

Appraising the Tax Aspect of Capital Allowance in the Nigerian Banking Sector

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Abstract

This paper appraises different types of capital allowances available in Nigeria as stated in the Nigerian Tax Laws as well as the items that qualify for capital tax allowances in the banking industry. Based on the appraisal, the paper discovers that the issue of capital allowances for banks is not a straight jacket thing. This is so, because there is yet to be a comprehensive list of what can qualify for such allowances under the Nigerian Tax Law and the system of making allowances does not look at the extent to which wear and tear has occurred or the expected life of the asset. The paper concludes that a general principle of taxation that encourages liberality should be the watchword when considering relief in the tax aspect of capital allowances in the banking sector.

1. Introduction

Capital allowance is a sort of relief given to either companies or individuals on certain assets that could be classified as plant, machinery and fixtures. Capital allowance is a repayment of the cost of assets by the government to the traders in order to encourage automation in industry with a resultant decrease in the taxes paid by them. Therefore, the higher the rate of capital allowances, the lower the tax, and vice versa.¹ The substance of the Second Schedule of the Companies Income Tax Act (CITA) is similar to the provisions of the Fifth Schedule of the Personal Income Tax Act.

A taxpayer cannot deduct capital expenditure in calculating its trading profits for corporate tax. Also any depreciation charged to its profit and loss account must be added back in its corporation tax computations. To an extent, this may mean that the taxable profit of the business exceed the profit shown in the taxpayer's accounts and may result in an apparently high tax charge.²

In the case of certain capital expenditure, capital allowances are given to take account for tax purposes of wear and tear and reflect the fact that the capital assets will, at some time, require

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¹C.S. Ola, *Income Tax Law for Corporate and Unincorporated Bodies in Nigeria*, (Heinemann Educational Books (Nigeria) Ltd, Ibadan, 1984) p.174.

² F. Christopher and W. Miles, *Taxation and Banking*, (London, Sweet and Maxwell, 1990), p.74.

to be replaced. Capital allowance is granted in lieu of depreciation as an allowable deduction in arriving at the chargeable income of an individual.³

Generally, capital allowances can be claimed on expenditure on industrial buildings, agricultural land and buildings, hotels, dredging, ships, commercial buildings in enterprise zones, mines and oil wells, scientific research, patents and knowhow and plant and machinery. It is only the last of these categories, plant and machinery, which is generally of direct relevance to banks.

A capital allowance is a form of standardized depreciation given under the income tax law on certain specified qualifying capital expenditure. They are granted in place of depreciation charges, which are disallowed by the income tax law in computing assessable income.⁴ The basic reason for the grant of capital allowances is to encourage those who trade or do business to develop, modernize and equip their business.⁵ Despite this however, the issue of capital allowances for banks is not a straightjacket thing, apart from the fact that the system of making allowances does not look at the extent to which wear and tear has occurred or the expected life of the asset, there is yet to be a comprehensive list of what can qualify for such allowances. Neither that, nor is the eligibility for allowances dependent on whether the capital asset used in the business will eventually require to be replaced. Instead, allowances are given at predetermined rates and only in respect of certain broad categories of specific capital expenditure.

2. Meaning of Capital Allowance

Ordinarily, capital allowances are allowances granted at approved specified rates on qualifying capital expenditure and on assets in use for the purpose of business at the end of the relevant basis period.⁶ Capital allowance is the allowance of a certain amount of money spent by a company on fixed assets to be taken off the profits of the company before tax is imposed.⁷ In other words, capital allowance is the amount of corporation tax payable, offered as an incentive to stabilise the capital base of a company after the payment of tax. This allowance is entrenched in the Second Schedule to the Companies Income Tax Act.⁸ On the other hand, the Fifth Schedule of Personal Income Tax Act provides for capital allowance, referred to as tax relief in respect of individuals.

The amount of capital allowance to be enjoyed in any year of assessment is restricted in Nigeria to 75% of assessable profit in the case of manufacturing companies and 66% in the case of others, except such companies in agro-allied industries that are not affected by this restriction. If leased assets are used in agro-allied ventures, the full 100% capital allowance claimed will be granted. Moreover, where the leased assets are agricultural plants and equipment, there will be an additional investment allowance of 10% on such expenditure.⁹

Thus, from the forgoing, it is true to consider capital allowance as a veritable tool for improvement of cash flow of businesses including the discounted cash flow of returns on investments. Capital allowances are allowances claimable by traders or self-employed persons in

³ A. A. James, *Personal Taxation in Nigeria*, 4th Edition, (J.A.A Nigeria Ltd, Lagos, 2001), p.79.

⁴ Section 23 (e) CITA, 1990.

⁵ I.A. Ayua, *The Nigerian Tax Law*, p.144.

⁶ S. Lekan & O. Sunday, *Taxation: Principles and Practice in Nigeria*, (Silicon Publishing Company, 2006) p.143.

