THE NIGERIAN ECONOMIC SUMMIT GROUP

FISCAL POLICY ROUNDTABLE REPORT

IMPACT ASSESSMENT OF THE 2021 FINANCE ACT

BY
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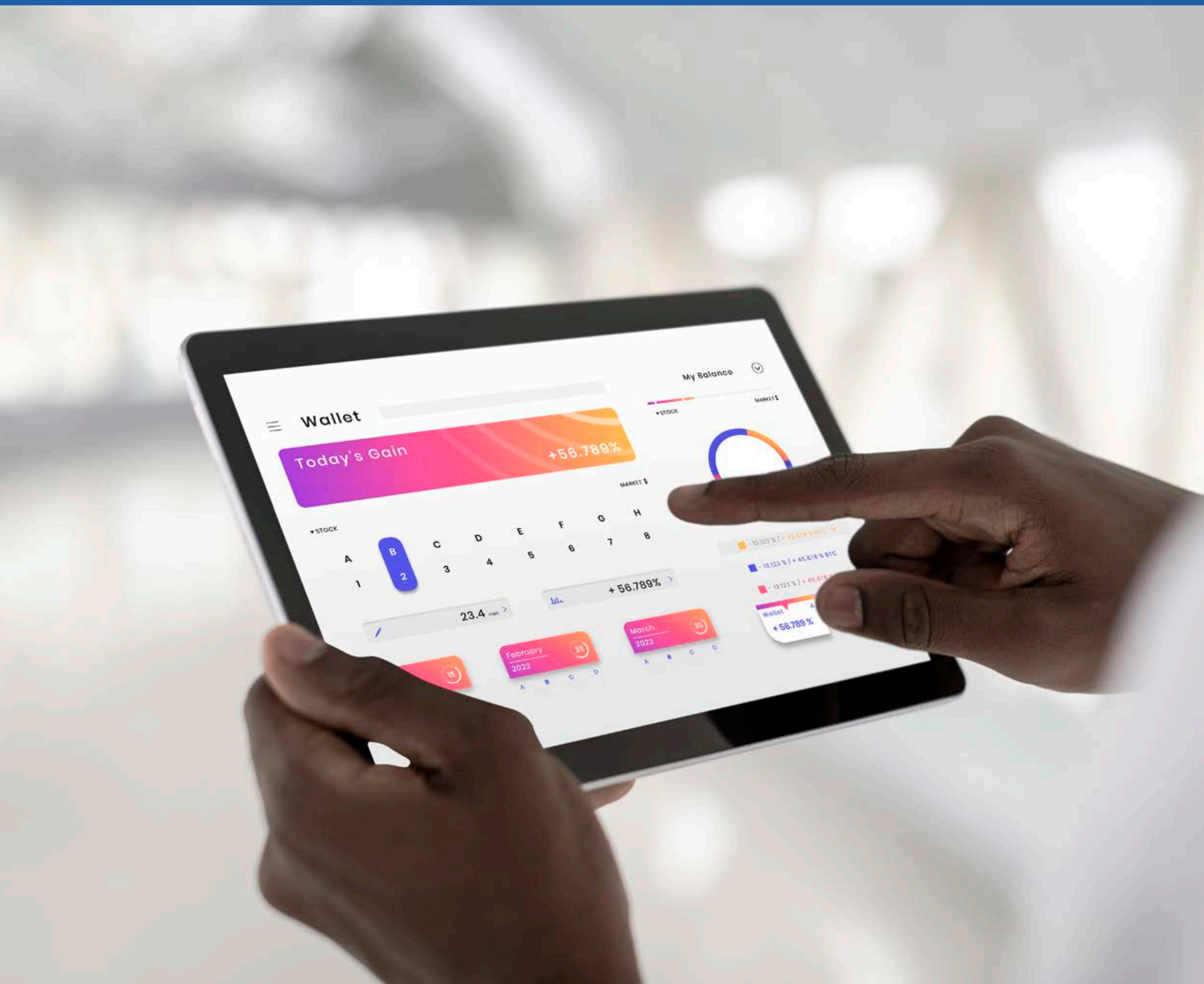
This report is the outcome of a Fiscal Policy Roundtable organised by the Fiscal Policy and Planning Thematic Group under the Trade, Investment, and Competitiveness Policy Commission of the Nigerian Economic Summit Group (NESG). The dialogue engaged public and private sector stakeholders to assess the likely impact of the 2021 Finance Act on households, firms, sub-sectors, and the macroeconomy at large.

As a key output of this process, this report draws upon contributions by leaders and experts who engaged in dialogue on the 10th of March 2022. It is intended to be a resource for governments, industry experts, and other stakeholders interested in the Impact of the 2021 Finance Act on households, firms and the macroeconomy. It is also a valuable resource for policymakers in articulating measures that can help design and implement subsequent Finance Acts.



