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Minds made for better working world
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Accounting Considerations of Recapitalisation Options
The Governor of the Central Bank of Nigeria (CBN) recently stated that the apex bank will consider an increase in the minimum capital base of banks in the country as part of its efforts to strengthen their capacity to support Nigeria’s drive of becoming a $1 trillion economy by 2026. The current capital base is stratified based on the type of banking license - banks with regional, national and international licenses are currently expected to maintain a minimum capital bases of N10 billion, N25 billion and N50 billion, respectively.

The proposed increase in the capital base is coming nearly two decades after the CBN’s 2004 banking reform which equally led to increase of the then prevailing capital base from N2 billion to N25 billion. The N25 billion is equivalent to $18.4m using the exchange rate as at 31st January 2024. The dollar equivalent is lowered by 90.2% when compared to $188.2m using the CBN monthly average official exchange rate of N132.9/US$ as at December 2005.

Essentially the 2004 banking reform was characterized by massive mergers and acquisition (M&A) activities which ultimately resulted in the reduction of the number of banks in the country from 89 to 25 banks.

The recent plan by the CBN to increase the capital base of banks could again led to M&A activities but not as widespread as was the case in 2004/2005 given the relatively solid financial positions of the banks today as well as the occurrence of several M&A activities in the banking sector over the past ten years.

While the CBN governor gave no indication as to the magnitude of the proposed hike in the capital base, we have assumed what the proposed increment will be based on three different scenarios underpinned on current macroeconomic conditions. On the back of that, we were able to determine the number of banks (across the three licence types) that may fall below the new minimum capital thresholds.

In a worst-case scenario, i.e., given a capital multiplier of 15, about 17 out of 24 banks would not meet the new minimum capital.

The financial soundness indicators as at 30th June 2023 showed that the banking industry is safe and resilient. However, banks should aim to maintain sufficient capital buffers and perform robust stress testing regularly. Banks are also encouraged to consider the capital that will be consumed for each facility at origination. Therefore, capital allocation can be achieved by implementing Risk Adjusted Performance Measures (RAPM), such as the Risk Adjusted Return on Capital (RAROC).

This publication delves into the various recapitalization options that banks that fall outside the proposed regulatory minimum base can adopt to strengthen their current position. At the same time, it assesses the tax and accounting implications of the various recapitalization options for effective planning and implementation purpose. It is important that Nigerian banks assess their capital base against their regulatory minimum and thereafter develop implementation strategies that will enable them navigate this regulatory changes.

We hope you find the publication insightful as much as we do.
Rationale for Proposed Bank Recapitalisation by the Central Bank of Nigeria (CBN)
As part of the banking reform by the Central Bank of Nigeria (CBN) in 2004, deposit money banks (DMBs) were directed to increase their minimum capital base by 1,150% from N2bn set in 2001 to N25bn with a deadline of 31 December 2005.

The N25 billion translated to $188.2m using the monthly average official exchange rate of N132.9/US$ in December 2005. Some of the key reasons which necessitated the 2004 banking reform were as follows:

Increasing the capital base of banks to support Nigeria's proposed $1trillion economy

In simple terms, recapitalisation is the process where companies restructure their debt and equity position to actualize stability in their capital structure. It is achieved when the regulatory authority (in this case, the Central Bank of Nigeria) requires banks to raise their operating capital to a tolerable threshold. Recapitalisation has been a recurring trend in the early days of the Nigerian banking sector. For instance, the CBN increased the minimum capital requirement every year from 1988 to 1990.

Source: African Economic Research Consortium, EY analysis
** The dollar equivalent of the minimum capital base were converted using monthly average official exchange rate of the naira from the CBN Statistical Bulletin, 2022

Nigeria’s minimum capital base (1989 - 2004), N’ million

Nigeria’s minimum capital base (1989 - 2004), $’million**

Source: African Economic Research Consortium, EY analysis
** The dollar equivalent of the minimum capital base were converted using monthly average official exchange rate of the naira from the CBN Statistical Bulletin, 2022
The significant increase in the capital base resulted in the reduction of the number of banks from 89 to 25 arising from consolidations. While this has put the surviving banks in a relatively strong liquid position, the action however resulted in many bank workers being laid off while business closure was occasionally reported.

In November 2023, the Governor of the CBN hinted about the possibility of a further increase of the minimum capital base of bank even though the banking sector has remained relatively stable over the past years. The Governor noted the increase is predicated on the fact that many of the banks are not adequately capitalized to support an economy with a GDP size of $1 trillion which is the target of the Federal Government of Nigeria. This statement has left many industry experts second guessing as it suggests that the apex bank may soon require banks operating in the country to increase their capital base. This indication is coming at a time of macroeconomic uncertainty including rising inflation rates, weak naira, as well as the pass-through impact of global geopolitical crisis on Nigeria’s economic stability.