⁷ Collins English Dictionary, (Collins Publishers, 2000). See also, <www.thefreedictionary.com/capital+allowance> accessed on 6th May, 2011.

⁸ CAP C21 Laws of the Federation of Nigeria, 2004.

⁹ <www.nipc.gov.ng/facpage.html> accessed on 6th, May, 2011.

respect of capital assets which they use in their businesses, trade or professions in earning their business income and which have suffered diminution in value during an accounting period.¹⁰ In actual fact, capital allowances are the repayments of the cost of assets by the government to the traders in order to encourage automation in industry, with a resultant decrease in the taxes paid by them.¹¹

Capital allowances are made in respect of capital expenditure or wasting assets but same must be granted as a kind of statutory depreciation allowance on the assets for the year to which they relate.¹² The person entitled to an allowance is, generally, the person or company who owns and is using the asset for the purpose of its trade or business.¹³

Capital tax allowances on the other hand, according to Abdulrazaq, 'are given to take account for tax purpose of wear and tear and reflect the fact that the capital assets will at some time require to be replaced'.¹⁴ However, the qualifying capital expenditure must have been incurred in a basis period, which is, the preceding basis period ending in the preceding tax year.¹⁵ He concluded that in alternative:

*It is always possible for a taxpayer to elect for deduction to be given on a renewals basis rather than to claim capital allowances. As, however, on a renewals basis no deduction is given for the original expenditure and a deduction can only be claimed for replacement; it is not common for a taxpayer to make a claim on this basis.*¹⁶

2.1 Categorisation of capital tax allowance

Capital tax allowances can be categorised into three, namely, first year allowance, annual allowance and balancing allowance.¹⁷

2.1.1 First Year Allowance

First year allowance otherwise known as initial allowance is an allowance granted to business which has incurred qualifying capital expenditure in a year of assessment in which the asset representing such expenditure was first put to use for the purpose of the business. In other words, where a company has incurred qualifying expenditure wholly and exclusively for the purpose of its trade or business in respect of any asset in its basis period for a year of assessment, it will be entitled to claim "an initial allowance" in the basis period for the year of assessment for which the asset was first so used for the purpose of its trade or business.¹⁸

One important issue to note is that, before a company will qualify for capital tax allowance such a company must have incurred a qualifying expenditure on an asset which is to be

¹⁰ C. S. Ola, *Income Tax Law in Nigeria*, (Heinemann Educational Books Nigeria, Plc, 1999) p.286.

¹¹ *Ibid.*

¹² J.O. Orojo, *Company Tax Law in Nigeria*, (London, Sweet & Maxwell, 1979), p.137.

¹³ *Ibid.*

¹⁴ M.T. Abdulrazaq, 'Capital Tax Allowance' in Abdulrazaq, M.T. (ed.) *Nigerian Tax Notes*, Vol. 5 No. 7, July 1999), p.1.

¹⁵ S. Lekan & O. Sunday, *Op. cit.*, p.144.

¹⁶ M. T. Abdulrazaq, 'Capital Tax Allowance', *Op. cit.*, p.1.

¹⁷ As categorised in S. Lekan & O. Sunday, *Op. cit.*, p.143. See also Ola, C.S. *Income Tax Law for Corporate and Unincorporated Bodies in Nigeria*, pp.183-184. J. O. Orojo, *Company Tax Law in Nigeria*, pp.143-146.

¹⁸ J. O. Orojo, *ibid.*, p.143.

used wholly and exclusively for the purpose of trade or business, and an allowance will only be granted to the taxpayer for the year of assessment in his basis period in which the asset is first used.

Apart from qualifying building expenditure, initial allowance will be granted to a business which has acquired second hand assets. The amount of initial allowance to be granted on an asset in a year of assessment is arrived at by applying the relevant percentage on the cost of the asset. This amount of initial allowance is not pro-rated regardless of the length of the basis period; the amount is also not reduced because the asset was acquired halfway through the basis period.¹⁹

2.1.2 Annual Allowance

Annual allowance is granted to a business which has incurred capital expenditure of the purpose of the business during each year of assessment the asset representing such expenditure was used and in use at the end of the basis period whether or not an initial allowance had been granted.²⁰ One important thing about Annual Tax Allowance is that its qualification is strictly premised on the fact that the asset to which allowance is requested must have wholly and exclusively been in use by him in his business.

