An Assessment of Agribusiness Tax Incentives in Nigeria

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Abstract

There are several reasons why governments grant tax incentives to businesses. Among other reasons are- regional investment, sectoral investment, performance enhancement, and transfer of technology. Tax incentives have reawaken investors' and are extensively used and exploited by agribusinesses in Nigeria to save the agricultural sector from total collapse. Although tax incentives seem to be relevant in promoting the growth of agribusinesses for improved performance, there is growing evidence that short-run gains arising from current deduction of capital expenditure, capital gains income, accelerated depreciation, investment tax credits and tax breaks may adversely affect the financial performance of agribusiness in the long-run. This study therefore assessed agribusiness tax incentives in Nigeria and recommends that tax incentives should be directed at small and growing agribusinesses because they are often short of funds due to their inability to borrow from capital markets. Reduced tax rates or tax holidays may not produce the required results. Measures such as investment tax credits that provide upfront funding might be more effective for agribusinesses in Nigeria.

Introduction

In addition to the general economic factors that impact on all businesses, agribusinesses have the added burden of uncertain weather conditions and fluctuating international and domestic market prices due to the nature of their products. They are also experiencing a reduction in available resources as a result of urbanization of food production areas. This means that as the world's population increases, greater pressure is placed on agribusinesses to increase output within social constraints and with diminishing resources. Added problems arise because the relative contribution of primary production to the economy is gradually declining, which has resulted to financial stress and poor performance of agribusinesses.

The financial stress and poor performance of agribusinesses in Nigeria have been the focus of much discussion, debate, and analysis in recent years. Bankers and lenders face significant risks in lending to agribusiness hence they deny most agribusinesses access to loan facility thereby worsen their financial condition. Projections of agribusiness financial conditions and failure rates, along with various policy responses to ameliorate financial stress and improved performance of the business, have received the most attention in the form of tax incentives.

There are several reasons why governments grant tax incentives to businesses. Among other reasons are- regional investment, sectoral investment, performance enhancement, and transfer of technology (Summers and Delong, 1991). Tax incentives have reawaken investors' and are extensively used and exploited by agribusinesses in Nigeria to save the agricultural sector from total collapse. Although tax incentives seem to be a viable option to promote the growth of agribusinesses for improved performance, there is growing evidence that short-run gains arising from current deduction of capital expenditure, capital gains income, accelerated depreciation, investment tax credits and tax breaks may adversely affect the returns to agribusiness in the long-run (Tanbasi, 2002). Supporting this view, Ogundele (1999) argued that the current trend in development planning is to discourage too many tax incentives because it makes no economic sense for a developing nation not to collect all the taxes it can.

There is no iota of doubt that tax incentives are granted by governments to enhance corporate performance, but the question arises as to the impact which these incentives have made in agribusinesses. According to Philip (1995), the list of existing incentives may appear long but there is little evidence of their critical significance in the investment and production decisions of Nigerian corporations generally. In view of the above, this study tends to theoretically assess the relevance of tax incentives to agribusinesses in Nigeria.

Literature Review

In its traditional form, an agribusiness is a business activity, which involves the cultivation of crops and rearing of animals for man's use. This definition ignores the industry sector that has responded to market forces and has moved away from primary production into manufacturing and distribution activities. In line with this, section 9(8a) of the Companies Income Tax Act (CITA) in Nigeria defines an agricultural trade or business to mean any trade or business connected with- the establishment or management of plantations for the production of rubber, oil palm, cocoa, coffee, tea and similar crops; the cultivation or production of cereal crops, tuber, fruits of all kinds, cotton, beans, groundnuts, sheanuts, beniseed, pineapples, bananas and plantains; animal husbandry-poultry, piggery, cattle, rearing and the like and fish farming. Obst, Graham and Graham (2007), supported this view and described an agribusiness as the sector involved in the production, processing and distribution of agricultural goods and services, and it includes all related activities. For example, the broiler chicken industry has responded to consumer demands by providing lean, tender, disease-free and chemical-free chicken pieces. The business has moved positively towards meeting consumer demands by controlling production and distribution processes.

