Pioneer Status in Nigeria: Recent Developments and Effects on Investments in Nigeria.

Background

At the end of the Federal Government’s State Visit to Beijing, China in July 2013, while addressing the international media on the attractions of Nigeria as an investment haven, the Minister of Industry, Trade and Investment, Mr. Olusegun Aganga, described Nigeria as a large market and a country which has one of the highest return on investment in the world.

The Nigerian Investment Promotion Commission ("NIPC") which is established under the NIPC Act CAP N117 LFN 2004 as an investment promotion agency of the Federal Government is one of the government agencies that could potentially make Mr. Aganga’s prediction a reality. The NIPC was created as a one-stop shop where relevant government agencies provide services to investors. Its mandate is to shorten and simplify administrative procedures for the incorporation of companies, issuance of business approvals, permits and licenses, thereby removing bottlenecks faced by investors in establishing a business in Nigeria, and ultimately, reducing the cost.

In line with its powers to make regulations under the NIPC Act, the NIPC recently released the Pioneer Status Incentives Regulations of 2014 ("the Regulations"). The purpose of this article is to highlight the effect of these Regulations, particularly in respect to investment opportunities in Nigeria.

Pioneer Status in Nigeria

A Nigerian company is expected to pay income tax on its profits accruing in, derived from, brought into or received in Nigeria. However, in certain instances, government grants tax incentives to boost investment. An example of such incentives is the grant of Pioneer Status.

Pioneer Status is a tax holiday granted to qualified (or eligible) industries anywhere in Nigeria. A five-year tax holiday is granted in respect to companies operating in eligible industries, while a seven-year tax holiday is given in respect of industries located in economically disadvantaged local government area of the Federation. The grant of Pioneer Status to a company in Nigeria is aimed at enabling such company operating within the pioneer industry make significant capital expenditure and a reasonable level of return of profit within its formative years without having to pay companies tax.

The enabling legislation as regards Pioneer Status in Nigeria is the Industrial Development (Income Tax Relief) Act 2004 ("The Act"). The Act provides that where the Nigerian government is of the opinion that any sector or industry in the economy is not being undertaken on a scale suitable to the economic advancement of Nigeria or that it is in the public interest to encourage the further development or establishment or advancement of trade in such sector or industry, the President of Nigeria is authorized to publish in a Gazette, a list of such industries to who qualify for pioneer status.

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1 Section 4 of the NIPC Act
2 Section 30 of the NIPC Act
3 This Tax holiday is in relation to Companies Income Tax
4 As stated in the NIPC Website: [http://www.nipc.gov.ng/investment.html](http://www.nipc.gov.ng/investment.html). It is important to note that the NIPC via its website seems to connote that once a company is located in an economically disadvantaged local government area, such company would be eligible for grant of pioneer status.
5 Section 1 of the Industrial Development (Income Tax Relief) Act
Currently some of the industries on that list are: rubber plantation and processing, real estate development and utilities, manufacture of cement, pharmaceutical, iron and steel from iron ore, gas cylinders, solar energy powered equipment and gadgets and maintenance of aircrafts.⁶.

**The Pioneer Status Incentive Regulation 2014 and Effects on Investment Opportunities in Nigeria**

The Regulations has enacted certain changes to supplement the Act. Outlined below are the changes and the effects on potential investments in Nigeria.

1. **Capital Expenditure:**

By virtue of Section 3(b) of the Regulations, the capital expenditure threshold required to enable a company apply for Pioneer Status has been increased to N 10,000,000 (Ten Million Naira Only). It is important to note that this threshold applies to both Indigenous and foreign companies.

Prior to enactment of the Regulations, to qualify for Pioneer Status, a wholly foreign-owned company must have incurred a capital expenditure of not less than N 5,000,000 (Five Million Naira Only) while an indigenous company must have incurred a capital expenditure of not less than N 150,000 (One Hundred and Fifty Thousand Naira Only).

The Regulations therefore appear to have done away with the prior distinction of foreign owned Nigerian companies and Indigenous Nigerian companies. The effect therefore of this is that both local and foreign companies eligible for Pioneer Status would need to meet the same criteria for as regards capital expenditure.