Annual tax allowances are additional to the initial allowance. An annual allowance, in respect of any asset, will be made to an individual who has incurred qualifying expenditure which is used wholly, necessarily, reasonably and exclusively for the purpose of trade, provided the asset is in use at the end of the basis period.²¹ In other words, when in its basis period for a year of assessment a company accruing an asset has incurred in respect thereof qualifying expenditure wholly and exclusively for the purposes of a trade or business carried on by it, whether or not an initial allowance may be made in respect of that qualifying expenditure, the company is entitled to an annual allowance on the residue of such expenditure at the end of the basis period of that year of assessment.²²

The usage of asset at the end of the basis period is a *sine qua non* for the initial or annual allowances. Not only that, the residue for the purpose of the annual allowance is the total qualifying expenditure incurred on or before the given date by the owner in respect of an asset, less the total of any initial or annual allowance made to that owner in respect of that asset before that date, an initial or annual allowance being deemed to have been made at the end of the basis period for the year of assessment for which the allowance is made.²³

As the name indicates, the annual allowance is granted annually and is computed on the balance of cost after the deduction of the amount of initial allowance claimable on the asset. Annual allowance, once calculated for a particular fixed asset item, will be the same amount for each of the year that the asset is in use until the cost of the asset is fully relieved.²⁴

¹⁹C. S. Ola, *Income Tax Law in Nigeria*, (Ibadan: Heinemann Educational Books Nigeria Plc.), *Op. cit.*, p.288.

²⁰ *Ibid.*

²¹ C. S. Ola, *Income Tax for Incorporate and Unincorporated Bodies in Nigeria*, *Op. cit.*, p.184.

²² J. O. Orojo, *Company Tax Law in Nigeria*, p.144.

²³ *Ibid.*

²⁴ A. A. James, *Companies Taxation in Nigeria*, p.101.

2.1.3 *Balancing Allowance*

A balancing allowance is got through balancing adjustments that will arise where a qualifying capital expenditure is disposed of. According to Lekan,²⁵ the idea is to bring the allowances into line with actual expenditure. In a nutshell, balancing allowance arises where there is a disposal of an asset. In other words, where a company owns an asset, on which it has incurred qualifying expenditure, and then disposes of the asset, if the asset is disposed of for an amount lower than the residue of the expenditure, a balancing allowance is made.²⁶ However, such an allowance will be made only if, immediately prior to its disposal, the asset was in use by the owner in the trade or business for the purposes of which the qualifying expenditure was incurred.²⁷ According to Orojo,²⁸ the asset is said to be disposed of if the following events occur:

- (a) In respect of a building, structure or works of a permanent nature
 - (i) If the relevant interest therein is sold, or
 - (ii) In the case of a concession, when the concession comes to an end, or
 - (iii) In the case of a lease, when it comes to an end other than by the merging of the reversionary interest in the leaser, or
 - (iv) If the building, structure or works are demolished or destroyed or cease altogether to be used for the purposes of the trade or business carried on by the owner.
- (b) In respect of plant, machinery or fixture, if they are sold, discarded or cease altogether to be used for the purposes of a trade or business carried on by the owner.
- (c) In respect of mining, if the assets are sold or cease to be used for the purposes of the trade or business of the company either because the company has ceased to carry on the trade or business or because it has received insurance or compensation money thereof.

It is important to note that, the continual usage of an asset is vital to the relief of tax through balancing allowance. Therefore, a balancing allowance will be made to an individual for a year of assessment only if the individual owns the asset and the asset is in use immediately prior to the disposal of the asset,²⁹ but when an asset on which capital allowances have been granted is disposed of, balancing adjustment will not be made.³⁰

3. *'Basis Period' for Capital Allowances*

In calculating capital tax allowances reference is always made to the 'basis period' of assessment. The essence of determining the basis period for capital allowances is to know which tax year will benefit from initial and annual allowances resulting from the acquisition of capital assets.³¹

'Basis period' for any year of assessment is the period by reference to which any assessable income for that year falls to be determined.³² The ascertainment of a basis period of an

²⁵ S. Lekan & O. Sunday, *Op. cit.*, p.89.

²⁶ *Ibid.*

²⁷ J. O. Orojo, *Company Tax Law in Nigeria*, p.145.

²⁸ *Ibid.*, pp.145-146.

²⁹ C. S. Ola, *Income Tax Law for Corporate and Unincorporated Bodies in Nigeria*, p.185.

³⁰ A. A. James, *Personal Taxation in Nigeria*, p.89.

³¹ S. Lekan & O. Sunday, *Op. cit.*, p.145.

³² C. S. Ola, *Income Tax Law for Corporate and Unincorporated Bodies in Nigeria*, p.187.

individual for a year of assessment is important for the purposes of making capital allowances on charges of that individual. What happens to an asset during a basis period may determine whether any allowance or charge is to be made in respect of that asset for that basis period.³³

In essence, the basis period for capital allowances is normally the same as that used in the computation of assessable income.³⁴ The principle for the determination of basis period for capital allowance purposes in personal taxation also applies to the computation of companies' taxation. Depending on the circumstances of each tax year, a capital allowance may fall into normal³⁵ or abnormal³⁶ basis period. Alternatively, it may fall into over-lapping basis period.³⁷ However, where there is a change in accounting year-end, and a qualifying capital expenditure is acquired on a date that does not fall into any basis period, it would be allocated to the latter tax year. If, on the other hand, the gap arises where there is a cessation of business, such an asset should be allocated to the earlier tax year.³⁸

