

TNP Insights



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Are Educational Institutions Exempt from Companies Income Tax under The Finance Act 2020?

The taxation of educational institutions has been a thorny issue in the past few years. It was always assumed that companies were exempt from taxation if they were engaged in the provision of educational services. Prior to 2018, Section 23 of the Companies Income Tax Act (the "CITA") provided that the profits of educational institutions will be exempt from companies income tax if:

1. the educational activities of the company are of a public character; and
2. the profits are not derived from any trade or business carried on by the company.

The CITA did not define the phrase "public character" and the language of the CITA seemed to imply that "educational activities" did not constitute a trade or business.

However, in 2018, the Court of Appeal affirmed the judgment of the Federal High Court in *Best Children International Schools ("BCIS") Limited v FIRS*, that educational institutions incorporated as limited liability companies are subject to companies income tax. The Court of Appeal reasoned that even though BCIS was engaged in providing educational services, it was incorporated as a limited liability company whose purpose is the making

profit and therefore should be subject to tax. According to the court, if the motivation of the promoters of BCIS were not profit, BCIS would have been set up as a company limited by guarantee. This meant that all limited liability companies providing educational services were automatically liable to companies income tax whether

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or not the company distributed its profits. The cumbersome process required to setup or transform to a company limited by guarantee also meant

that educational institutions incorporated as limited liability companies had no quick solutions in view.

At the time, even schools limited by guarantee were affected by the lack of clarity around the definition of "public character". In *American International School ("AIS") v FIRS*, the revenue authority argued that the size of the fees charged by AIS disqualified certain members of the public from enjoying its services therefore its educational activities were not of a public character (even though AIS was limited by guarantee and did not distribute its profits). The Tax Appeal Tribunal rightly rejected this argument and further held that the FIRS did not prove that: (a) any segment of the public was excluded from the educational services provided by the AIS; (b) any profits or income were distributed to the directors or guarantors of AIS; or (c) AIS generates income from any sources other than the provision of educational services. Thankfully, the issue of whether limited liability companies providing educational services are subject to companies income tax has been laid to rest by the Finance Act 2020 which defines "public character" as used in the CITA as follows:

"Public Character" with respect to any organisation or institution means an organisation or institution —

- (i). *that is registered in accordance with relevant law in Nigeria;*
- (ii) *does not distribute or share its profit in any manner to members or promoters.*

This means that any educational institution incorporated in Nigeria in any form whatsoever (whether as an LTD, LTD/Gte, etc), will be exempt from companies income tax as long as it does not distribute or share its profit to its members or promoters.

As helpful as this provision of the Finance Act 2020 is, it should be noted that by using the phrase "in any manner", the draftsman has given the taxman a measure of discretion to decide what amounts to distribution or sharing of profits. Therefore, the taxman may look beyond mere declaration of a dividend and may interpret or deem other payments as a means of distributing or sharing profits if the circumstances permit. Obviously, such action by the taxman will always be subject to judicial review.

Conclusion

Educational institutions are advised to obtain expert tax advice when setting up and arranging their business in Nigeria in order to properly manage their tax exposure.