Position Paper on the 70% Windfall Tax on Foreign Exchange Gains by Banks

Background

1 President Bola Ahmed Tinubu, in a significant move, presented a Bill to amend the 2023 Finance Act, introducing a 50% windfall tax on foreign exchange (FX) profits by banks. Upon approval, the Senate passed a 70% windfall tax on FX Gains by banks, a 20% increase from the initial proposal.

2 The windfall tax seeks to boost domestic revenue mobilisation, targeting the windfall profits reported by banks following the unification of exchange rates by the government. These gains often result from favourable exchange rate movements or large-scale foreign exchange transactions, which are influenced by external market conditions rather than the banks' operational strategies.

3 While the Nigeria Economic Summit Group (NESG) understands the government's focus on increasing revenue given the current state of the government's fiscal position, the timing, magnitude, and potential implications of the windfall tax raise a lot of concern and risk.

Implications of the 70% Windfall Tax on Foreign Exchange Gains by Banks

4 **Policy Inconsistency/ Legal Concerns on Retroactive Taxation:** The Bill, as approved by the Senate, imposes *"a levy of 70% on the realised profits from all foreign exchange transactions of banks in the 2023 to 2025 financial year"*. This suggests that implementation could apply retroactively, which is at variance with the National Tax Policy (NTP) and the legal provisions in the Constitution. The National Tax Policy (2017) provides that "Tax policies and laws shall not be retroactive". The Constitution also prohibits legislation with retrospective effect.

5 **Loss of investor confidence and loss of potential FDI:** The relative arbitrariness of the windfall tax could negatively impact investor confidence because it could set a precedence for retroactive taxation. This precedence, if allowed, will imply that tax opinions to investors will include the possibility that the government, without notice and possibly retroactively, can tax any sector, any amount at any time for any reason – as long as the government needs to raise revenue. The attendant concerns about unfair and erratic business policies can undermine foreign direct investment (FDI) in Nigeria. This is also coming at a time when efforts are in top gear to improve Nigeria's Ease of Doing Business index.

6 **Contradiction to perceived bank recapitalisation:** It would be recalled that the CBN recently announced a recapitalisation of all banks in Nigeria over a period of 24 months, from 1 April 2024 to 31 March 2026. The CBN had also, in a circular signed by the Director Banking Supervision Department (BSD) on 14 March 2024.

In addition, a letter dated 11 September 2023, upon reviewing the impact of the FX rate regime, directed banks not to utilise the FX revaluation gains to pay dividend or fund operation expenses. *The CBN advised that the FX gains should be set aside to serve as a buffer against the implications of the FX policy reform, which may include - breaches of the single obligor and net open position limits, possible increases in asset quality risks, pressure on industry capital adequacy, and any adverse change in the FX rate.* If the windfall tax is imposed, banks may be constrained from complying with the recapitalisation exercise. The CBN and the Ministry of Finance should critically analyse this unintended outcome.

7 **Concerns about Equity and Fairness:** Understandably, the government aims to ensure that companies benefiting from favourable conditions contribute fairly to the economy. However, there are questions about the fairness and transparency of targeting banks specifically for windfall taxes, suggesting that other sectors and industries may have benefitted from the devaluation differently.

8 **Double Taxation:** The proposed windfall tax may amount to double taxation as the Company Income Tax Act (CITA) already prescribes a tax rate of 30% and 20% on the profits of large and medium-sized companies, respectively. Banks have already filed and settled their taxes on profits for the 2023 financial year, which include FX transactions, and the Bill suggests banks will now be required to pay tax arrears. This highlights the risk of double taxation due to the uncertainty on the required tax remittance on FX gains, considering banks would have paid 30% on profits, including FX earnings under the CITA.

Implications of the 70% Windfall Tax on Foreign Exchange Gains on Banks

9 **Perception of desperation to extract undeserved value** - Just recently, the Cybercrime Act implementation was suspended by the president due to the public outcry over the insensitivity of the timing, amongst other reasons. This windfall tax, at this point, could create the impression that the government is too desperate to reach into pockets of the private sector to plug its deficit gap. While this can and should be done, it must be done in a structured manner that retains the integrity of whatever existing sectors we have and existing tax laws.

10 **Reduced productivity and competitiveness:** This tax will significantly affect banks' net profits, potentially reducing shareholder dividends and impacting stock prices. The increased tax liability may necessitate adjustments in banks' foreign exchange operations and overall business strategies. Also, banks may need to reassess and modify their foreign exchange trading strategies to mitigate the impact of the tax, which could affect their competitiveness and market behaviour.

Recommendations

11 While the proposed windfall tax on foreign exchange gains can provide necessary revenue for the government, it is essential to balance this with the potential long-term impacts on the banking sector. A collaborative approach involving dialogue and phased implementation could help achieve the desired outcomes without causing undue disruption. The NESG recommends that the relevant authorities should put the implementation of the legislation on hold while a thorough review is done.

12 **Stakeholder Engagement:** We propose a robust stakeholder engagement to review the legislation. We recommend a structured dialogue between the government, regulatory bodies, and the banking sector to discuss the rationale behind the windfall tax and explore mutually beneficial solutions.

13 **Gradual Implementation:** We recommend that the government considers a phased or tiered approach to implementing the tax, allowing banks time to adjust their operations and financial planning accordingly.

14 **Alternative Measures:** The government could also explore alternative revenue-generating measures that do not disproportionately impact the banking sector, ensuring a balanced approach to economic growth and stability. Here are some suggestions:

- The tax waiver on FGN securities
- Differential and Sectoral taxes for banks

Recommendations

- The tax waiver on FGN securities expired in 2022 and the fiscal authorities have been silent on the implementation. The implementation will generate significant revenues for the government and without disrupting any existing framework. However, with so much time having passed without any clear guidance from FIRS, there's a genuine concern that the clawback will be retrospective and this is affecting offshore investment sentiment negatively.
- Differential and Sectoral taxes for banks will go a long way in changing banking behaviour to redirect assets to growth sectors that will in turn spur overall real sector activities. For example, tax on bank revenues from agric./ manufacturing activities can be reduced to below the existing corporate tax rate by a significant margin, while tax on revenues from trading can be increased above the existing corporate tax rate.

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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