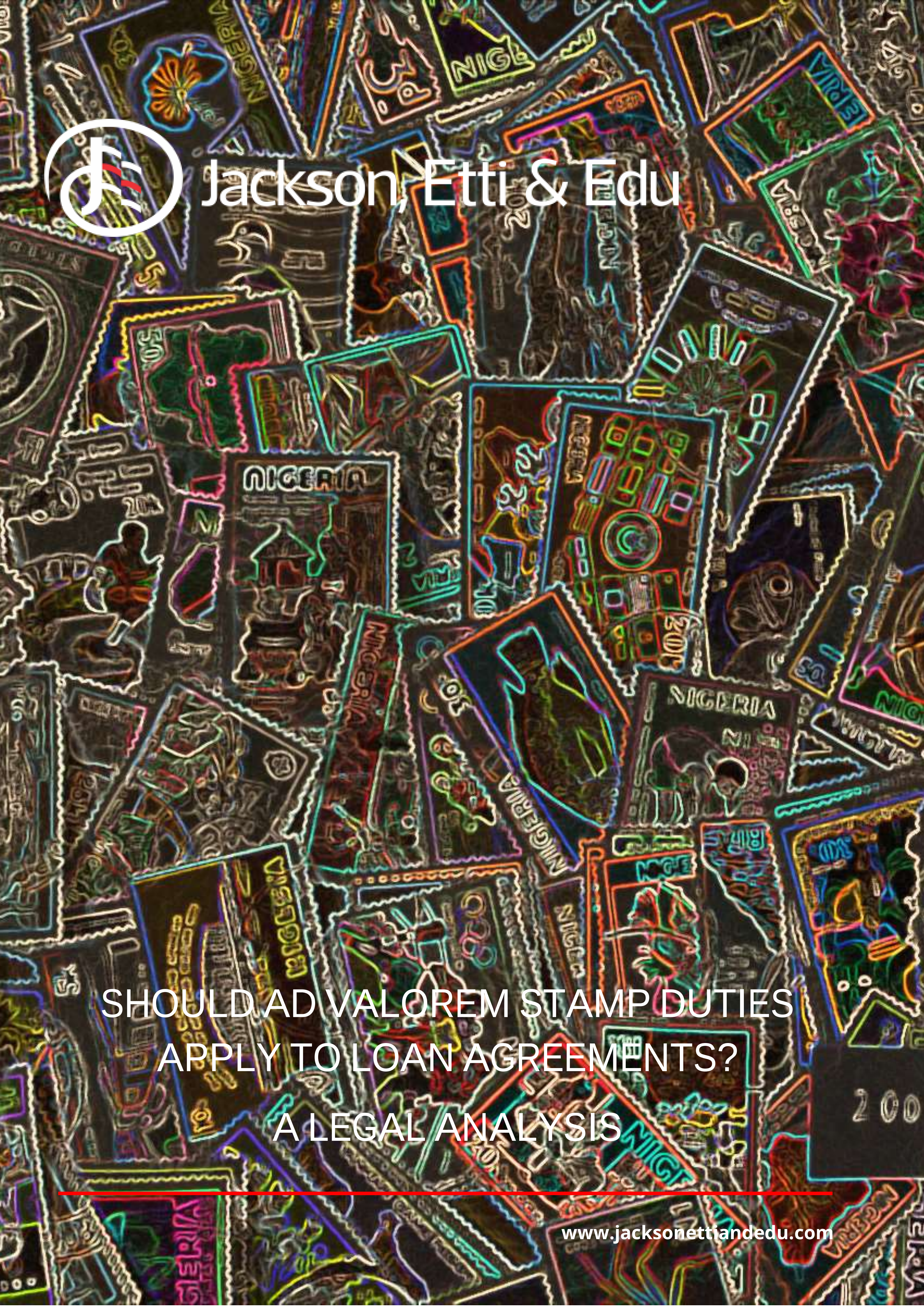

Jackson, Etti & Edu

SHOULD AD VALOREM STAMP DUTIES APPLY TO LOAN AGREEMENTS?

