MODULE 6

CAPITAL GAINS TAX

OUTLINE

- Basis of assessment.
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- Indexation relief.
- Capital gains tax as it applies to stocks shares and quoted securities.
- Treatment of Capital Transactions of Partnerships and companies.
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Basis of assessment.

- Capital Gains Tax Act 1967 came into force on 1st April, 1967. The Act is now referred to as the Capital Gains Tax Act, Cap. C1, LFN 2004. The disposal of a taxpayer's fixed asset is a capital transaction and the profit arising therefrom is referred to as capital gain.
- Capital gains tax is chargeable at the rate of 10% on the total amount of chargeable gains accruing to any person in a year of assessment after making such deductions as may be allowed under the Act in the computation of such gains.
- Capital gains are assessed on actual or current year basis.

Exemptions and Reliefs

Gains accruing to the following are exempted from capital gains tax:

- Exemption for charities, etc.
- Statutory bodies, etc.
- Retirement benefit schemes.
- Decorations
- Stocks and shares, etc
- Replacement of business assets: exemption of tax on gains arising from takeover; tax not chargeable on Unit Trust proceeds reinvested
- Life assurance policies
- Rights under policies of insurance, other than life assurance policies
- Personal injury
- Principal private residences
- Chattels sold for N1,000.00 or less in a year
- Motor cars Gifts.

- Repealed
- Double taxation relief
- Relief in respect of delayed remittances of gains

Computations of Gains and Losses

- The gains chargeable to tax os computed by deducting from the consideration accruing to any person on a disposal of assets any sum to be excluded from that consideration and the amount of any allowable expenditure on such disposal. In other words, a chargeable gain is the excess of the sale proceeds (disposal value) of a chargeable asset over the cost of the asset and other allowable expenditure or deductions.
- Any amount taken into accounting computing income or profits or gains or losses of the person making the disposal under the PITA, CITA or PPTA is to be excluded from the consideration for a disposal of asset for computing capital gains. Note that the amount taken into account in the computation of a balancing charge under the Income Tax Acts is not excluded from the consideration for the disposal of an asset.

- Computation of Capital Gains Tax

Gross sale proceeds		x
Less incidental costs of disposal		(x)
Net sale proceeds		x
Less allowable expenses:		
Original cost of acquisition	x	
Incidental cost of acquisition	x	
Enhancement expenditure	x	
		(x)

- Capital gains x
- Capital gains tax at 10% x
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Indexation relief

- The expenditure allowable in computing the chargeable gain arising on the disposal of an asset can be increased to take account of inflation for the period of ownership of an asset up to the 31 December 2002.

  For disposals made on or after 1 January 2003 indexation relief will **only** apply for the period of ownership of the asset up to 31 December 2002:

  Where indexation relief does apply, you should note the following:

  (a) If the expenditure incurred on acquiring or enhancing an asset was incurred more than twelve months before the date of its disposal, the amount of that expenditure may be adjusted to take account of inflation (subject to certain limitations in the case of development land.

  (b) The adjustment is made by multiplying the relevant item of allowable expenditure by a factor, the "multiplier", which reflects the change in the All Items Consumer Price Index during the period since the asset was acquired. The multiplier to be applied depends on the year of assessment in which the expenditure was incurred and the year of assessment in which the disposal is made.

  (c) A schedule of multipliers for the years 1995/96 et seq.

  (d) The adjustment for inflation cannot operate to charge an amount in excess of the monetary gain, or to transform a monetary loss into a gain; neither can it increase a monetary loss or transform a monetary gain into an allowable loss. If, as a result of the adjustment for inflation, a loss would be substituted for a monetary gain, or a gain for a monetary loss, the disposal of the asset is treated as giving rise to neither a gain nor a loss.

Capital gains tax as it applies to stocks shares and quoted securities

- Gains accruing to a person from the disposal by him of Nigeria Government securities, stocks and shares shall not be chargeable gain under the Act.
- In this section, “Nigeria government securities” include Nigeria Treasury bonds, savings certificates and premium bonds issued under the Savings Bonds and certificates Act

Treatment of Capital Transactions of Partnerships and companies

Where two or more persons carry on a trade or business in Partnership:

- Tax in respect of chargeable gains accruing to them on the disposal of any partnership assets shall be assessed and charged on them separately;
- Any partnership dealings shall be treated as dealings by the partners and not the firm as such.

Tax treatment of Legatees and artificial transactions

- **Artificial Transactions**:

  Where the relevant tax authority is of the opinion that any disposition is an artificial or fictitious transaction or where any transaction which reduces or would reduce the amount of any capital gains tax is artificial or fictitious, the tax authority shall disregard such disposition and may direct that such adjustment shall be made respect to the liability of any person for the payment of capital gains tax as it consider appropriate. The adjustment is made so as to counteract the reduction of liability to capital gains tax affected or reduction which would otherwise be effected, by the transactions and any person concerned with such transaction shall be assessed accordingly. Any person affected by the tax authority's direction can appeal against it in like manner as if such direction were an assessment to capital gains tax.

- **Connected Persons:**

  Transactions between connected persons are deemed to be artificial or fictitious if in the opinion of the relevant tax authority those transactions have not been made on terms which might fairly have been expected to have been made by persons engaged in the same or similar activities dealing with one another at arm's length.

  Where a person acquiring an asset and the person making the disposal are connected, the transaction is considered to be artificial or fictitious and if the consideration for the acquisition/disposal is less than the market value of the asset, the consideration is deemed to be the market value.

Illustration 1

- Pure & Clean Limited was a distributor of alcoholic drinks for many years. purposes, the company decided to relocate from the North to the Niger Delta region.

