of the Central Bank of Philippines. Some countries (Japan and Thailand) set limits on the tax deduction for loan losses⁴⁸. In Thailand, banks can deduct loan loss provisions from taxable income up to 25 percent of net income or 0.25 percent of total outstanding loans, whichever is less. Loan losses may be written off for tax purposes only when civil action has been brought against the debtor, the debtor has declared bankruptcy or died⁴⁹.

Generally in Nigeria, a company (bank inclusive) is not allowed to deduct its loss in computing the profits of its trade or business as if they were expenses; however, a company can statutorily apply for relief for the amount of loss incurred by it in its trade or business for the purpose of computing its assessable profits for the year of assessment⁵⁰. Despite the directive of the CBN that when IFRS is adopted in Nigeria, the Banks would be required to make provisions for loans as prescribed in the relevant IFRS

⁴⁷ Emil above, note 43

⁴⁸ *ibid*

⁴⁹ *ibid*, similarly, see Escolano, in William, note 2, above, pp.144-176. See also Beattie, note 2, above, pp. 148-151 & 156-159

⁵⁰ Emil, above, note 43

Standards⁵¹; the applicable rule as regards the deductibility for tax purpose of bad debt provisions still remains same as those applying to any other business.⁵²

4.0 PROCEDURE FOR COMPUTATION OF PROFIT AND REGULATORY ACCOUNTING FOR TAX PURPOSE

4.1 Computation of Profit for Tax Purpose

For each year of assessment tax is payable at the current rate of 30% of the total profits of every company, any year of assessment wherein, the ascertainment of total assessable profits from all sources of a company result in a loss, or no tax payable, or tax payable which is less than the minimum tax, the tax payable by the company shall be the minimum tax computed.⁵³

Taxable profit is arrived at after the treatment of the loss relief, capital allowances, balancing allowances and balancing charges. In other words, the assessment for total profit of a bank for any year of assessment is at 4 stages. The stages are aggregates of all assessable profits from all sources, the total of the assessable profits from all sources, including the balancing charge, the deduction of loss relief due and the deduction of any investment and capital allowance to be granted⁵⁴.

Therefore, in the computation of profit for tax purpose, debtors are generally included, and for that, debtors are brought into account at their face value.⁵⁵ The total profits of any banks for any year of assessment shall be the amount of its total assessable profit from all sources for that year together with any additions thereto

⁵¹ O.J. Orojo, *Company Tax Law in Nigeria*, (London: Sweet & Maxwell, 1979) p.152.

⁵² See, CBN Prudential Guidelines For Deposit Money Banks In Nigeria, May, 2010 <<http://ndic.org.ng/files/Prudential%20Guidelines%205%20May%202010%20Final.pdf>> accessed on 23rd May, 2014

⁵³ Orojo, above, note 48, p.1.

⁵⁴ James, above note 29, p.69.

⁵⁵ Companies Income Tax (CITA), *Cap C21 Laws of the Federation of Nigeria* 2004, s.27(1)

of the amount of balancing charge less deductions due for loss relief investment allowance and capital allowance.⁵⁶

In arriving at the chargeable bank profit, losses, if any, incurred in the preceding year of assessment are also to be deducted. Contrary to what is obtained in personal taxation, there is no current year loss relief available to banks. It is only the carry forward relief that is available. Invariably therefore, going by the provision of Section 29(1) of the Companies Income Tax Act, 2004, the assessable profits from all sources are to be aggregated. If a loss has been incurred from any one source, such cannot be aggregated with the profits from other sources to determine total profit. What will be done is a carried forward relief against future profit from the same source. As simple as this procedure is, the lack of clear rule to determine taxable bank profit coupled with the ambiguity in the combined interpretation of sections 29(1) and 31(2) of Companies Income Tax Act greatly compounded the problem of determination of Bank taxable profits, and bad debt in practice.

4.2 Ambiguity in Sections 29(1) and 31(2) Examined

The combined interpretation of provisions of Sections 29(1) and 31(2)⁵⁷ is fraught with ambiguity. While section 29(1) provides that the profits of any company for each year of assessment from such sources of profits shall be the profits of the year immediately preceding the year of assessment from each source; section 31(2) restricts the losses that may be relieved in any year to the assessable profits from the trade or business in which the loss was incurred. This practice is not equitable and it seems to punish genuine businesses for incurring real losses.