3.1 Qualifying Capital Expenditure

An incurred expenditure in a basis period on assets used for a trade or business is a qualified capital expenditure and same is entitled to capital tax allowance. The qualifying expenditure is the capital expenditure in a basis period in respect of specified assets used for the purposes of a trade or business of the company.³⁹ Therefore, where the expenditure is incurred for the purposes of a trade or business which a company is about to carry on and is incurred in respect of an asset owned by that company, such expenditure would have been a qualifying expenditure. If it had been incurred by the company on the first day on which it carries on that trade or business, then the expenditure is deemed to be qualifying expenditure incurred by it on that day.⁴⁰

Capital allowances are given where a person carrying on a trade (or profession, employment or office) incurs capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade.⁴¹ According to Abdulrazaq:⁴²

The meaning of the word machinery has usually been felt to be self evident. The definition of the word 'plant' is much less clear and many cases have considered whether or not particular items constitute 'plant'. In thereof, according to him, the word 'Plant' is interpreted according to its use in ordinary English.

³³ *Ibid*, p.188.

³⁴ A. A. James, *Op. cit.*, p.92.

³⁵ If the basis period for assessable profit is exactly the same basis period for capital allowance, that is, the preceding year basis, then it is a normal basis period.

³⁶ If two basis periods coincided or overlap or if there is a gap in between two basis periods due to the change in accounting date, then, such is an abnormal basis period.

³⁷ For further elucidation on sample year of assessment, see C. S. Ola, *Income Tax Law for Corporate and Unincorporated Bodies in Nigeria*, pp.187-189; A. A. James, *Op. cit.*, pp.92-95

³⁸ S. Lekan & O. Sunday, *Op. cit.*, pp.145-146.

³⁹ J. O. Orojo, *Company Tax Law in Nigeria*, p.138.

⁴⁰ See Schedule 5 Paragraph 1 PITA, and Schedule 2 of CITA. See also *Ibid*, pp.138-139, and I. A. Ayua, *Nigerian Tax Law*, (Lagos, Spectrum Law Publishing, 1996), pp.183-184.

⁴¹ 5th Schedule PITA, 2004 & 2nd Schedule CITA, 2004. See also M. T. Abdulrazaq, 'Capital Tax Allowance', p.2.

⁴² *Ibid*.

However, as later observed by the learned professor of tax, the term "machinery" *has acquired a highly distinctive meaning for tax (and other) purposes as a result of court decisions over the years and it is only by reviewing the authorities that guidelines can be found indicating whether an item does or does not qualify.*⁴³

Other capital expenditure that qualify for capital allowances⁴⁴ are:

- a. Qualifying building expenditure: This is incurred on the construction of building structure or work of a permanent nature;
- b. Qualifying mining expenditure: This is incurred in connection with or in preparation for the working of a mine, oil well or other source of mineral deposits of a wasting nature;
- c. Qualifying plantation expenditure: This is incurred in connection with a plantation on the clearing of land for planting and on planting.
- d. Qualifying research and development expenditure incurred;
- e. Qualifying expenditure incurred on plant in use in agricultural trades and business within the meaning of Section 9 of the CITA;
- f. Qualifying vehicle expenditure incurred on a fleet of buses of not less than three used for public transportation;
- g. Qualifying public transportation (inter-city) new mass transit coach of 25 seats and above operated by a recognized private establishment.

In the banking sector, there are some items which are regarded as plant and qualifying for capital tax allowances. Amongst those items are: aerials, air conditioning installations, automatic barriers, automated teller machine, bells, blinds, boiler plants and auxiliaries, book room doors, burglar alarms, cameras (and close circuit installation) canteen fitting and equipment, *et cetera*.⁴⁵

A capital allowance must be claimed before it can be granted. However, if same is not claimed by the company, the tax commissioner can determine the appropriateness or otherwise of the allowance. In *FBIR v Azigbo Bros Ltd.*⁴⁶ the question was 'whether the view of the Board in ignoring capital allowances until they were claimed was *prima facie* reasonable'. The court held that it was, the assessment having been made to the best of the Board's judgment. In other words, a company that does not wish to be granted capital allowances in any particular assessment year can achieve that objective by not putting forward a claim for such in its tax computation.⁴⁷

⁴³ *Ibid.*

⁴⁴ As outlined in S. Lekan & O. Sunday, *Op. cit.*, pp.149-151 & I. A. Ayua, *Op. cit.*, pp.183-184.

⁴⁵ For a comprehensive list, see M. T. Abdulrazaq, 'Capital Tax Allowance' p.7-10. See also F. Christopher, and W. Miles, *Taxation and Banking*, (London, Sweet and Maxwell, 1990), pp.79-81.

⁴⁶ (1963)2 All NLR 198.

⁴⁷ A. A. James, *Op. cit.*, p.100.