A LEGAL ANALYSIS

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Introduction

Sometime in the second half of year 2016, the Federal Inland Revenue Service ("FIRS") issued a notice titled "Establishment of Stamp Duties Offices in all States of the Federation and the FCT", which contained a list of instruments, items and applicable stamp duty rates chargeable by the FIRS. Interestingly, in the list of instruments chargeable with ad valorem duty is an item called "Loan Capital/Agreement" which is chargeable with ad valorem duty of 25 Kobo for every 200 Naira. This terminology and the consequential charge payable has generated significant controversy particularly pertaining to the definition of loan agreement, whether loan agreements fall within the purview of stamp duty law and if they do should ad valorem duty apply to unsecured loan agreements.

Understanding the Framework of Stamp Duties Tax

Stamp duties is a form of tax which is chargeable in respect of the various matters and transactions stipulated in the Stamp Duties Act, Cap S8, Laws of the Federation of Nigeria, 2004 ("Act") at the rates stipulated in the Act. By virtue of the Act, any instrument executed in Nigeria, or relating to any property in Nigeria, or any matter or thing done or to be done in Nigeria is required to be charged with applicable stamp duty and stamped in accordance with the Act. Generally, the effect of failure to stamp an instrument is inadmissibility of such instrument in evidence in civil proceedings in Nigeria except that where such instrument is a registered security instrument within the ambit of Sec 197 of the Companies and Allied Matters Act ('CAMA'), the additional effect by virtue of Sec 202 CAMA is that such instrument is void for any amount for which it is not stamped.

It is instructive that the Act clearly specifies the instruments and transactions chargeable with nominal and ad valorem stamp duties, the timing for stamping of documents and the administrative framework for operation of stamp duty. Interestingly, by virtue of Sec 114 of the Act, all duties, fines and penalties not commenced or prosecuted within 5 years of the offence are statute barred and Sec 116 clearly specifies that any amendments to the duty chargeable on instruments/transactions may be varied by the National Assembly or State House of Assembly in respect of those documents that fall within the exclusive purview of the relevant legislative body.

Analysing the Legality of Ad Valorem Stamp Duty on Loan Agreements

As a form of taxation, the determination of applicable stamp duty must be based on the clear provisions of statute. This basic principle is hinged on Smithsonian canons of taxation, particularly the canon of certainty. According to Adam Smith "the tax which each individual is bound to pay ought to be certain and not arbitrary". The Stamp Duties Act specifically provides which transactions and instruments ad valorem duties are payable and it would seem that the FIRS has extended the rates payable on 'Loan Capital' to 'Loan Agreements'. Consequently, the implication of this annexation by FIRS is that it suggests that 'Loan Capital' and 'Loan Agreements' are of the same genre and thus, can be conferred with the same status and also more gravely that FIRS has the power to make that unilateral annexation.

The obvious question then is what is Loan Capital? how distinct is it from Loan Agreement? and then, does FIRS have the power to make such annexation? The provisions of section 102 of the Act is very interesting and revealing, not only in terms of the imposition of duty on loan capital, but also with respect to what constitutes loan capital.

Now under Sec 102 (5) 'loan capital' is defined as follows:

Loan Capital "means any debenture stock, other stock, funded debt by whatever name known or capital raised by any corporation, company or body of persons formed or established in Nigeria which is borrowed or has the character of borrowed money, whether it is in the form of stock or in any other form, but does not include any overdraft at the bank or loan raised for a merely temporary purpose for a period not exceeding 12 months"

In the robust definition provided above, the critical elements are (i) 'debenture stock' (ii) 'other stock' (iii) 'funded debt' and (iv) 'capital raised… which is borrowed or has the character of borrowed money'. A careful analysis of these elements suggests that they can all be classified as debt security that is issued by a company or corporate, the critical characteristic being that all involve an issuance process by a company. The rationale for this conclusion is not farfetched. A cursory look at Sec 166 -177 and 183 – 196 of CAMA reveals that 'Debenture Stock' are debt instruments that are issued by a company; whereas even though 'Other Stock' is not expressly defined, the Act defines 'stock' to mean "…any share …in the capital stock or funded debt of any local authority, corporation or company…" thus suggesting some form ownership right in an instrument issued by a company; while 'Funded Debt' is not defined under the Act, its dictionary definition is "debt that is due after one year and is formalized by the issuing of bonds or long term instruments'. The final element i.e. 'Capital Raised…" does embody all forms of debt, however the use of 'Loan Capital' in Section 102 (1) of the Act reinforces our view that its application refers strictly to debt security that is issued by a company.