4.3 Regulatory Accounting for Loan Losses

On the classification of loans and setting minimum reserves, it is the responsibility of the bank regulatory agency in most of the countries to specify such scheme. However, this should be

⁵⁶ Emil, above note 41

performed systematically in a consistent manner and, most often, in conformity with the objective criteria for such classification.

The common practice of financial accounting is the recording of loan at their face value until same became fully worthless and then written off. Therefore, on a bank's financial statement, the value of loans are often shown on a net basis, and a provision or reserve account is established for potential losses present in the portfolio of loans⁵⁸.

Specific reserves are linked to specific loans and amount of reserve required usually depends on the length of time that payment of interest and principal have been past due. The general reserve is not linked to specific loans but reflects losses that experience indicates are present in the portfolio of loans but not yet specifically identified. Any amount set aside for future losses should be accounted for as appropriations of retained earnings; that is, not recognized as a current expenses.⁵⁹

Just like ordinary losses, some loans in the commercial banks will be uncollectible, and for that, in order to safeguard an uncontrollable loss, banks at times established a reserve for loan losses equal to about 25% of the amount of these loans. The reserve for loan losses is not for future losses because they are already present in the portfolio of loans past due for 6 to 12 months and should be recognized as an expense for this period even though it is not possible at this time to identify just which loans will alternately be worthless. For countries that use a loan classification scheme, a loan would be considered impaired when a specific reserve is required for the loan. In addition, when interest ceases to accrue on a loan, uncollected interest that had been previously accrued should be reversed⁶⁰.

⁵⁷ Companies Income Tax (CITA), *Cap 60 Laws of the Federation of Nigeria 1990*, s. 27 (1) now Companies Income Tax (CITA), *Cap C21 Laws of the Federation of Nigeria 2004*, s. 29(1) See also, James, above note 29, p.64.

⁵⁸ CITA, 2004.

⁵⁹ Emil, above note 41, p.2.

⁶⁰ *Ibid.* p.3.

However, since there is a capital adequacy standard in most countries, bank, like any other business, is enjoined to maintain sufficient capital to provide security and cushion to cover large and or unanticipated losses. In banks, there is closely related issue to the treatment of loan losses and the treatment of unpaid interest. Most banks, at least larger banks, are on the accrual method of accounting and thus accrue interest income on loans as the claim arises and not when the income is received.

For this, it is important to note that the general losses provision cannot be greater than 1.25% of risk-weighted assets. This, in part, ensures that the regulatory authority does not set a high mandatory general provision to offset the tendency of certain banks to under-provide for non-performing loans.⁶¹ Thus, whenever a loss is to be deducted, the aggregate deduction from assessable profit or income in respect of any such loss must not exceed the amount of such loss and the deduction for any particular year of assessment must not exceed the amount of the assessable profits included in the total profits for that year of assessment, from the trade or business in which the losses were incurred⁶².

4.4 PROOF OF BAD DEBT

The Onus of proving that a debt is bad rests with the taxpayer,⁶³ but in some instance, the nature of a debt will be what will qualify a debt to be bad or not, hence the opinion of Rowlatt J in *Anderton and Halsted v Birrill*,⁶⁴ that:

What the statute requires, therefore, is an estimate to what extent a debt is bad, and this is for the purpose of a profit and loss account. Such an estimate is not a prophesy to be judged as to its truth by after events,

⁶¹ *Ibid.* p.6.

⁶² *Ibid.*

⁶³ Orojo, above note 37, pp.153-154.

⁶⁴ Abdulrazaq, above note, 25, p.57.

but a valuation of an asset de praesenti upon an uncertain future to be judged as to its soundness as to estimate upon the then facts and probability.

In some instance, the court was of the opinion that the declaration as bad or otherwise of a debt is surely on the appropriate tribunal.⁶⁵ In the words of the court per Russell of Killowen 'whether a debt is wholly or partially and to what extent bad or irrevocable is in every case (and whether debt is a human being or a joint-stock company or other entity) a question of fact to be decided by the appropriate tribunal upon a consideration of the relevant facts of that case'. Furthermore, a time, a bad debt by circumstances could turn to serviceable and recoverable debt. According to Lord Porter in *Absalom v Talbot*⁶⁶,

— attention, however, had been drawn to the practice in the past of the Inland Revenue authorities of making an allowance in respect of losses for bad debt or doubtful debts as and when they occur, though the debt itself was originally treated as being of its face value in a previous year's accounts. Such a practice necessitates, I think, the corresponding obligation on the part of the taxpayer to submit in a later year to an increase in the sum at which a debt previously treated as bad or doubtful should be brought into account if, in fact, a payment greater than the assumed value had been obtained or seems likely to be obtained, on a later occasion.

