Issue#2

EDS REPORT

Policy Brief: Tax Incentives for Startups

eds ecosystem dialogue series

by Ventures Platform

About the

Ecosystem Dialogue Series

The Ecosystem Dialogue Series (EDS) is a platform that enables periodic and thematic policy dialogue between government and other key stakeholders of the technology entrepreneurship ecosystem.

The principal objectives of the program are to; increase startup participation in the policy-making process; to foster collaboration between government and startups, to highlight policy challenges and propose policy recommendations.

We believe the implementation of the policy recommendations will create the enabling environment for entrepreneurship & innovation to thrive in Nigeria. Special thanks to **Google** for the support of this program.

INTRODUCTION

The document provides a report on stakeholder consultations on the EDS Edition: Tax Policy Incentives for Startups. The EDS took place in Abuja and Lagos on the 27th of September and 26th of October, 2018 respectively.

Both sessions brought together relevant stakeholders in a conversation aimed at discussing current tax policies and incentives, and the challenges startups face in complying with and benefiting from tax policies in Nigeria. The objective of these discussions was to generate tax policy recommendations that will promote not only the growth and development of Nigeria`s tech startups, but overall economic growth and development in the country.

Nigeria's Startup Ecosystem is in its early stages but has great potential. Increasingly, the digital startup space is growing rapidly and is one of the key sectors contributing not only to economic diversification, but enabling the productivity of other sectors of the economy. The growth in Nigeria's technology sector is evidenced by the increasing number of technology hubs and ecosystem support initiatives that are springing up to support the rise in technology startups and entrepreneurs. The establishment of seed funds like Microtraction, the Nigerian Angel Business Network, Growth Capital Fund, Ventures Platform Fund, Singularity Investments etc, and the recent funding rounds of **Andela ($40m), Cars45 ($5M) and Paystack ($8M)** testify to a progressive ecosystem, despite existing challenges. According to the **VC4Africa** Nigeria Report (2018), average investments in technology entrepreneurship in Nigeria amounted to $93,651 in 2018 which is 22% higher than the previous year. These technology companies have not only gained international exposure, but are an indicator for job creation and overall economic development.

To maximize the impact of innovation and technology entrepreneurship in Nigeria, it is imperative that the regulatory environment is favorable to the emergence of high impact tech startups.

Emerging economies such as India, Rwanda, and Tunisia have implemented tax policy interventions such as tax exemptions and reliefs for startups and their investors. These countries have prioritized startup support as they understand the transformative role and impact technology startups play in boosting economic growth and development. The enormous potential that technology entrepreneurship holds for Nigeria makes it imperative for policy makers to collaborate with representatives of the startup ecosystem to develop and enact policies that will engender a favorable policy environment for innovation and technology entrepreneurship.

Objective of the EDS Tax Policy Edition

The objective of the Tax Policy edition of the EDS was to enlighten tech startups on current tax policies and incentives, and propose a set of tax incentives that would be favorable to tech startups and the Nigerian economy on the long-run.

Tax Incentives is one of the key policy focal areas of Ventures Platform and a priority area for the tech startup ecosystem. According to the Technology Entrepreneurship Ecosystem Report, reducing or waiving tax obligations for a period could relieve operational burden and reserve cash for business development. Towards this, the report recommends the introduction of tax breaks, rebates, social benefit subsidies or exemptions for high impact startups and their investors. The rationale for the recommendation is the fact that the start-up failure rate in Nigeria is very high, with most endeavours ceasing before they can go through enough iterations to validate their business proposition. It is thus necessary for the Government to provide support in the early stages of startup development in order to improve their chances of survival. The more successful tech companies are created, the more jobs are created and the more economic prosperity the country enjoys.

“Reducing or waiving the tax obligations and providing social benefit subsidies for a period could relieve the operational burden and reserve cash for business development.” - Technology Entrepreneurship Ecosystem Report, Nigeria.