Moreso, the rationale for the higher threshold may also be to prevent abuse of the incentive as its has been known in the past and to ensure that investors (whether local or foreign) make substantial capital expenditure to be eligible for pioneer status. However, some cottage/small scale industries who may be deserving of pioneer status may not hit the Ten Million Naira threshold. This could potentially cut off small/local industries that could benefit from pioneer status.

2. **Payment of Service Charge**

The Regulations⁷ also provides that an applicant company shall pay to the NIPC, a 2% service commission charge to be determined from its estimated savings (that is, the savings which the company would make as a result of the tax exemption). The applicant company is also mandated to submit to the NIPC, its 5 year financial projections to assist the NIPC in evaluating the 2% Service Charge to be paid to the commission.

Where the applicant company records negative pre-tax earnings in its projections, the service charge shall be calculated on the higher of the following:

- Either 0.5% of its net assets; or
- 0.25% of its turnover.

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⁶ The published list is not exhaustive as the Act stipulates that “an application may also be made under this section for any industry to be included in the list of pioneer industries and pioneer products”- Section 1 (2 ) of the Industrial Development (Income Tax Relief) Act

⁷ Section 5 of the Regulations.
This new provision in the Regulations does not identify the elements to be considered in the NIPC’s calculation of tax savings. The probable key element which would be considered is savings from Companies Income Tax. Clarity should be provided as to whether the calculation of tax saving would be calculated only with respect to Companies Income Tax or whether other factors would be considered.\(^8\)

Related to this, the Regulations does not provide for a methodology by which the 5 year projections of the applicant company would be made. The responsibility of making such projections is left to the discretion of the applicant company. The effect of this is that companies may deliberately misrepresent the 5 year projections of such companies in order to obtain pioneer status.\(^9\)

More importantly, is the fact that the Service Charge appears to be a ‘Greek gift’ as it takes away with another hand what it has given (tax savings), that is some of the tax savings which the company stands to benefit now has to be paid to the NIPC as a service charge.

3. **Applicant’s Regulatory License.**

The Regulations further provides that when making an application for Pioneer Status to the NIPC, the applicant must submit the relevant regulatory license to operate in the sector or business activity.\(^10\)

The applicant is required to furnish the relevant regulatory license to operate in the sector or business economy. Although most of the industries upon which an application for pioneer status can be made require the applicant to obtain a license to operate in such industry, there are some industries stated therein for which there are no regulatory requirements. This creates uncertainty as to what licenses would be required by investors and applicants for pioneer status operating in such industries. A reading of the Regulations would mean that without such regulatory license, the application for pioneer status would be incomplete. This has to be clarified.

4. **Processing Fees**

The Regulations also state that the processing fee for the application of pioneer status is N 200,000.\(^11\)

Apart from the increase in the capex requirement highlighted above, there has also been an increase in the processing fee for grant of pioneer status. Prior to the Regulations, the processing fee was N 100,000. This has now been increased by 100% to N 200,000. This again highlights the increase in costs brought about by the Regulations.

On the other hand however, the NIPC Application form for pioneer status which hitherto cost N 40,000 can now be downloaded from the website of the NIPC or obtained from the office of the NIPC free of charge.\(^12\)

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\(^8\) For example, it is unclear whether Withholding Tax on dividends to be distributed by the company from profits earned during the pioneer period will be included in the calculation of tax savings.

\(^9\) Although compromising the financial books of a company are with the intent of short changing NIPC of the 2% service charge is a ground for revocation of a pioneer status certificate.

\(^10\) Section 3 of the Regulations.

\(^11\) Section 3 (3i) of the Regulations.

\(^12\) Section 2 of the Regulations.
Conclusion

In its quest to promote both local and foreign investment in the country, the Regulations has created a more uniform process for the application and grant of the pioneer status. However, while aiming to standardize and promote investment in Nigeria, the Regulations have no doubt increased the cost associated with grant of pioneer status.

A drawback of the Regulations with regards to the new capex threshold is that this requirement is that local small cottage industries which would desire a grant of pioneer status would be at a disadvantage due to their inability to meet the new capex requirement. Perhaps an exemption should be considered for such small industries.

Again, the new requirement of the Regulation especially in relation to the payment of the Service Charge negates the whole essence of a tax holiday. It then begs the question why the Regulations seek payment of the service charge from the estimated savings which the company would make by reason of the tax exemption? This may dissuade investors both local and foreign from making viable investments in Nigeria.

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