Section 102 (1) provides as follows:

"Where a corporation, company or body of persons formed or established in Nigeria **propose to issue any loan capital**, they shall, before the issue thereof, deliver to the Corporate Affairs Commission a statement of the amount proposed to be **secured** by the issue."

Having established that 'Loan Capital' referred to under the Act refers to debt security that is issued by a company the question then is does Loan Agreement fall within this definitional purview? Our answer is a resounding No. Loan Agreements are documents which evidence a debt given to a company by a lender. While clearly both 'Loan Capital' and 'Loan Agreement' can be broadly classified as 'Debt' the operative difference is that the former is a type of debt issued at the instance of a company to an investor and is evidenced by a certificate or note, whereas the latter does not undergo any issuance process and it is given at the instance of a lender.

If the distinction above is accepted, then by deduction Loan Agreements could never have been within the contemplation of the Act, given Sec 102 (1) requires a company to '…deliver to the Corporate Affairs Commission a statement of the amount proposed to be secured by the issue'. Our reading of this part of the Act is that a company raising loan capital is required to notify the CAC of the amount it intends to raise during the issuance process. Considering that the borrowing powers of a company are enshrined in Sec 166 of CAMA, there is nothing in CAMA that suggests that a company must inform CAC of any loan facility obtained by a company.

Additionally, it is instructive that the word 'Loan Agreement' is not used in any part of the Act and given the position of the Courts that where the provisions of a law are clear and unambiguous, no other extraneous meaning should be read into such provisions while interpreting it therefore the use of 'Loan Agreement' within the Act is out of scope.

Finally, a reading of Sec 116 of the Act clearly indicates that it is only the National Assembly and State House of Assembly that have the power to modify, repeal and add additional stamp duty rates therefore the inclusion of 'Loan Agreement' in the list of instruments for which ad valorem duty is chargeable under the Act, amounts to an attempt to amend the provision of a Statute by administrative notice, and is a usurpation of the powers of the legislature which is solely responsible pursuant to Sec 116 to make laws on stamp duties within the Federal Republic of Nigeria.

Ancillary Issues Relating to Ad Valorem Stamp Duty on Loan Agreements

Granted that in every loan transaction, the most crucial concern of the lender is the ability to recover the loan principal and interest. Every lender always considers with greatest amount of details, what recourse is available to it in the possible event of a borrower's default in repayment. This is the reason most loans are backed by security. Nevertheless, there are also instances where lenders are willing to lend without security. In most of these cases, the paramount consideration, again revolve around the ability of the lender to recover both the principal loan and interest from the borrower. However, other than security, the lender is more concerned with the repayment cashflow, the borrower's credit rating or credit support from the borrower's parent company or affiliates. Once comfortable on these issues, the need for security becomes less important.

In a secured lending, the lender relies on the enforcement of its security as a buffer upon the occurrence of default. The realisation of such security is limited to the stamp duties paid on the security document. The provision of section 202 of CAMA reveals that the amount recoverable by a lender in a claim for the enforcement of security over the secured assets is limited to the amount for which stamp duties was paid in relation to that security document (otherwise known as secured amount). Hence it is understandable why in a secured lending, there is compelling reason to stamp with ad valorem duty.

Whilst the realisation of the security may be adduced as the preeminent motivation for ad valorem stamping in a secured lending, an unsecured lender has no recourse to any assets as an assurance of its ability to recover the indebtedness; it relies solely on the borrower's promises and undertakings in the loan agreement hence applying ad valorem stamp duty on unsecured Loan Agreements disincentivises both the lender and borrower and makes the cost of borrowing even more expensive.

Conclusion

It is our considered view that the continued application and indeed the propriety of ad valorem stamp duty tax on Loan Agreements by the FIRS is questionable and clearly debatable. Whether or not this continued practice will be challenged, and it is clear from the above that there are grounds for challenge, this remains more of a question of when rather than if; even as we hope that FIRS would reverse itself and act within the ambit of the law.

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