  The company's warehouse costing ₦800,000 in May 2001 when it was acquired was sold in January 2011 for ₦ 1,400,000. The amount realized from the sale of the warehouse was used for the acquisition of the land and erected of a new house in Port Harcourt. The building of the warehouse was completed in September, 2011 at a cost of ₦2,050,000.

  Pure & Clean Limited disposed of its second warehouse in the North in February 2012 for ₦2,100,000, having built it in 2001 at a cost of ₦1,600,000. In November 2012, he invested ₦1,700,000 of the proceeds in the acquisition of a new warehouse in Oil Mill while the balance was used as running cost.

On 1st January,2015, there was a fire outbreak which razed the warehouse in Oil Mill to them ground. Pure & Clean Limited received ₦1,900,000 as compensation from Extinguisher Insurance Plc.

On 1st March 2015, Pure & Clean Limited sold the warehouse in Port Harcourt for ₦2,700,000. Out of that the company had to pay legal and sales agent's fess of ₦40,000 and ₦60,000 respectively.

Required:

Compute the capital gains tax liability assuming that all possible claims which reduce or defer the liability are made and the rate of capital gains tax at 10%

Solution

PURE & CLEAN LIMITED

Computation of Capital Gains Tax Liability

	₦	₦
2011 YOA		
Sales proceeds		1,400,000
Less cost of acquisition		800,000
Capital gain		600,000
Less capital gain rolled-over:		
Sale proceeds reinvested	1,400,000	
Less cost of old asset	800,000	
Capital gain rolled-over		600,000
Chargeable gain		-
Capital gains tax Liability		-

2012 YOA

Sales proceeds		2,100,000
Less cost of acquisition		1,600,000
Capital gain		500,000
Less rolled-over relief:		
Sale proceeds reinvested	1,700,000	
Less cost of old asset	1,600,000	
Rolled-over relief		100,000
Chargeable gain		400,000
Tax liability at 10%		40,000

2015 YOA

Oil Mill Warehouse:		
Compensation received		1,900,000
Cost of warehouse	1,700,000	
Less rolled-over relief	100,000	
Deemed cost of warehouse		1,600,000
Chargeable gain		300,000
Tax liability at 10%		30,000

Port Harcourt Warehouse:

Sale proceeds		2,700,000
Less allowable deductions:		
Legal fees	40,000	
Sales agent's commission	60,000	100,000
Net sale proceeds		2,600,000
Less:		
Cost of warehouse	2,050,000	
Less capital gain rolled-over	600,000	
Deemed cost of warehouse		1,450,000
Chargeable gain		1,150,000
Tax liability at 10%		115,000

Illustration 2

Mr. Dantata acquired a building erected on a piece of land at a cost of ₦6,000,000 on 1st June,2007 and immediately paid professional charges of ₦400,000 in connection with the purchase.

In December 2007, he erected a bungalow on the excess space at the cost of ₦1,000,000. In may 2011 he sold the bungalow to his brother for ₦2,000,000 although the professional valuers put the market value of the bungalow sold at ₦3,000,000. The market value of the rest of the property was put at ₦9,000,000.

On 30th September, 2014, Mr. Datep sold the remaining property for ₦14,000,000 and incurred the following expenses:

	₦
Legal expenses	200,000
Renovation prior to sales	250,000
Advertising	20,000
Sales agent's commission	2.5% of sale proceeds

Required:

Determine the capital gains tax liability for the relevant years of assessment.

Solution

MR DANTATA

Determination of Capital Gains Tax Liability for the Relevant Years of Assessment

		₦
2011 YOA		
Market value of the bungalow		3,000,000
Less cost of Acquisition: (note 1)		
$\frac{A}{A+B} \times C = \frac{₦3,000,000}{₦3,000,000 + ₦9,000,000} \times$ ₦7,400,00		1,850,000
Capital gain		1,150,000
Capital gains tax at 10%		115,000
2014 YOA		
Sale proceeds		14,000,000

- Less allowable Deductions:
- Legal expenses 200,000
-

Renovation prior to sale	250,000	
Advertising	20,000	
Sale agent's commission		
(2.5% x ₦14,000,000)	350,000	820,000
Net sale proceeds		13,180,000
Less cost of acquisition (note 2)		5,550,000
Capital gain		7,630,000
Capital gains tax (10% x ₦7,630,000)		763,000

Notes:

1. i. Mr. Dantata and his brother are connected persons, therefore, the transactions is deemed to be fictitious. The market value of the bungalow of ₦3,000,000 instead of the actual sale proceeds of ₦2,000,000

ii. Cost of acquisition of the building:	₦
cost of building	6,000,000
professional charges	400,000
• cost of construction of bungalow	1,000,000
•	7,400,000

2. Cost of the part of the land not disposed of in 2011.

	₦
Cost of the building	7,400,000
Less cost of part of land disposed of in 2011	1,850,000
	5,550,000

3 formula for computation of part of cost of acquisition disposed of:

A = Market value of the bungalow disposed of

B = Market value of the rest of the land not disposes of

C = Total cost of acquisition

Review Questions

1. Mrs. Goodfriday acquired a building costing ₦4,000,000 in February,2010 and spent ₦500,000 on improving it in July 2010. He sold the building to his son-in-law for ₦6,000,000 in December, 2012 after ascertaining from his professional valuers that the building could be sold for ₦ 8,000,000 as at that date.

   Required:

   Compute the capital gains tax liability of Mr. Godfather.
2. Mention six institutions, societies or bodies which are exempted from capital gains tax.
3. In relation to capital gains tax, exp the terms "artificial transactions" and "connected persons" and discuss the tax implications of transactions carried out between connected persons.
4. What do you understand by the terms?
   a. Chargeable Persons;
   b. Chargeable Assets and

References

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