3.2 Qualifying plant and machinery

Qualifying plant expenditure is a capital expenditure incurred on plant, machinery or fixtures.⁴⁸ Not only that, capital expenditure incurred on equipment, furniture, fittings, fixture and motor vehicle can also qualify as qualifying plant expenditure.⁴⁹ The rate of this allowance is 10% of the expenditure.⁵⁰

However, the definition of the word 'plant' is much less clear and many cases have considered whether or not particular items constitute "plant". In *Yarmouth v France*,⁵¹ the observation of Lindley L.J. on what constitutes plant was that:

in its ordinary sense, it includes whatever apparatus is used by a businessman for carrying his business... not his stock in trade which he buys or makes for sale; but all goods and chattels, fixed or moveable, live or dead, which he keeps for permanent employment in his business.

From the above quotation, it is evident that a major requirement for the qualification of items to be 'plant' is that such items must be part of the plant in which the business is operated. In other words, such items must be of permanent features, the removal of which is likely to affect the value of the plant. Invariably, therefore, most cases of dispute have concerned whether a particular item on which allowances were claimed was part of the premises in which the business was carried on or part of the plant with which the business was carried on. If the items are of the former, no allowances would be available, while in the latter, allowances would be available.⁵²

Apart from the test of permanency or plant attachment which could be used to determine qualifying plant, functional test is another guideline principle for what qualifies as plant for capital tax allowance purpose. For the functional test, the case of *IRC v Barclay Curle & Co. Ltd.*⁵³ is instructive. In that case, allowances had been claimed in respect of a dry dock which the crown argued was a building or structure and, accordingly, not plant. Lord Reid stated that building and structures and machinery and plant were not mutually exclusive terms and that a structure could also be plant if it fulfilled the function of plant in a trailer's operations. In that case, the dry dock performed the function of raising and lowering a ship and holding it in position when the water had been removed. It was accordingly held to be plant.

Any attachment of temporal nature, i.e., sockets wiring, window panels, lightings and external signs which were designed to attract customers into the store are not plant, but a transformer converting main voltage to a lower voltage qualify as plant.⁵⁴ Not only that, a semi-permanent structure like a swimming pool and grain silo have also been held to be plant in certain circumstances.⁵⁵ The functionality test was further used in the case of *Hampton v Fortes Autogril*,⁵⁶ where the court disagreed with the position of the commissioners that a false ceiling

⁴⁸ J. O. Orojo, *Op. cit.*, p.140.

⁴⁹ C. S. Ola, *Income Tax Law in Nigeria*, p.286.

⁵⁰ Sec 32(2) CITA, 2004.

⁵¹ (1887) 19 QBD 647 at 658.

⁵² As was reflected in the definition of what constitutes 'plant' by Lindly, L.J. and further used by Uthwatt, J. in the case of *J. Lyons & Co. Ltd. v Attorney General* (1944) All ER 477.

⁵³ 46 TC 221.

⁵⁴ As was held in *Cole Brothers v Phillips* (1982) STC 307.

⁵⁵ See *Cooke v Station Caraan Ltd.*, 49 TC 514 and *Schofield v R & H Ltd.* 49 TC 538. See also M. T. Abdulrazaq, *Op. cit.*, p.4.

⁵⁶ (1980) STC 80.

was part of the apparatus covered as plant. According to the Court, the ceiling was just a ceiling and as such did not perform a function in carrying on a trade any more than the remainder of the premises.

The basic thing to be gleaned in this case was that, a non-functional and temporal apparatus, even if same is attached to the premises, cannot qualify as a plant. Though the use of premises test too could not be said to have cleared the dust of confusion on what constitutes plant in qualifying for capital allowances. The confusing status of the constitution of plant for capital tax allowances has been a major headache of the court in a number of cases, ranging from *Leeds Permanent Building Society's case*,⁵⁷ where it was held that certain decorative screens placed in the windows of Building Society branch offices were plant, up to the case of *Wimpy International Limited*⁵⁸ and the case of *Scottish and Newcastle Breweries*,⁵⁹ wherein Lloyds L.J. quoted with approval a statement by Hoffman, J. who had decided the *Wimpy case* in the High Court that:

the question seems to me to be whether it would be more appropriate to describe the item as having become part of the premises than as having retained a separate identity. This is a question of fact and degree to which some of the relevant identities, the degree of permanence with which it has been attached, the incompleteness of the structure without it and the extent to which it was intended to be permanent or whether it was likely to be replaced within a relatively short period.