1. Background

The Finance Acts (enacted in 2019, 2020 and 2021) have become an emerging fiscal tradition in Nigeria. The primary objective is to progressively reform the fiscal environment and enhance non-oil revenue while supporting the implementation of Nigeria's annual budgets. The most recent amendment of the Act, the 2021 Finance Act, was signed into law on 31st December 2021. It addresses five (5) key fiscal reform areas: domestic revenue mobilisation, tax administration, International Taxation, Financial Sector Reform, and Public Financial Management. It modifies thirteen (13) existing tax and fiscal laws. These include the Capital Gains Act; Companies Income Tax Act; Personal Income Tax Act; Tertiary Education Trust Fund (Establishment Act), among others (Mazars, 2022; National Assembly, 2021).

Some highlights of the key changes in the 2021 Finance Act include: 10% Capital Gain Tax on gains from the disposal of shares; Education Tax increased from 2% to 2.5%; Excise duty extended to carbonated, sweetened, non-alcoholic beverages at N10 per litre; tax on the turnover of non-resident digital service firms; NASENI levy of 0.25% of Profit before Tax; affirmation of FIRS as the primary agency of the Federal Government on tax collection, etc. The Ministry of Finance opines that the Finance Act yielded tangible results. Actual Non-oil tax revenue for 2021 stood at N1.62 trillion and was 18.8% above the target revenue.

It is expected that the 2021 Finance Act will consolidate the success of the previous Acts in accelerating non-oil revenue generation in Nigeria (FMBNP, 2022). From an ex-ante assessment, there are expected trade-offs emanating from the 2021 FA. On the one hand, the Act contains tax measures and administration changes to help the FGN raise more non-oil tax revenues and realise fiscal sustainability. However, on the other hand, the Act intends multiple tax increases that may be burdensome for domestic businesses and discourage foreign investment. For instance, the Capital Gains Tax on shares may raise investment costs for wealthy individuals and large firms in the private sector. At the same time, the Sugar tax is expected to push up production costs in the non-alcoholic beverage sub-sector. Consumers of these beverages will also likely disproportionately bear the resulting tax burden (PwC Nigeria, 2022).

2. Fiscal Context

The Nigerian economy remains in recovery after contraction due to the COVID19 pandemic. Real GDP grew by 5.01% and 4.03%, respectively, in the second and third quarters of 2021 (Central Bank of Nigeria, 2021). The combined growth of 9.04% is smaller than the combined decline of -9.72% in 2020 Q2 (-6.10%) and 2020 Q3 (-3.62%). The Federal Government introduces different policy measures to ensure that the economy recovers and experiences sustained economic growth. From a Keynesian macroeconomic management perspective, the government can stimulate the economy using expansionary fiscal options: increased government spending and deficit financing. This corroborates the widening fiscal gap in Nigeria over recent past years. There is, however, a need to close the widening fiscal gaps in the face of high fiscal deficits and debt stocks in Nigeria. This is being currently pursued by efforts to generate more revenue, particularly from non-oil sources.

The Finance Act is one of the direct policy tools intended for domestic revenue mobilisation. The projected revenue for the fiscal year 2022 is N10.71 trillion, which is 32% higher than the 2021 budget. The 2021 Finance Act introduced 'new' taxes and increased some tax rates to meet rising revenue projections. For instance, the Education Tax rate was raised from 2% to 2.5%, while the excise tax was extended to non-alcoholic beverage drinks. These tax changes point to restrictive fiscal measures. A policy issue then arises: should restrictive fiscal rules be pursued in an economy under recovery? The policy dilemma is how the government can raise more revenue to fund the budget when businesses grapple with rising costs and dwindling demand. What are policy measures needed to mobilise revenue without stifling investment and economic growth?

There is, therefore, the need for an evidence-based assessment of the impact of the tax measures as presented in the 2021 Finance Act. This would include the Act's likely direct and indirect effects and its likely micro and macro impact on the economy. There is also a need to identify loopholes and articulate measures to help policymakers design subsequent Finance Acts. As such, the Fiscal Policy Roundtable engaged relevant stakeholders to assess the likely impact of the 2021 Finance Act on households, firms, sub-Sectors, and the macroeconomy at large.

3. Nigeria's Fiscal Landscape and Economic Challenges

The fiscal landscape covers three broad areas: public revenue, public debt, and public spending, which are interconnected. Nigeria's tax system faces structural challenges at the federal and sub-national levels with a bit of fiscal space to provide relief and other interventions.