The recent plan for bank recapitalisation has however become necessary in the light of the devaluation of the naira. As at 31st January 2024, the exchange rate stood at over N1,356/$1 at the official market which means that the current minimum capital requirement in dollar terms has plunged by 90.2% to $18.4m (compared to $188.2m as at the 2005 banking consolidation) for banks with national banking licence.

Consequently, the indication that CBN might be directing banks to increase their capital base is borne out of the apex bank's plan to strengthen the capacity of deposit money banks (DMBs) to support Nigeria’s plan to become a US$1 trillion economy by 2026.

DMBs support the economy through various ways including granting credit facilities to businesses to stimulate industrial growth and economic development. Sadly, this has not been the case given the risk inherent in lending relative to the gain derived from investing in risk-free securities such as Treasury Bills and government bonds.
In 2023, Nigerian banks granted N62.5 trillion as credit to the private sector. While this is commendable given the dire financing needs of businesses, significant funding gap remains especially for micro, small and medium enterprises (MSMEs) which largely makes up the majority of businesses in the country and contribute substantially to the country’s export and GDP. MSMEs’ unmet finance demand stands at over N13 trillion according to a recently commissioned study by the International Finance Corporation (IFC).

It therefore remains uncertainty the extent to which the proposed increase in the minimum capital base will help in stimulating the level of credit to the private sector that would further propel economic growth.
Impact and Benchmark Analysis of CBN’s Bank Recapitalization Exercise
Impact of the CBN’s bank recapitalisation on regulatory ratios

According to the CBN financial stability report, the financial soundness indicators showed that the banking system remained stable and resilient. The Capital Adequacy Ratio (CAR) and Liquidity Ratio (LR) stood above the minimum regulatory thresholds at 11.2% and 48.4% respectively, at the end of June 2023. The CAR, still within the regulatory threshold, has declined slowly from 13.8% as at December 2022 to 11.2% as at June 2023 largely due to the foreign exchange unification. The impact of recapitalisation will vary among the Deposit Money Banks (DMBs) based on their licenses and minimum capital requirements.

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital adequacy ratio</td>
<td>10% - 15%</td>
<td>15.1%</td>
<td>16.5%</td>
<td>14.6%</td>
<td>14.1%</td>
<td>13.8%</td>
<td>11.2%</td>
</tr>
<tr>
<td>Liquidity ratio</td>
<td>30%</td>
<td>44.4%</td>
<td>41.3%</td>
<td>54.8%</td>
<td>42.6%</td>
<td>44.1%</td>
<td>48.4%</td>
</tr>
<tr>
<td>NPL ratio</td>
<td>5%</td>
<td>6.0%</td>
<td>5.7%</td>
<td>4.9%</td>
<td>5.0%</td>
<td>4.2%</td>
<td>4.1%</td>
</tr>
</tbody>
</table>

Source: CBN

The new capital requirement will become a barrier for issuance of new banking licenses and raise the ceiling for the existing DMBs. The existing banks may require the injection of fresh capital to meet the new capital requirement. The regional and national banks with a minimum capital of N10bn and N25bn respectively are less capitalised today when compared with the international banks (N50bn). The capital base of the international banks have grown over N500bn today and any additional capital for recapitalisation will require less capital market activity relative to the regional and national banks. This implies that more effort will be required by the regional and national banks to meet any new capital requirements.

By complying with the new capital requirements, banks will meet the regulatory CAR. Each bank’s new CAR will be impacted by the amount of the additional capital relative to their current regulatory capital and risk weighted assets. While more capital is more liquidity, CBN might consider a push on the minimum Loan to Deposit Ratio (LDR) of 65% and failure to comply to the LDR might lead to CRR debit. This action compels the Banks to deploy excess liquidity leading to a downward trend in the liquidity ratio from the current level.

The ratio of nonperforming loans could potentially rise towards 5% depending on the bank’s ability to finance viable projects. However, macroeconomic and geopolitical factors should be considered as they have significant impact on obligors or organisations taking the loans.
Impact of the CBN’s bank recapitalisation on regulatory ratios

**Minimum capital adequacy and buffer levels**

The CBN guidelines on regulatory capital specifies the minimum levels of capital adequacy and capital buffers that are applicable to banks depending on the nature of their authorization and their systemic importance to the Nigerian economy. All banks are required to hold and maintain capital buffers above the regulatory minimum, as specified by the CBN from time to time. The capital buffers should be in the form of Common Equity Tier 1 (CET) and should be above the minimum CET1, Tier1 and Total Capital Adequacy levels. The capital buffers comprise of the capital conservation buffer (CCB1) and countercyclical capital buffer (CCB2). The domestic systemically important banks (D-SIBs) are required to set aside high loss absorbency (HLA) of 1% to their respective minimum CAR. The HLA should also be fully met with CET1 capital.