The ultimate goal of an agribusiness like every other business is wealth maximization and one reliable means of achieving this purpose is through cost minimization. But as a business entity, an agribusiness is mandated to pay a certain percentage of its income as taxation to the state to promote public sector activities and this compulsory payment constitutes a major cost and serves as a barrier to the goal of wealth maximization of agribusiness, thereby threating its growth and survival. Although other businesses equally pay tax, the taxation of agribusinesses should be minimal to promote agricultural growth for economic development. Many agribusinesses have been forced out of business because taxation has eroded their profits with little or nothing as dividends for owners thereby discouraging investors' willingness to supply the fund they needed to stay in business (Uki, 2004).

In order to reduce their tax liabilities, agribusinesses see tax planning as a viable option. Okoye and Akenbor (2010) claimed that tax planning refers to the procedures followed by business to minimize or reduce due tax commitments and which do not conflict with the legal procedures in effect. This implies that tax plans which contravene existing legislations are not acceptable and that is the essence of ensuring that tax plans do not run foul of the law. According to Stigliz (1985), effective tax planning is based on three principles-postponing taxes from the current period to future period, arbitraging across different income streams facing different tax treatments, and shifting income from high tax brackets to low tax brackets. It has been observed that even with tax planning effort, agribusinesses have not improved their performance (Uki, 2004). It is against this backdrop that government provides some financial assistance in form of tax incentives to prevent the failure of agribusinesses considering their role in economic growth and development. According to Philip (1995), tax incentive is a deliberate reduction in or total elimination of tax liability granted by government in order to encourage particular economic units to act in some desirable ways-invest more, produce more, employ more, save more, consume less, import less, pollute less and so on. Kiabel and Nwikpasi (2001) asserted that tax incentive could be in the form of reduction in tax rate, reduction in tax base, tax deferment or outright tax exemption.

Section 9 (8a) of CITA indicated the following tax incentives for agribusinesses –

(i) Loan interest earned by banks on lending to agricultural business is exempted from tax with effect from 1991. However, the government expects that the loan would have the following features – moratorium period is not less than 18 months; rate of interest is not more than the base lending rate (i.e the average cost of capital) of the bank granting the loan.

(ii) The rate of initial allowance on plant and machinery used in agricultural production has been reviewed from 25% to 95% with effect from 1st January, 1996. The 5% balance is retained in the books until the asset is sold. Similarly, annual allowance rate on Ranching and Plantation had been increased from 15% to 50%

(iii) With effect from 1st January, 1996, plantation equipment expenditure now attracts 95% initial allowance as against the former 20%.

(iv) Small agricultural businesses with turnover of less than N1 million in the year of assessment are charged to the lower concessional rate of 20% for the first five years of their operation.

(v) A loss incurred by a business in agricultural production can be carried forward for an indefinite number of years to be set-off against profits in the same line of business.

Certain deduction and incentive provisions are only available to those taxpayers who can show that they are carrying on farming of agricultural business. The test is generally met where it can be established that the intention of the taxpayer is to make a profit. Inland Revenue accepts that any of the following activities are carried on for agricultural purpose: apiarists, beekeeping; animal husbandry; dairy farming; grain and seed growers; market gardening; orchardists; poultry farming; sharemilking; tobacco growing; and viticulture and growing grapes (Egeni and Obaro, 2006). Inland Revenue rulings and case laws have determined that the following activities are not within the definition of a farming or agricultural business: dealing in livestock; leasing or bailing livestock (as bailor); aerial top-dressing; and providing services to persons carrying on farming or agricultural business, e.g agricultural contracting, seed cleaning, dressing, etc.

Items of income derived from an agricultural business include: compensation for condemned stock; depreciation recovered on sale of farming assets; proceeds from sale of minerals, metal, timber, or flax; prize money won at any agricultural show; estimated value of meat and produce used for private or domestic purpose; grazing fees, and leasing and rent for farm property; proceeds from the sale of dairy produce; proceeds from the sale of meat; proceeds from the sale of wool; income equalization deposit scheme refunds and interest; insurance proceeds for crop or stock losses; produce, wool, and livestock on hand at balance date; stud fees; and unexpired portion of accrual expenditure (Henshew and Smith, 2001; Jacks, 1992).