According to the Institute of International Finance, at the end of 2020, the global debt of governments, companies and households stood at $281 trillion [about 355% of global GDP (government 105%)]. There is a need for policy measures and interventions that stimulate inclusive economic growth, create prosperity, and improve revenue mobilisation in Nigeria.

The 2021 Finance Act amends thirteen (13) tax and fiscal laws. The President signed the Act on 31st December 2021, and it became effective on January 1, 2022. The Act was designed to support the implementation of the 2022 Budget, the Medium Term Expenditure Framework (MTEF), the Strategic Revenue Growth Initiatives, etc.

Key Objectives of the Finance Act are to:

- Adopt appropriate fiscal policies to respond to economic challenges
- Reform extant fiscal policies to prioritise job creation, economic growth, and socio-economic development.
- Raise revenue for Government

Notable changes introduced by the Finance Act 2021:

New taxes / increases	Rationalised incentives	Tax breaks	Small businesses	Other reforms
• TET from 2% to 2.5% • CGT on shares • Excise tax on sweetened beverages • NASENI levy • Police Tax	• No export exemption for downstream • Life assurance premium exclude deferred annuity • No CIT exemption for educational institutions	• Min tax rebate from 0.5% to 0.25% • WHT on Unit Trust as final tax	• Deemed utilisation of capital allowances • No exemption from Police Trust Fund levy	• Deemed CIT for NRCs • Restriction of CA • Technology solution for FIRS • FIRS as primary tax agency

With support from the Bill and Melinda Gates Foundation, the Fiscal Policy Roundtable of the Nigerian Economic Summit Group conducted a national study on tax morale/ tax perception about two years ago. At the end of the study, the Roundtable came up with a 10-Point Agenda as Imperatives for a Sustainable Fiscal System. It was discovered that the tax morale of Nigerians at the time of the survey was one of the lowest in the world.

Imperatives for a sustainable fiscal system: The 10-Points Agenda

Policy

1. Government at all levels should publish revenue collection data annually by type of tax, number of taxpayers and cost of collection
2. Political leaders and MDAs should be fully compliant with the law and demonstrate this to the public
3. Taxation should be clearly linked to the provision and improvements in the quality of public infrastructure and social services

Legislation

4. Government should amend the constitution to clarify the taxing powers of various tiers of government, to eradicate overlapping jurisdictions that result in multiple taxation

4. Government should amend tax laws to resolve ambiguous and draconian provisions
5. Full and effective compliance with tax obligations should be a pre-condition for political offices

Administration

7. Utilize one central identification number that harmonizes various identities (NIN, TIN, BVN etc)
8. Tax authorities should promote professionalism and implement continuous training and capacity building for tax officials at all levels
9. Tax authorities should ensure full adoption of technology platforms and measure the rate of usage by taxpayers as a basis for continuous improvement

*NESG Tax Perception Survey

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4. Key Issues and Implications of the 2021 Finance Act

4.1 Key Issues and Sectoral Implications of the Re-Introduction of Excise Duty On Non-Alcoholic Beverages

The 2021 Finance Act enables the government to generate more revenue, fuel medium-term growth and consolidate the economic recovery from the COVID pandemic. The Act introduced the excise tax, a production tax on non-alcoholic beverages. This tax is perceived as a burden to the sector as most businesses are currently in a survival mode. The implications of introducing the excise tax include a shrink in purchasing power and a rise in inflation, with an overall impact of a decline in the industry's performance. Moreover, the per capita consumption of sugar in Nigeria is about eight kilograms, below the World Health Organization's benchmark for excess sugar consumption problems. This implies that the government's introduction of the excise tax to curb excess sugar may not be supported by evidence.

4.2 The Capital Market/Investment Impact of the Finance Act

The Act introduced the Capital Gains Tax (CGT), which is essential for deepening revenue diversification and tax receipt. However, with the capital market in recovery, the introduction of the tax can dissuade investors from participating in the capital market.

For instance, the introduction of excise taxes on non-alcoholic beverages has an indirect impact on the capital markets. The inconsistencies in the cash flow of companies as the market is still in recovery will ultimately have a negative impact on the capital market. The tax will therefore stifle the ability of corporations to raise capital due to the unavailability of funds for equities. Asset managers may also be forced into an asset class that appears to be right in the short term but not in the long term.

4.3 Implication of the 2021 Finance Act for an Enabling Domestic Business Environment

The timing of the introduction of new taxes, particularly the excise tax, is not favourable to the manufacturing sector as all operators in the economy are recovering from the attendant impact of the COVID-19 pandemic. For the manufacturing sector, aside from the substantial increase in the cost of raw materials, the industry has also contracted.