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The Tax Policy edition of the EDS event had representatives from the Nigerian Investment Promotion Council (NIPC) Mr. Uwem Akpang, Deputy Director Incentives Policy, and Mr. Olufemi Olarinde, Tax Policy Manager, Federal Inland Revenue Service (FIRS) as government officials present for the discussions. It also had in attendance startups and representatives of innovation hubs in attendance. The NIPC provided information on the Pioneer Status Incentive and the FIRS provided information on current efforts made to ease compliance such as e-filing, e-registration, e-receipt, e-payment, e-stamp duties, and e-payments, amongst others. To enlighten the startups in attendance, the FIRS also highlighted all the current tax obligations required of startups in Nigeria as well as current tax incentives that are available to startups.

"Tech entrepreneurship ecosystem in Nigeria - OC&C Strategy" Available at: https://www.dropbox.com/home/Tech%20Entrepreneurship%20Ecosystem%20In%20Nigeria%20Research.

Tax incentives for startups in Nigeria include:

1. **Exemption of filing of Company Income Tax Returns** for the first 18 months of establishment.

2. **The Pioneer Status Incentives,** exempts startups from paying Company Income Tax for the first 3 years and is renewable for another 2 years, making a possible total of 5 years exemption period.

3. **Reduction in Company Income Tax**: Section 40(6) of the Company Income Tax Act (CITA), allows a 20% tax rate for startups engaged in agriculture, manufacturing, solid minerals or wholly export trade for the first 5 years of commencement of business, where the turnover is less than 1 million.

4. **Exemption from Minimum Tax**, Section 33 of CITA provides that a company (startups) shall be exempted from payment of minimum tax for the first 4 years of commencement. These means that such company may not pay tax if there is no total profit.

5. **Exemption from Companies Income Tax for those in Mining of Solid Minerals**: Section 36 CITA provides that a new company going into the mining of solid minerals shall be exempted from tax for the first three years of its operation.

6. **Deduction for Research and Development**: Section 26 CITA provides for the deduction of amount expended on research and development, not exceeding an amount equal to 10% of the total profits.

7. **Exemption of Capital Gains Tax (CGT)** from take-overs, absorption or merger: Section 32 CGTA exempts gains arising from acquisition of shares, either taken over, absorbed or merged by another company as a result of which the acquired company loses its identity as a limited company, provided no cash was exchanged in respect of the shares.

8. **Indefinite carry forward of losses**:Under Section 31(3) of CITA, Startups are allowed to carry forward their losses indefinitely.

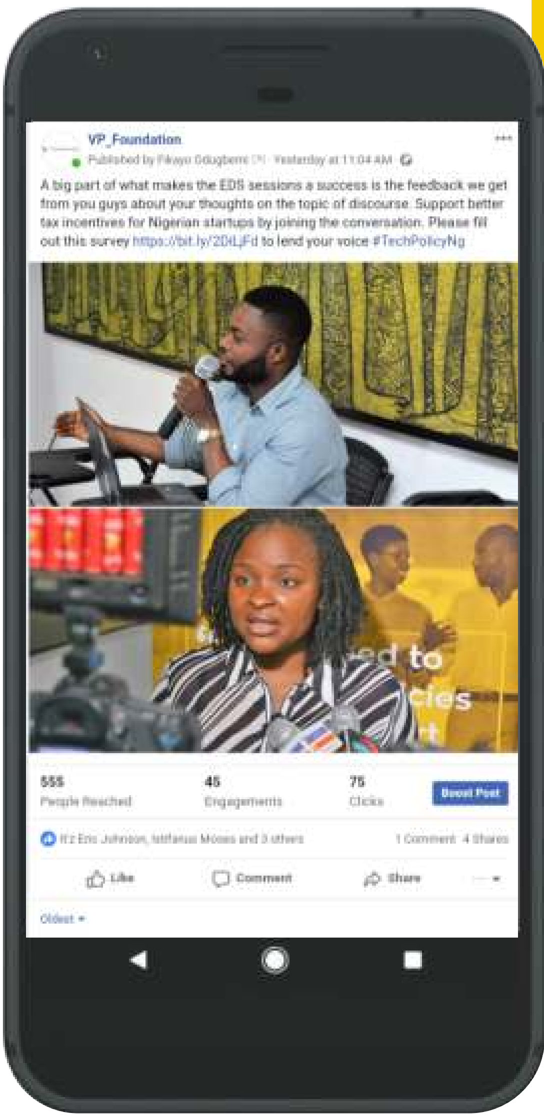
9. **Exemption of tax from loan**: Startups who obtains loan can get exemption of tax on interest accrued on such loan, Section 19(7) PITA, Section 11(2) CITA.