According to Iyere (2000), the usual principles governing the deductibility of business expenditure apply to agribusinesses just as for any other business. Accordingly, items such as telephone rental, newspapers, and the business proportion of motor vehicle expenses, are all deductible to the extent that they are incurred in the production of gross income. In addition, there are some deduction rules peculiar to farming:

- Where food (as part of lodging) is provided to employees and the actual cost of this cannot be determined, the CIR will allow a deduction of $10 per person per week.
- Where the domestic dwelling is situated on the farm property, 25%of any outgoings on house power or house repairs and maintenance constitute deductible expenditure. This applies mainly to full-time farmers, although in certain circumstances part-time farmers may also qualify.
- Expenditure incurred on fertilizer and lime, including the spreading of it, is deductible either in the year incurred or any of the following 4 income years (the taxpayer can choose).
- Wages paid by farmers to their spouses for farm work performed, e.g cooking for employees etc, will be deductible provided the prior approval of the CIR has been obtained.

A basic principle of tax law is that expenditure on improvements to land is capital expenditure and is not deductible for tax purposes (although specific land improvements may be depreciable under the depreciation regime). However, farmers are allowed to deduct certain expenditure of a developmental nature. Immediate deductibility is available for expenditure incurred on:

- The destruction of weeds, plants, or animal pests detrimental to the land;
- The clearing, destruction, and removal of scrub, stumps, and undergrowth;
- The repair of flood or erosion damage
- The planting and maintaining of trees for the purpose of shelter and preventing and combating erosion; and
- Construction of fences for agricultural purposes, including the purchase of wire or wire netting for the purpose of rabbit-proofing new or existing fences.

While the taxpayer must be engaged in a farming business on the land, ownership of the land is not a prerequisite for a deduction.

In developing an incentives system, Governments need to clearly list and analyse the market imperfections and the extent of the imperfections that the incentives are designed to reduce or eliminate. The costs of granting incentives can then be compared to the benefits of removing or reducing the imperfections. According to Tanzi and Partha (1992), periodic review of the incentives regime by Governments offers a potential double benefit. On the one hand, it can help Governments prevent revenue leakage by eliminating excessive incentives or unnecessary tax breaks to investors. On the other hand, it can help them update incentives packages to provide real value to investors that will attract more investment. There are many ways to assess the relative advantages of tax incentives in order to determine whether use or continued use is warranted. One simple way is for developing countries to list the objectives such incentives are designed to achieve and compare them with any revenue loss or other unintended results associated with their employment.

Nigerian government has over the years allowed tax incentives and reliefs as follows:

1. Pioneer Companies- Tax holiday subject to a maximum of 5 years, is granted to companies with pioneer status on the basis of newness and relevance of the products by the Companies. We shall know this fully in this paper.
2. Export Free Zone Exempt Profit -100% exemption for profits obtained from export-oriented undertaking established within and outside an export Free Zone for 3 consecutive assessment years.
3. Solid Minerals Mining - For a new company going into the mining of solid minerals for the first 3 years of its operation.
4. Hotels Income Exempt from Tax- 25% of income in convertible currencies derived from tourists, provided the income is put in a reserved fund to be utilized within 5 years for the building expansion of new hotels, conference centers and new facilities for tourism development.
5. Spare parts Fabrication- For a Company engaged wholly in the fabrication of spare parts, tools and equipment for local consumption and export; 25% investment tax credit is allowed on qualifying capital expenditure, S. 28 F (1) of CITA.
6. Locally Manufactured Plant- 15% investment tax credit is allowed for a company, which produces totally manufactured plant, machinery or equipment.
7. Replacement of Obsolete Plant- 15% investment tax credit for a Company, which has incurred an expenditure for the replacement of all obsolete plant and machinery..
8. Investment Tax Relief- Relief is granted for 3 years to Companies located at least 20km away from essential infrastructure such as electricity, water, tarred roads and telephone services, when expenditures are incurred on such infrastructure
9. Investment Allowance -10% tax relief for Companies in the first year of purchase of plant and machinery used for agricultural Production and manufacturing by agricultural and manufacturing and companies. This is in addition to the normal initial and annual allowances.
10. Rural investment Allowance -granted to Companies established in rural areas lacking infrastructural facilities. The same rates are applicable as in Investment tax relief as follows:
    -No facilities at all 100%
    -No electricity at all 50%
    -No water at all 30%
    -No tarred road at all 15%
    -No electricity at all 5%
11. Tax free interest Relief is granted on the following interest charges:
    - Full tax exemption on interest on foreign currency deposit account of a non resident Company opened in or after 1St January, 1990
    - Full exemption on interest on foreign currency domiciliary account accruing on or after 01/10/1990.
    - Graduated Tax Relief on interest on foreign loans or interest payable on any loan granted by a bank for manufacture for export.
    - Interest on loan granted by bank on or before 1st January, 1997' to a Company engaged in agricultural trade or business, or for the fabrication of any local established by the Company under the Family Economic Advancement Programme. The incentives arc based on the conditions that the moratorium is not less than I 8 months and the interest rate is not more than the base lending rate at the time the loan was granted.