<table>
<thead>
<tr>
<th>Capital Elements as % of TRWA</th>
<th>National and Regional Banks</th>
<th>International Banks</th>
<th>D-SIBs</th>
</tr>
</thead>
<tbody>
<tr>
<td>CET1</td>
<td>7.0</td>
<td>10.5</td>
<td>10.5</td>
</tr>
<tr>
<td>Tier1</td>
<td>7.5</td>
<td>11.25</td>
<td>11.25</td>
</tr>
<tr>
<td>CAR</td>
<td>10.0</td>
<td>15.0</td>
<td>15.0</td>
</tr>
<tr>
<td>CCB1</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>CCB2</td>
<td>As determined by CBN from time to time</td>
<td></td>
<td></td>
</tr>
<tr>
<td>HLA</td>
<td>Not Applicable</td>
<td>Not Applicable</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Source: CBN  
TRWA - Total Risk Weighted Assets

CCB1 requires that banks build up capital buffers during business-as-usual periods which can be used to absorb losses during periods of crisis. CCB2 will be required where CBN determines that there is a build-up of credit risk which could lead to system-wide stress. The countercyclical buffer which ranges from 0% to 2.5% of TRWA will be used to support broader macro prudential goal and financial system stability.

Overall, the banking industry CAR remained above the regulatory threshold at 13.8% in December 2022, and declined to 11.2% at the end of June 2023 mainly due to foreign exchange unification. We expect the banking industry CAR to decline further at the end of December 2023 due to the devaluation of naira between June and December 2023.

Although achieving the minimum capital threshold is a positive step, banks should aim to maintain sufficient capital buffers to accommodate Pillar 2 risks and perform robust stress testing regularly.

Despite the adherence of most banks to the regulatory minimum CAR, one regional bank and two national banks failed to meet the regulatory minimum CAR of 10% at the financial year end 2022.
The minimum capital for national banks set at N25bn translated to $188.2m in December 2005 is approximately N263bn using N1,356/$ which was the official CBN rate as at 31st January 2024. This implies that the recapitalization may require a capital multiplier of 10 or more based on the exchange rate differentials. On this basis, a worst-case scenario given a 15x capital multiplier for twenty-four banks will be considered based on the type of banking licenses held. We have benchmarked the current capital of these banks against the current capital requirement and four recapitalization scenarios. The result showed that:

### Current state analysis

<table>
<thead>
<tr>
<th>Licence type</th>
<th>Intl</th>
<th>Natl</th>
<th>Regl</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of banks under each license type</td>
<td>6</td>
<td>12</td>
<td>6</td>
</tr>
<tr>
<td>Current capital requirement (N'bn)</td>
<td>50</td>
<td>25</td>
<td>1</td>
</tr>
<tr>
<td>Capital requirement ($'mn) @ N1,356/$</td>
<td>37</td>
<td>18</td>
<td>7</td>
</tr>
<tr>
<td>Number of banks below the capital requirement</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

### Scenario analysis

<table>
<thead>
<tr>
<th>Recapitalisation scenarios</th>
<th>Intl</th>
<th>Natl</th>
<th>Regl</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figures are in N' billion</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4x capital multiplier</td>
<td>200</td>
<td>100</td>
<td>40</td>
</tr>
<tr>
<td>6x capital multiplier</td>
<td>300</td>
<td>150</td>
<td>60</td>
</tr>
<tr>
<td>10x capital multiplier</td>
<td>500</td>
<td>250</td>
<td>100</td>
</tr>
<tr>
<td>15x capital multiplier</td>
<td>750</td>
<td>375</td>
<td>150</td>
</tr>
</tbody>
</table>

The national and regional banks are less capitalised on the worst-case basis given a capital multiplier of 15.