The impact of debt on foreign exchange earnings is worrisome. An increase in debt, particularly foreign debt, is closing the foreign exchange space and continues to increase the pressure on the availability of foreign exchange, particularly for the manufacturing sector, which is largely dependent on the importation of raw materials.

The introduction of new taxes through legislation rather than executive actions will continue to increase the tax burden, especially on those already paying taxes. Many Nigerians, corporate entities, and individuals are not within the tax net. Many do not pay taxes, while for those who pay, many do not pay the correct amount. This indicates that the country's tax net is not broad enough.

4.4 Labour and Welfare Issues Arising from the Tax Amendments

The introduction of punitive taxes will harm critical sectors of the economy that contribute significantly to employment creation. Since the government is not expected to generate employment in the economy, the tax will limit the ability of the organised private sector and the manufacturing sector to create employment. According to the Nigerian Labour Congress (NLC), the food and beverage industry could lose up to 1.9 trillion naira in revenue due to the new excise duty imposed on the sector. From the duty, the government is likely to realise 81 billion naira; however, the government could also lose up to 197 billion naira in VAT, company income tax, and tertiary education tax, among others.

The excise duty imposed on the food and beverage industry will have a far-reaching effect on labour productivity. Labour, both in the public service and private sector, depends on products from the food and beverage industry for their daily consumption. An increase in the cost of daily consumables due to the tax hike will affect the quantity demanded by workers, resulting in a weak and unproductive labour force.

5. Recommendations

Ensure a more robust consultation with stakeholders

The government must ensure consultations and engagements with stakeholders across various sectors before introducing new taxes and the amendment of existing ones. This would help ensure that their various concerns have been addressed and a consensus is reached on the best action to take regarding the imposition of taxes. It will also ensure the proper timing in the imposition of new taxes. Even after a tax is imposed, the government must ensure continuous engagements with all stakeholders across sectors of the economy.

Establish a period for moratorium and advanced notices

A moratorium period that allows for constructive dialogue between the industry and the government on the shape and form of administering sector-specific taxes is necessary. There is the need for advanced notices concerning policy announcements and implementation as advanced notices will aid in planning as against when policies/regulations are introduced and expected to take effect immediately.

Ensure that taxes do not stifle growth

The government needs to consider the implication of tax increases on industry growth, job creation, Foreign Direct Investment (FDI), and GDP. For example, the food and beverage industry needs to be protected as it generates about 1.5 million jobs. The industry also remitted more than 100 billion naira in import duties in the last three years and more than 200 billion in VAT in the last five years. Therefore, there is a need to ensure that the taxes introduced do not stifle growth but rather create a suitable investment climate that will attract foreign private investors. Among other implications, taxes that stifle growth will negatively impact the economy as companies devote fewer amounts to corporate social responsibility (CSR) initiatives geared towards socio-economic change.

Ensure the proper administration of technology and widen the tax net

The Finance Act's introduction of technology into the tax management and tax collection system is essential. It will help the government identify tax obligations on all taxpayers and ensure the correct amount of taxes is collected. However, it is crucial to ensure that the taxpayer does not see technology administration as an imposition or an additional burden to the operational cost. Efforts should be made to capture people outside the tax net and ensure that the right amount of taxes is paid.

6. Bouquet of Possible Interventions from Private-led, Public-led and Public-Private Joint Collaborations

Key Priorities, Action Steps, Responsibilities, and KPIs

Key Priorities	Government Driven		Private Sector Driven	
	Responsibility	**Action Step and KPIs**	**Responsibility**	**Action Step and KPIs**
Ensure adequate consultation with stakeholders	Federal Ministry of Finance, Budget and National Planning	Continuous engagements with the organised private sector to assess the effects of policies	NESG	Continuous engagements with the government through evidence-based research and development
Establishment of a Moratorium Period	Federal Ministry of Finance, Budget and National Planning	Early announcements of policies to aid early planning (minimum of 6 to 12 months)	NESG	Facilitate dialogue sessions between the industry and the government on the shape and form of administering sector-specific taxes
Ensure that taxes do not stifle growth	Federal Ministry of Finance, Budget and National Planning / National Assembly	Remove counterproductive taxes and embark on research on the implication of tax increases on industry growth, job creation, Foreign Direct Investment (FDI), and GDP		
Ensure the proper administration of technology and widen the tax net	Federal Ministry of Finance, Budget and National Planning Federal Inland Revenue Service (FIRS) / Joint Tax Board (JTB)	Widen the tax base to capture people outside the tax net		

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ABOUT THE NESG

The NESG is an independent, non-partisan, non-sectarian organisation, committed to fostering open and continuous dialogue on Nigeria's economic development. The NESG strives to forge a mutual understanding between leaders of thought so as to explore, discover and support initiatives directed at improving NIgeria's economic policies, institutions, and management.

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