12. Deductible Capital Allowance- Full capital allowance are granted to agricultural and manufacturing companies in respect of assets in use In agricultural production and manufacturing.
13. Research and development- 20% investment tax credit on qualifying expenditure is available to companies engaged in research and development for commercialization. Levies paid to National Science and Technology Fund is also allowed as deduction in arriving at company's taxable profits.
14. Tax-free Dividends -This comes through:
    - Franked Investment Income (FII) provisions
    - Three year tax- free dividend on foreign currency equity ordinary shares imported into Nigeria
    - Five year tax Free dividend for companies in priority sectors in Nigeria such as agricultural production and processing, petrochemical or liquefied natural gas production, and
    - Tax-free dividends to priority companies for the period of tax holidays
    - Dividends distributed by Unit Trust Companies
    - Five: year tax incentive for dividends from small companies in the manufacturing sector
    - Dividend received from investments in wholly export-oriented businesses
    - Dividends, interest, rent, royalty derived from foreign
    - Profits of a Nigerian company in respect of goods exported from Nigeria provided that the proceeds are repatriated to Nigeria and used for the purchase of raw materials, plants, equipment and spare parts.
    - The Interest on foreign currency domiciliary account in Nigeria accruing on or after 1 January, 1990.
15. Tax Treaties with other Countries -This is aimed at:
    - Eliminating double taxation through the granting of credit for taxes paid by a Nigerian company in the other company etc.
    - The protection of tax incentive legislations of the government which would otherwise be nullified by the tax measures of the other country
    - The creation of a stable tax regime, which a prospective investor can rely on
    - Concessions of treaty-rules for investment income which are lower than domestic rates and are available to treaty partners only.
16. Gas Industry Incentive -granted to companies engaged in gas utilization (downstream operations) such as tax free period of up to 5 years and accelerated capital allowances.
17. Small Business Rate- 20% tax rate for 4 years for a company whose turnover is N/M in the year of assessment. This is applicable to companies whose business falls under manufacturing, agricultural production, or mining of solid minerals or wholly export trade companies.

Empirical Evidence

Several studies have established a link between tax incentives and corporate financial performance. A few of the studies are reviewed below.

Abou and Takor in 2003 conducted a study on "the Relevance of Tax Incentives in Export-oriented Enterprises in Lebanon". 117 managers of export businesses in Lebanon were considered for the study to indicate whether tax incentives significantly promote their investment. The data generated from the study, which were analysed using simple percentages, revealed that tax incentive is a strong tool for investment promotion in export-oriented businesses. Similarly, a study on the tax incentives applicable to businesses in Brazil was carried out by Gomes in 2006. Gomes conducted a pilot study of twenty-five (25) business executives and his findings indicated several forms of tax incentives applicable to businesses in Brazil. These include-reduced corporate tax rate, loss carry forward, tax holidays, investment tax credits, investment allowance, reduced taxes on dividends and interest paid abroad, preferential treatment of long-term capital gains, deductions for qualifying expenses, zero or reduced tariffs, employment based deductions, tax credits for value addition, tax reductions/credits for foreign hard currency earnings.