In a later case⁶⁷, Lord Greene M.R disagrees with the opinion of Lord Porter. In his opinion,

⁶⁵ 16 TC 200.

⁶⁶ As was held in *Dinshaw v Bombay Income Tax Commissioner* 13 ATC, 286.

⁶⁷ 26 TC 166.

Lord Porter seems to have taken the extreme view that even if it were no change of the debt value would justify that change in the account of the year place.

However, despite Lord Greener's doubt that the universal practice of re-appraising debt basis is by now so established that it is unlikely to decide that it was wrong or misguided⁶⁸.

5.0 CONCLUSION AND RECOMMENDATION

Premised on the discussion in this paper that, as profit is envisaged in the banking business, some loan may at times occur. And so for the entire loan to be repaid, such loans would be bad debts. Bad debts are debts that are irrecoverable. But before a debt can be categorized as a bad debt, the nature of such debt will be a determining factor. The onus of proving that a debt is bad rests on the bank (in most cases). However, in some instances, the onus (otherwise) of a debt may rest on the appropriate authority.

In Nigeria, loan losses are allowed to be written off by a bank with the approval of the CBN when such losses are confirmed worthless and uncollectible and some are written off the books of account of the bank at the end of the year.

of loss and bad debt reliefs in the banking industry. To guard against this and to forestall the collapse of the banking institution due to heavy tax burden, the following are recommended.

5.1 Enactment of a Clearer Rule for the Determination of the Taxable Bank Profits

Doing this will guarantee easy assessment of tax in the banking industry; it will also reduce the problems that the revenue officers face while determining some complex transactions in the banking industry. Invariably, this will ease the assessment procedure in the deductibility of loss and bad debt in the banking industry.

5.2 Amendment of Section 29(1) and Section 31(2) Companies Income Tax Act

Since the combined interpretation of provisions of sections 29(1) and 31(2) Companies Income Tax Act CITA, is fraught with ambiguity because while section 29(1) provides that the profits of any company for each year of assessment from such sources of profits shall be the profits of the year immediately preceding the year of assessment from each source; section 31(2) restricts the losses that may be relieved in any year to the assessable profits from the trade or business in which the loss was incurred. This is practically impossible and same may punish genuine businesses for incurring real losses. To guard against this, the paper recommends for the amendment of the sections to accommodate group consolidated tax returns system which will facilitate accurate determination of the year loss as it was incurred and relief thereto.

5.3 Adequate Use and Constant Reference to Tax Information Circular

Tax Information Circulars, though, not a statutory tax book, but the adequacy of same can serve as veritable paraphernalia for an administrative directive on adequate tax reporting and compliance in the banking sector. Since Information Circulars mostly contain explanation on tax statutes and directions, it may aid the easier determination of loss and bad debt relief.

5.4 **A call for distinct legislation on the deductibility of loan losses in the Nigerian Banking Sector**

Despite the directive of the CBN that when IFRS is adopted in Nigeria, the Banks would be required to make provisions for loans as prescribed in the relevant IFRS Standards⁷⁰; today in Nigeria, the applicable rules as to the deductibility for tax purpose of bad debt are still the same as those applying to any other business, this, the paper humbly argued is not equitable. The rule fails to take in to cognizance the distinct and un-predictable nature of banking business; therefore, enacting a distinct legislation on loan losses and debt in the banking industry is the best way to solve this problem.

⁷⁰ *The Nigerian Tribune* (Nigeria), November 29, 2011, p.1. See also, *The Sun Newspaper* (Nigeria), of the same date.

⁷¹ See, CBN Prudential Guidelines For Deposit Money Banks In Nigeria, May, 2010 <<http://ndic.org.ng/files/Prudential%20Guidelines%205%20May%202010%20Final.pdf>> accessed on 23rd May, 2014