### Number of banks across license type that would not meet the minimum capital requirement

<table>
<thead>
<tr>
<th></th>
<th>Intl</th>
<th>Natl</th>
<th>Regl</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Capital</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>4x capital multiplier</td>
<td>0</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>6x capital multiplier</td>
<td>0</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>10x capital multiplier</td>
<td>1</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td>15x capital multiplier</td>
<td>1</td>
<td>10</td>
<td>6</td>
</tr>
</tbody>
</table>

- One regional bank and one national bank with negative capital did not meet their capital requirements on the base case.
- Under scenario 1, four regional banks and four national banks did not meet their capital requirements.
- While all international banks met the capital requirements in scenario 2, thirteen banks comprised of seven national banks and six regional banks did not meet their capital requirements.
- Scenario 3 and 4 showed that seventeen out of twenty-four banks did not meet their capital requirements.
Recapitalisation Options
DMBs generally have a wide-range of recapitalisation options that they can leverage to raise necessary funds if the CBN directs them to increase their capital base. Some of the different recapitalisation options includes:

1. Mergers and acquisitions (M&A)
2. Initial public offerings (IPO)
3. Placements and/or right issues
4. Undistributed profit (retained earnings)

### Recapitalisation through mergers and acquisitions (M&A)

Mergers and acquisitions has been the most widely adopted recapitalisation options by Nigerian financial services players including DMBs, insurance companies and pension fund administrators (PFAs). Generally, M&A refers to the consolidation of companies through different types of financial transactions.

M&A was largely the vehicle adopted by banks in 2005 to attain the new N25bn capital base resulting in the reduction of the number of banks from 89 to 25. According to the CBN, 76 out of the total 89 banks were all involved in M&A. Interestingly, M&A activities in the banking sector has continued since with the recent ones resulting in over $3 billion investment injected into the banking sector.

<table>
<thead>
<tr>
<th>Names of DMBs</th>
<th>Investors/Acquirer</th>
<th>Close date of M&amp;A</th>
<th>Amount ($’million)</th>
<th>Shareholding stake</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ecobank</td>
<td>Qatar National Bank</td>
<td>September 2014</td>
<td>503.0</td>
<td>23.5%</td>
</tr>
<tr>
<td>Ecobank</td>
<td>Nedbank</td>
<td>October 2014</td>
<td>493.0</td>
<td>20.0%</td>
</tr>
<tr>
<td>Enterprise Bank</td>
<td>Heritage Bank</td>
<td>October 2014</td>
<td>394.0</td>
<td>100.0%</td>
</tr>
<tr>
<td>Mainstreet Bank</td>
<td>Skye Bank</td>
<td>October 2014</td>
<td>727.0</td>
<td>100.0%</td>
</tr>
<tr>
<td>Diamond Bank</td>
<td>The Carlyle Group</td>
<td>November 2014</td>
<td>147.0</td>
<td>18.0%</td>
</tr>
<tr>
<td>Union Bank</td>
<td>Atlas Mara</td>
<td>December 2014</td>
<td>270.0</td>
<td>21.0%*</td>
</tr>
<tr>
<td>Keystone Bank</td>
<td>Sigma Golf-River Bank Consortium</td>
<td>March 2017</td>
<td>81.5</td>
<td>100.0%</td>
</tr>
<tr>
<td>Skye Bank</td>
<td>Polaris Bank</td>
<td>September 2018</td>
<td>N/A**</td>
<td>N/A**</td>
</tr>
<tr>
<td>Diamond Bank</td>
<td>Access Bank</td>
<td>March 2019</td>
<td>Merger</td>
<td>Merger</td>
</tr>
<tr>
<td>Union Bank</td>
<td>Titan Trust Bank</td>
<td>June 2022</td>
<td>490*</td>
<td>93.4%</td>
</tr>
</tbody>
</table>

Source: CBN, Estate Intel

* Atlas Mara later increased their stake to c.49% on 26th June 2018
** Polaris was created by the CBN as a bridge bank to oversee the liquidated Skye Bank
* this includes a combination of debt of $300 million and equity injections of $190 million

The decision by an acquiring bank to take the M&A path as a route to boost their capital should the CBN decide to increase the minimum capital base will be informed by several factors including:

- The bank’s corporate strategy
- The strategic alignment and synergistic potentials of the deal
- The situation of the domestic capital market.
2. Recapitalisation through initial public offers (IPOs) and right issues

The capital market offers immense opportunities for banks to achieve any proposed recapitalisation requirements by the CBN. This is because the market serves as an avenue for the flow of both foreign and domestic investment funds.

Privately owned banks that are unable to meet any proposed minimum capital that the CBN may prescribe could decide to offer its shares to members of the public to increase its minimum capital base. But leveraging the initial public offerings (IPO) options as a recapitalisation vehicle requires that banks assess the right time for it within the context of the current global and domestic market dynamics and macroeconomic indicators.

IPOs are complex and the extent of complexity is largely dependent on the size of the Bank, the listing process amongst others. To properly navigate this complexity, it is important that interested privately owned Banks begin to assess their IPO readiness that will help them understand their current state and identify any gaps prior to becoming a public company.