10. **Rural Investment Allowance**: Section 34 CITA allows a Startup who incurs capital expenditure on the provision of facilities such as electricity, water or tarred road for the purpose of a trade or business to expend such before paying tax.

11. **Investment tax relief:** Sections 40 CITA provides that where a company has incurred an expenditure on electricity, water, tarred road or telephone for the purpose of a trade or business carried on by the company, the company shall be allowed an "investment tax relief".

12. 95% **accelerated capital allowance**: Second Schedule of CITA provides accelerated capital allowance at 95% of qualified capital expenditure on Mining in the first year of use of the asset.

Key concerns raised by startups from the above conversations include:



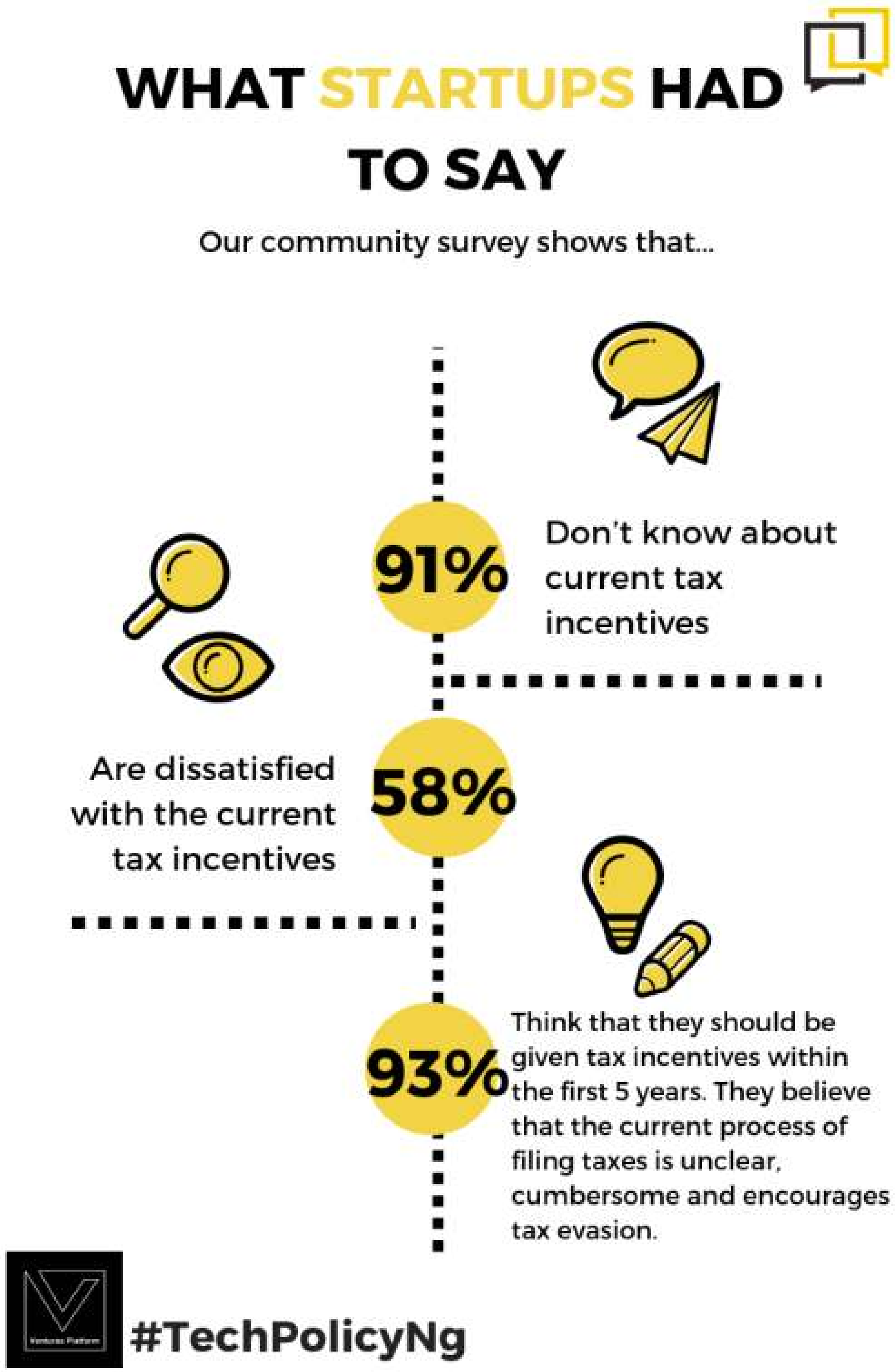
1. Poor awareness creation on current tax policies and incentives hinders startups from maximising these tax incentives. From our community survey, 91% of startups do not know about tax policies and incentives.

