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REGULATORY UPDATE

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THE IMPLICATION OF THE NIGERIAN WINDFALL TAX ON THE BANKING SECTOR

On 17th July 2024, President Bola Ahmed Tinubu, through a letter and an Executive Bill to the Nigerian Senate, one of the arms of the National Assembly, requested an amendment to the Finance Act 2023 via the Finance Bill 2024 ("**the Bill**") to introduce a one-time "Windfall Tax" at a rate of 50% on the foreign exchange gains realised by banks in their 2023 financial statements. In his letter, the President explained that the revenue from this tax would be allocated to funding capital infrastructure development, education, healthcare access, and public welfare initiatives.

The primary rationale for imposing the windfall tax on Nigerian banks arises from the substantial foreign exchange gains these institutions have realised due to the depreciation of the Naira. Putting things in context, the Central Bank of Nigeria ("**CBN**") introduced reforms that devalued the Naira, resulting in significant profit increases for banks holding considerable foreign currency reserves or engaging in foreign exchange transactions.

On 23 July 2024, the Senate passed this Bill into law, albeit increasing the tax rate to a significant 70%. This new tax has prompted various reactions from stakeholders, particularly due to its retroactive application. This analysis will examine the government's objectives, explore the potential impact of the tax on various industries, and address concerns related to double taxation, especially within the banking sector.

ANALYSIS OF THE WINDFALL TAX AND THE NIGERIAN SITUATION

The concept of a windfall tax is not new and has been implemented by various countries over time. Windfall taxes are temporary levies imposed on companies or industries that experience unexpectedly high profits, often due to external factors such as market fluctuations or government policies.

For instance, in the United States, the Crude Oil Windfall Profit Tax Act of 1980 was imposed on oil producers following a surge in oil prices. Similarly, several European countries, including the United Kingdom, France, and Germany, have either considered or implemented windfall taxes on energy companies during periods of elevated energy prices. Typically, windfall taxes are imposed to redistribute excess profits generated by a few entities due to favourable but unforeseen circumstances, thereby promoting economic balance.

In Nigeria, the introduction of the windfall tax which retroactively targets the profits of banks for their 2023 fiscal year on which company income tax has been paid already has sparked discussions about the legality of the law. The key question is whether this law is constitutional and whether the legislature has the authority to enact a law with such retroactive effect.

Examining the retroactive nature of the Tax

In the Court of Appeal case of *Alhaji Yau Isa Mai Alewa v. Sokoto State Independent Electoral Commission [1]*, the court defines retroactive laws as "a legislative act that looks backwards or contemplates the past, affecting acts or facts that existed before the Act came into effect".

Similarly, in the Court of Appeal case of the *University of Ilorin v. Mr A.I. Adeniran [2]*, the court held that a retroactive or retrospective law is a legislative act that looks backwards or contemplates the past, affecting acts, and facts that existed before the Act came into effect. The Court further stated that a retroactive or retrospective law is not unconstitutional unless it: (a) is in the nature of an ex post facto law or a bill of attainder, or (b) impairs the obligation of contracts, or (c) divests vested rights, or (d) is constitutionally forbidden." An ex post facto law is one that retroactively changes the legal consequences of actions that were committed before the law was enacted.

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[1] (2007) 15 NWLR (Pt. 1057) 285.
[2] (2007) 6 NWLR (Pt. 1031) 498.

If the windfall tax is applied in a manner that penalises banks for profits that were legally earned under the previous fiscal regime, it could be challenged as an ex post facto law.

Additionally, the windfall tax must not impair the obligation of existing contracts. It should not undermine legal obligations established under the financial conditions that existed before the tax was introduced. If the retroactive tax disrupts these obligations, it could be deemed unconstitutional.

The tax must also avoid divesting vested rights. If banks had legitimate expectations or vested rights to their profits based on the prior legal framework, imposing a retroactive tax could be seen as depriving them of these rights. The constitutionality of the windfall tax will depend on whether it unlawfully deprived banks of rights they were entitled to under the law at the time.

Finally, the retroactive tax must not contravene any other specific constitutional provisions. While the Nigerian government has the authority to introduce a windfall tax, the retroactive application of this tax must be carefully evaluated to ensure it does not violate the constitutional protections outlined in the relevant cases. The judiciary may need to determine whether the windfall tax, as implemented, adheres to the boundaries established by Nigerian law regarding retroactive legislation.

Double Taxation Concerns

In the case of *Delta Oil (Nigeria) LIMITED v FBIR [3]*, the court held that "Double taxation means no more than an income being taxed twice in the hand of the same beneficiary of an income". In the instant case, the foreign exchange gain of the 2023 financial year has already been subjected to tax in the 2024 year of assessment, consequently, subjecting the same gains that have already suffered tax in the 2024 year of assessment, consequently, subjecting the same gains that have already suffered tax in the 2024 year of assessment, is no more than double taxation. The banks being subjected to Windfall Tax on an income that has already been subjected to Company Income Tax which covers various incomes including earnings from foreign exchange gains, may be considered as double taxation.