In a nutshell, qualifications of items for plant which will make same qualify for capital tax allowance is a question of fact for determination by the commissioners. According to Abdulrazaq,⁶⁰ the only instance where this could be overturned was if it was discovered that it was a decision which no reasonable body of commissioners could have reached. Qualifying expenditure can be actual or deemed. It is actual where a company has, in fact, carried out an expenditure; while it is deemed where the company is about to carry on or incurred a expenditure in respect of an asset owned by the company. Succinctly put, therefore, the qualifying expenditure can be said to be the capital expenditure incurred in a basis period in respect of specified assets used for the purposes of a trade or business of the company.⁶¹

Where the expenditure is incurred for the purpose of a trade or business which a company is about to carry on and is incurred in respect of an asset owned by that company, it would have been a qualifying expenditure. However, if it had been incurred by the company on the first day on which it carries on that trade or business, then the expenditure is deemed to be qualifying expenditure incurred by it on that day.⁶² Courts have decided on series of occasions on different categories of spending in companies' plant that qualify for capital tax allowances. On one instance,⁶³ the court upheld that the interest and commitment fees borrowed to finance the construction of oil rig were expenditure on the provision of finance rather than of plant and

⁵⁷ *Leeds Permanent Building Society v Procter*, (1982) STC, 821.

⁵⁸ *Wimpy International Ltd v Warland* (1989) STC, 273.

⁵⁹ *Scottish and Newcastle Breweries* (1988) STC 149 at 173.

⁶⁰ M. T. Abdulrazaq, *Op. cit.*, p.4.

⁶¹ J. O. Orojo, *Company Tax Law in Nigeria*, p.138.

⁶² *Ibid*, pp.138-139.

⁶³ In the case of *Ben-Odeco Ltd. v Powlson* (1978) STC, 460.

accordingly did not qualify for allowances. In another instance,⁶⁴ the court held that the expenditure on barge used in companies trade qualifies for capital tax allowance.

The major reason for the latter decisions was that the expenditure amounted to expenditure on the provision of plant.⁶⁵ This is actually in consonance with capital allowance which is basically to improve the cash flow of business, including the discounted cash flow of returns on investments in respect of capital assets which they use in their businesses, trades or professions in earning their business income and which have suffered domination in value during an accounting period.⁶⁶ This allowance according to Ola, C.S.⁶⁷ is a:

... repayment of the cost of assets by the government to the traders in order to encourage automation in industry, with a resultant decrease in the taxes paid by them. The higher the rates of capital allowances, the lower the tax, and vice versa.

Apart from the initial capital expenditure, there are some other miscellaneous items that also qualify for allowable deduction, especially in the banking sector. Notably amongst them is the building alternation and demolition cost. In this instance, the capital expenditure on alterations to an existing building which are incidental to the installation of plant or machinery for the purpose of a trade is treated as expenditure on the plant and machinery and therefore forms part of the total cost on which allowances are available.⁶⁸

A great dichotomy exists between the alteration and addition to a building. In the former, capital tax allowance is available while same is not available in the latter. Therefore, where machinery and plant is demolished and replaced by new plant and machinery, the demolition costs are again treated as part of the expenditure on the new machinery in so far as these exceed any proceeds of sale or other monies received in respect of the old plant. If the demolished plant is not replaced, the costs of demolition are treated as allowable additions to its expenditure on plant and machinery.⁶⁹

Premised on this, any sums expended for the renewal or alternation of implement, utensil or article employed in the earning of the income and if same is incurred in maintaining the plant and machinery or equipment in good working condition as when they were purchased, will certainly qualify for allowable deduction.⁷⁰ However, the deciding factor for the qualification is whether the expenditure has been incurred to maintain the operating capability of the asset as it was when purchased or to enhance that operating capability. If it is the former, it is revenue expenditure deductible in accordance with the provisions of Section 24, but if it enhances the operating capability, it should be treated as a capital expenditure and capital allowances claimed thereon.⁷¹

Other areas where allowable deduction is permitted are items that can facilitate the lasting and enhancing functionality of the plant and machinery. Amongst these facilities are fire safety efforts. On this, the expenditure, in complying with a notice served by the fire authority in

⁶⁴ In the case of *Bolton v International Drilling Company Ltd.* (1983) STC, 70.

⁶⁵ See details in M. T. Abdulrazaq, *Op. cit.*, p.11.

⁶⁶ C. S. Ola, *Income Tax Law for Corporate and Unincorporated Bodies in Nigeria*, p.174.

⁶⁷ *Ibid.*

⁶⁸ *Ibid.*

⁶⁹ See Section 20, CITA.

⁷⁰ See Sec 24 (d) CITA.

⁷¹ See 24 (d) CITA.

connection with premises, is treated as expenditure on machinery and plant.⁷² Not only that, if software is purchased with a computer, the Inland Revenue normally accepts a claim for capital allowances on the capitalized cost of the computer and software.⁷³

The thin line on the dichotomy between plant and building is of concern to the qualification of capital allowances. The base line of differentiation, however, is that those expenses that have the appearance of capital expenditure and which are allowed as deductions in computing income and are excluded from the scheme of capital allowances and items like renewal, repair or alteration of any implement, utensil or article employed in acquiring the income belongs to this category; while apparatus used by a businessman for carrying on his business qualifies as plant.⁷⁴