2. Many of the tax incentives do not support digital/technologically driven startups such as the Exemption from Company Income Tax and Reduction in Company Income Tax, which are critical tax areas of concern.

3. Cumbersome, expensive, complex process of filing taxes and obtaining the Pioneer Status is discouraging and unrealistic. According to our community survey, 93% of startups think that the current policy process is cumbersome, unclear and encourages tax evasion. The Pioneer Status takes about 25 weeks to process, requires N100 million non-current tangible assets and costs a total of N3,200,000 million in processing fees.

4. High rate of Company Income Tax (30%) and low value for tax remittance.

5. Poor customer service as well as unreliable and inefficient e-tax platforms discourages startups from engaging with tax authorities.



Key Policy Recommendations by startups from the Interactive Session are:

1. **Tax Education**: Tax Authorities should invest more in providing more education and awareness of tax policy. Towards this, authorities can adopt the use of graphical or animated illustrations to convey tax policies in a way that can be clearly understood. This can also be an open source guide that can be easily accessible.

2. **Dedicated Tax Payer Service Unit:** A more dedicated taxpayer service unit should be assigned in the FIRS to address complaints, provide tax education and ease tax payer engagement with Tax Authorities. Adopting chatbots on the FIRS website to limit traffic into FIRS office is an option that can be explored.

3. **Include ICT companies** in the exemption from Company Income Tax incentive and reduce the Company Income Tax rate for startups for up to 5 years.

4. **Design an incentive similar to the Pioneer Status Incentive that is inclusive of startups**, eliminating barriers such as non-current tangible assets requirements, as well as reducing the timeframe and high cost of obtaining the status. FIRS/NIPC can partner with selected hubs to verify startups who should be awarded the Pioneer Status Incentive. Hubs would be able to design a process that will adapt compliance and educates startups on tax policies.

Conclusion & Next Steps:

Ventures Platform agrees with the policy recommendations highlighted by startups and calls on the NIPC, FIRS, the Federal Ministry of Trade & Investment, and other relevant regulatory body to look into these incentives and take relevant action on them.

Both NIPC and FIRS agree that startups need tax incentives and such incentives should be clearly adapted to better suit tech startups. These incentives are to encourage companies especially high impact tech startups to grow into viable businesses that will in turn generate more taxes and stimulate economic growth. To achieve this, the NIPC and the Federal Ministry of Trade and Investment would need to review current incentives and work with key stakeholders in the startup ecosystem, to co-design and agree on favorable tax incentives that will support high impact tech startups in Nigeria.

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deserve a public
procurement process
that favours them.

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