While the Nigerian government possesses the authority to introduce a windfall tax, the retroactive application of such a tax must be scrutinised carefully to ensure compliance with constitutional provisions, particularly regarding retroactive laws and the prohibition against double taxation. The ruling in Delta Oil (Nigeria) Limited v FBIR emphasises that double taxation occurs when the same income is taxed twice in the hands of the same entity. Given that banks have already paid Company Income Tax on their foreign exchange gains, the imposition of an additional windfall tax on those gains could potentially constitute double taxation. Only by ensuring that the windfall tax aligns with these legal standards can the government effectively balance its revenue-raising objectives with the protection of businesses' legal rights.

[3] Delta Oil (Nigeria) Limited v FBIR 1988, Federal High Court Law Report.

IMPACT OF THE IMPOSITION OF THE WINDFALL TAX ON THE BANKING SECTOR AND THE ECONOMY

While the objective of the government in increasing its revenue that can be appropriated toward meeting the numerous needs of the citizenry cannot be underplayed, the windfall tax if successfully imposed is set to significantly impact the banking industry in Nigeria. Some possible impacts include as follows:

At the proposed tax rate of 70%, the windfall tax is exceedingly higher than the 30% companies' income tax rate that is payable by large companies in Nigeria and potentially reduces banks' profit margins, particularly for those recently benefiting from favourable foreign exchange conditions.

The windfall tax when passed into law has the impact of eroding the profits of banks which may negatively affect the financial health, and shareholder returns of these banks. Particularly now CBN has directed the banks to increase their capital base. In this regard, CBN has increased the capital base of banks with international authorisation to ₦500,000,000,000 (Five Hundred Billion Naira) while that of national banks has been increased to ₦200,000,000 (Two Hundred Billion Naira). The collection of the windfall tax which the banks would have applied toward meeting their capital adequacy ratio would put great strain on these banks.

The windfall tax could exacerbate perceptions of policy instability and unpredictability within Nigeria's economic environment. Investors, particularly foreign ones, typically seek stable and predictable regulatory conditions. The sudden imposition of a 70% tax rate, especially retroactively, introduces uncertainty and raises concerns about further government interference in the banking sector and beyond. Retroactive taxation complicates investment planning by creating ambiguity in tax liabilities, potentially deterring investment and economic activity. There is also a prevailing concern that the banking sector might be just the beginning, with potential extensions of similar policies to other industries, further amplifying investor apprehension.

Additionally, the windfall tax is expected to significantly impact Nigerian firms and industries that depend on the banking sector for financial support and operations. To offset the increased tax burden, banks subject to applicable laws may impose stricter lending conditions and higher interest rates. This adjustment could lead to elevated capital costs for businesses, making it more difficult for them to obtain financing for expansion or operational needs. Consequently, this could hinder business growth and overall economic development, as companies struggle to manage the combined effects of increased taxation and reduced access to affordable capital.

CONCLUSION AND RECOMMENDATIONS

While the windfall tax has the potential to enhance government revenue and address economic imbalances, it poses risks including legal challenges related to its retroactive application and concerns about double taxation. These issues could undermine the tax's effectiveness and create compliance challenges for banks and even on the ability of the government to collect the tax.

To ensure the tax is implemented effectively and equitably, it is crucial for the government to continue engaging with stakeholders, such as the banking sector, legal experts, and economic analysts. Addressing any constitutional and practical concerns that arise will help mitigate unintended adverse effects and support a transparent tax system. By resolving these issues, the government can better achieve its revenue goals and support essential public initiatives without compromising economic stability.

The following recommendations can also be considered by the government:

a. In other to optimise the benefits of the windfall tax, it is imperative that the generated revenue be strategically allocated toward capital infrastructure projects, education, healthcare, and public welfare initiatives. By effectively utilizing these funds, Nigeria can address its budget deficits and foster long-term economic development, ensuring that the tax's revenue contributes to sustainable growth and public well-being.

b. To mitigate the potential negative effects on the banking sector and the broader economy, the government should consider implementing measures to alleviate the financial burden on banks.

c. To cultivate a stable and predictable investment environment, the government should endeavour to avoid abrupt and significant changes to tax policy. Clear communication regarding the rationale behind the windfall tax and its intended impact will be essential in building investor confidence and reducing concerns about future policy shifts, thereby promoting a more stable economic climate.

d. Continuous monitoring and evaluation of the tax's impact on the banking sector and the economy are essential. The government should regularly assess whether the tax achieves its intended goals without causing unintended consequences. Regular reviews will enable timely adjustments and improvements to the policy as needed, ensuring that it remains effective and responsive to emerging challenges.