4. Capital Allowance on Leasing and Hire Purchase

Due to diversification in the contemporary banking business, some banks, apart from pure banking services of taking deposit from customers, now engage in other services such as leasing and hire purchase sales. In the case of leasing, where a company owns an asset on which it has incurred lending expenditure to another person in its trade or business and leasing the asset to such person who uses it wholly, exclusively, necessarily and reasonably for the purposes of his trade or business during the term of the lease, the company is deemed to have incurred capital expenditure from the date when such an expenditure was incurred as though the owner were using the asset for its own purpose in the same way as the asset is, in fact, used by the other person. The basis period is taken to be the year immediately preceding the year of assessment.⁷⁵

The functionality requirement for this allowance is that the items must have been used 'wholly and exclusively by such person in such trade or business'. If this happens,

*...the provision of this Schedule shall apply with such necessary modification as the relevant tax authority may direct, as though such expenditure were incurred wholly and exclusively for the purposes of a trade or business carried on by the owner from the date when such expenditure was incurred....*⁷⁶

This provision shall apply in the case of a building leased by its owner to any other person as though such leasing were a trade or business carried on by the owner, and if he incurred the capital expenditure in respect of that building after the 31st day of March, 1955 irrespective of the use thereof intended by the owner at the time he incurred such expenditure. What this means, in essence, is that, if a company owns an asset on which it has incurred capital expenditure for the purpose of leasing it for use by another person in its trade or business and leases the asset to such person who uses it wholly and exclusively for his trade or business during the term of the lease, the company is deemed to have incurred capital expenditure from the date when such an expenditure was incurred as though the owner were using the asset for his own purpose in the same way as the asset is, in fact, used in the year immediately preceding the year of assessment.⁷⁷

⁷² A. A. James, *Op. cit.*, p.97

⁷³ M. T. Abdulrazaq, *Op. cit.*, p.12

⁷⁴ *Ibid*, pp.12-13.

⁷⁵ See the case of *Daphine v Shaw* (1962) 11 TC, 256.

⁷⁶ See Schedule 2 Paragraph 19, CITA.

⁷⁷ A. A. James, *Op. cit.*, p.92.

On hire purchase, the hire purchase agreement should be such that the hirer will use and ultimately acquire the asset. The hirer is therefore treated as if he owns the asset. However, this is subject to the following modifications:

- 1) The amount of expenditure to be capitalized in each year of assessment will be limited to the deposit and installment actually paid during the period.
- 2) The installment payment to be capitalized will exclude the interest portion of the hire purchase price. Therefore each year of assessment capital allowances will be computed on the capital portion of the installment actually paid for during the period as well as any deposit.⁷⁸

The basic distinction between a finance lease and hire purchase agreement lies in the provision of the lease dealing with the eventual ownership of the machinery or plant on completion of the agreement.⁷⁹ Under finance lease, the lessee will obtain a tax deduction for the rental payment which he makes whereas under a hire purchase agreement he will obtain a tax deduction for his finance cost and obtain capital allowances for his capital cost. As soon as expenditure has been incurred on plant and machinery acquired under a hire purchase agreement, the whole capital cost is treated as having been incurred for capital allowance purpose. This is clearly beneficial as far as the purchaser is concerned as he will receive writing down allowances on the full expenditure at a time when he may have incurred very little of the capital cost.⁸⁰

From the foregoing, the deductible inference on capital allowance as regards, hire purchase is that, the qualifying expenditure as regards the asset acquired on hire purchase agreement is limited to the amount of the installments paid by the hirer during his basis period, excluding the computation of such qualifying expenditure of any interest paid under the agreement. The hirer is deemed to be the owner of the asset.⁸¹

5. Conditions for Granting Capital Allowances

To qualify for capital allowances, the following conditions must be satisfied:

- a) The capital allowance must be claimed for by the company except where revenue authority is of the opinion that it is just and reasonable to grant allowances without claim.⁸²
- b) The claimant must be the owner of the asset that is the subject of claim.⁸³ However, an asset acquired through a hire-purchase agreement or through an ordinary contract of hire or lease can be the subject of a capital allowance claim.⁸⁴
- c) The capital expenditure incurred must be for the purposes of the trade or business. Any element of private use of the asset must be eliminated.
- d) The expenditure must be incurred in the basis period, meaning the period of the profits on which any assessable income for that year of assessment falls to be computed, that is, the preceding year.⁸⁵

⁷⁸ See Schedule 18 (1) & (2) CITA, 2004. See also J. O. Orojo, *Company Tax Law in Nigeria*, p.142.

⁷⁹ C. S. Ola, *Income Tax Law in Nigeria*, p.306.

⁸⁰ M. T. Abdulrazaq, *Op. cit.*, p.15.

⁸¹ *Ibid.*

⁸² See Sub-paragraph 22 of Paragraph 1 CITA, 2004.

⁸³ Schedule 2, Paragraph 22, CITA.

⁸⁴ *Stocks v Costain Property Investments Ltd.* (1984) STC, 204.