In 2009, Jayeola Olabisi conducted a study on "Tax incentives as a catalyst for Economic Development in Nigeria. The population of the study consisted of twelve selected companies in Lagos and 120 management staff were chosen from the selected companies through a purposive sampling method. A questionnaire designed in four likert-scale was used for the study. The data generated from the data were analyzed with the simple mean while the stated hypotheses were tested with chi-square (x^2) test. The findings from the study claimed that tax incentive has a positive significant impact on investment decision, but usually leads to reduction in government revenue. More so, Iyare and Alabi in 2001 carried-out a study on the impact of tax incentives on the stock price of selected manufacturing companies quoted in the Nigerian Stock Exchange. Forty-three (43) executive directors from selected manufacturing companies were considered for the study. Data were tested using the regression analysis and their results showed that tax incentives enhance the stock price of manufacturing firms.

Finally, in 1996, Mary Holland in her Ph.D Dissertation conducted a study on "Income tax incentives for investment in agro-allied business". She operationalized tax incentive into investment allowance and loss relief. The main objective of her study was to examine the extent to which tax incentives influence investment of agro-allied business in free-trade zone areas. In order to collect the necessary data for the study, Holland considers eighty-three business executives whose businesses are located in the nine free-trade zones in Uruguay. A well-structured questionnaire was administered on those respondents. The data generated from the study were analysed with the simple mean, while the t-test was used for hypotheses testing. Part of her findings showed that investment allowance and loss relief has a positive significant impact on corporate investment of agro-allied businesses.

Conclusion and Recommendations

There are strong synergies between agribusiness and the performance of agriculture for development. Dynamic and efficient agribusiness spurs economic growth and a strong link between agribusiness and smallholders can reduce rural poverty. Agribusiness has a large and rising share of Gross Domestic Product (GDP) across developing countries. Though agriculture declines from 40 percent of GDP to less than 10 percent, as GDP per capita rises, agribusiness (including agricultural trade and distribution services) typically rises from under 20 percent of GDP to more than 30 percent before declining as economies become industrial (World Development Report, 2008).

Tax incentives may be targeted at investment in regions that are disadvantaged due to their remoteness from major urban centres. Operating in a remote area may entail significantly higher transportation and communications costs in accessing materials used in production, and in delivering end products to markets. These higher costs place the location at a competitive disadvantage relative to other possible sites. Moreover, firms may find it difficult to encourage skilled labour to relocate and work in remote areas that do not offer the services and conveniences available in other centres. Workers may demand higher wages to compensate for this, which again implies higher costs for prospective investors. Tax incentives may be provided in such cases to compensate investors for these additional business costs. Again in this situation, the "first best' solution would be for Government to develop the infrastructure s as to reduce these costs. As a second best solution, the Government could compensate the investor for the cost of constructing shared infrastructure and in training workers in the region. To the extent that these incentives attract new investments, and/or forestall the outmigration of capital and labour from these regions, they may contribute to improving income distribution through subsidizing employment via investment initiatives, rather than through direct income supplementing programmes.

Although intended to redress institutional failure, incentives have the potential to introduce distortions in the economy by their impact on the economic and tax environment. They can influence fiscal and monetary policies, but at the same time, can create a requirement for effective management and administration of the incentives.

Advocates of tax incentives point to their extensive use in some high-growth Asian economies as positive evidence of their effectiveness. However, it has been suggested that this positive association probably has less to do with the nature of the incentives themselves than with the characteristics of the countries where they are used, such as the quality of the civil servants and the efficiency of public bureaucracy. Such characteristics tend to minimize the political-economy costs of providing the incentives. Assessing the relative advantages and disadvantages of tax incentives is a complicated and 'controversial issue. The main difficulty in assessing their benefits is in determining if incremental investment is indeed the result of incentives. As noted earlier, it is generally recognized that incentives are not the prime determinant of investment decisions. If investment is in fact the result of incentives, difficulties arise in quantifying the positive effects, such as technology transfer or creation of employment, and possible negative effects, such as economic distortions or potential for corruption. Nonetheless, in spite of these problems, assessment of incentives is a useful, even necessary, exercise. If nothing else, this assessment may place bounds on the extent of the incentives offered.

To be effective, incentives should be directed to small and growing agribusinesses because they are often short of funds due to their inability to borrow from capital markets. Also, such firms are in a non-taxpaying situation in the initial years. The types of incentives employed will determine their effectiveness. For example, reduced tax rates or tax holidays may not produce the required results. Measures such as investment tax credits that provide upfront funding might be more effective for the agribusinesses in Nigeria.

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