- e) The claimant must incur qualifying capital expenditure as defined in Paragraph 1 of Second Schedule to CITA, 2004, in respect of the defined assets.
- f) An application in writing must be made to the tax authority. In practice, the tax authority would require a certificate of acceptance in any one year in excess of ₦20, 000 up to 1994 year of assessment. With effect from 1995 the value of qualifying capital expenditure, requiring a certificate of acceptance has been fixed at ₦500, 000. This certificate is issued by the Industrial Inspectorate Division of the Federal Ministry of Industries.

5.1 Manner of calculating capital allowances

In calculating capital allowances, the balancing charge should be added to the assessable income for the year of the assessment for which such charge falls to be made.⁸⁶ In other words, capital allowances are generally calculated on a 'pool' of capital expenditure. This means that, instead of allowances being calculated on individual items of expenditure, expenditure on qualifying items is (with certain exceptions), added to the 'capital allowance pool' brought forward from the previous period.⁸⁷ Similarly, the proceeds from disposals of qualifying fixed assets (in so far as these do not exceed the original acquisition cost) reduce this pool.

Coupled with that, the amount of any capital allowance should be deducted from the year of assessment for which such allowance falls to be made. And, where the total of the allowance due cannot be fully utilized due to non-availability or insufficiency of that remainder, the balance un-utilised is to be carried forward for use in future years as if they originate in those years until when fully utilised.⁸⁸ In other words, an annual writing down allowance (currently 50% for qualifying plant and machinery) is given in respect of the balance of the pool and the residue net of the allowance is carried forward to the next and subsequent accounting periods when a further writing down allowance is given until the pool is exhausted.⁸⁹

Apart from the fact that an election can be made to disclaim the allowance or to claim a reduced allowance for any period, if the proceeds which must be brought into account in respect of any disposals, exceed the additions and carried forward balance, a balancing charge (i.e., a taxable addition to income) is made equal to the amount of the excess. This effectively recaptures the allowances which have been given in so far as they exceed the difference between the amounts paid for and the amount received on sale of the assets in question.⁹⁰ Furthermore, un-utilised allowances in the year of permanent cessation of a trade shall be available for relief against the remainder of assessable income for the preceding year of assessment and so on for other preceding years up to the fifth year before the year of cessation.⁹¹

Altogether, it can be seen that the method of calculating capital allowance is somewhat esoteric and does not depend on a company's depreciation charge in its accounts or its accounting policy. The distortions which this produces between taxable and accounts profits, were greater when 100 per cent. First year allowances were available for plant and machinery but they can still

⁸⁶ B. Bakwaph-Kanyip, 'Companies Income Tax' in M. T. Abdulrazaq, (ed.) *CITN Nigerian Tax Guide and Statute*, (1st Edition, The Chartered Institute of Taxation of Nigeria, 2002), p.184.

⁸⁷ M. T. Abdulrazaq, 'Capital Tax Allowance', p.16.

⁸⁸ A. A. James, *Op. cit.*, p.98.

⁸⁹ M. T. Abdulrazaq, 'Capital Tax Allowance', p.13.

⁹⁰ *Ibid.*

⁹¹ *Ibid.*

⁹² A. A. James, *Op. cit.*, p.99

be seen where, for example, a company purchases a substantial item of plant on the final day of its accounting period. This expenditure will be treated in the same way as any other addition for the 22 per cent. Allowance is not reduced to reflect the fact that the plant was only held for one day during the period; on the other hand, the depreciation charge in the accounts would reflect this. This difference is normally equalized by an appropriate deferred tax provision in the account.⁹²

Furthermore, for an item of expenditure to be deductible, it must be of a revenue nature, rather than of a capital nature. However, relief from taxation may be given in respect of capital expenditure by means of the system of capital allowances, the appropriate allowance being set against taxable profits in a manner similar to that of relieving losses.⁹³

6. Conclusion

This paper has established that capital allowances, though a tax relief is not a general relief. It is a relief for certain items that met some statutory qualification of 'plant and machinery' and qualifying for capital expenditure on asset that is in use for the purpose of business at the end of the relevant basis period. In a nutshell, capital tax allowances are given to take account for tax purposes of wear and tear and the qualifying capital expenditure must have been incurred in a basis period that is preceding basis period ending in the preceding tax year.

The paper also establishes that, before a company could qualify for capital tax allowance, the asset on which allowances are being claimed must be used in the course of the business, profession, trade or vocation. Furthermore, such allowances shall be made only to the person or company on whom the burden of wear and tear rests; and in the case of a leased asset, the burden will rest on the lessor.

Finally, since the survival of companies is a major concern to both the government as well as the company promoters, instead of the string qualifications and determination of qualified capital allowance items, it is recommended that a general principle of taxation to the effect that relief should be given in respect of wastage of assets that are used up or consumed in the course of carrying on a business should be encouraged under the capital allowance reliefs.

⁹² M. T. Abdulrazaq, 'Capital Tax Allowance' p.14.

⁹³ B. Bakwaph-kanyip, *Companies Income Tax* p.184.