Meanwhile, right issues are also one of the options that banks can explore to boost their capital base towards meeting the proposed minimum requirement by the CBN. With right issue, Banks can offer additional shares to its existing shareholders at a reduced price. This is particularly important for Banks that do not want to dilute their current shareholding structure that would normally arise from adoption of other recapitalization options such as IPOs, placements, M&A etc.

3. Recapitalisation through private placements

Banks could also explore the option of private placement (non-public offering) which entails selling additional stocks directly to private institutional or high-net worth investors which could include private equity funds, venture capitalists or development finance institutions (DFIs) or HNIs. It is particularly suited for banks with strong financials that may neither want to go public through IPOs or go the route of M&As.

Private placement are however subjected to a different regulatory process compared to initial public offers.

4. Capitalisation of earnings

Banks that do not meet up with the minimum capital base that the CBN will propose can also adopt the strategy of converting their earnings into capital stock for existing shareholders. It is noteworthy to distinguish between capitalization of new earnings from capitalization of undistributed profit/retained earnings which was adopted by the National Insurance Commission (NAICOM) for the recapitalization of insurance companies in Nigeria.

Capitalisation of undistributed profit entails the transfer of funds from retained earnings to paid-up capital i.e., converting the bank’s retained earnings (which already forms part of the shareholder’s fund) into capital stocks. Such exercise does not necessarily lead to accretion of the existing shareholder’s fund.

Nonetheless, the decision of a bank to adopt this recapitalization option will ultimately be dependent on the CBN’s preferred recapitalization options as well as the ability of the bank to generate the quantum of earnings sufficient to be capitalization to restore them to the proposed regulatory minimum capital base.

5. Leveraging equity/debt financing from holding companies

Recent trend in the Nigerian banking sector suggests a gradual transition towards a financial holding company (HoldCo) structure where some commercial banks are wholly-owned subsidiaries of a parent company, usually the HoldCo. This trend is spurred by a CBN circular to all banks in December 2011 introducing the financial holding company structure into the banking system. The financial HoldCo structure allows banks to operate non-core banking businesses such as insurance, asset management, pension fund and other permissible financial services along with their core banking businesses.

According to CBN, a HoldCo is a corporate entity whose primary objective overseeing equity investments in two or more companies, with all of them being its subsidiaries. Importantly, these subsidiaries are involved in the provision of financial services, and at least one of them must function as a commercial, merchant or specialized bank.
There are currently five financial HoldCos in Nigeria (see table 1) with three of these HoldCo having 100% direct holding in three banks with international banking licence.

<table>
<thead>
<tr>
<th>S/N Holding Companies</th>
<th>Year founded</th>
<th>Number of subsidiaries</th>
<th>Banking subsidiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 First Bank Nigeria Holdings Plc</td>
<td>September 2012</td>
<td>7</td>
<td>First Bank Nigeria Limited</td>
</tr>
<tr>
<td>2 Access Holdings Plc</td>
<td>February 2022</td>
<td>4</td>
<td>Access Bank</td>
</tr>
<tr>
<td>3 Guaranty Trust Holding Company</td>
<td>July 2021</td>
<td>8</td>
<td>Guaranty Trust Bank Plc</td>
</tr>
<tr>
<td>4 Stanbic IBTC Holdings Plc</td>
<td>November 2012</td>
<td>11</td>
<td>Stanbic IBTC Bank</td>
</tr>
<tr>
<td>5 First City Monument Bank Group Plc</td>
<td>June 2013</td>
<td>7</td>
<td>First City Monument Bank Limited</td>
</tr>
</tbody>
</table>

Source: CBN, Companies’ websites
Table 1: List of financial holding companies in Nigeria

The banking subsidiaries of HoldCos particularly stands at an advantageous position in the event that the CBN decides to raise the capital base. The options open to such subsidiary extends beyond M&A, placement or right issues to include raising the needed funding directly from the HoldCo.

To do this, the HoldCo could approach the capital market for debt funding either through issuance of commercial papers or outright right issues. The proceeds to the HoldCo from such endeavour is thereafter injected into the banking subsidiary as an equity. This arrangement is particularly advantageous given that it helps to address the constraint where banks are outrightly disallowed from recapitalizing through debt funding or debt to equity conversion.
Tax Implications of the Recapitalisation Options
Mergers and acquisitions (M&A) are commonly exercised recapitalization tools within the banking sector in Nigeria. Despite their proliferation, it is essential to discern their associated tax implications, influenced by local stipulations such as Companies Income Tax, Value Added Tax (VAT), Capital Gains Tax (CGT), and Stamp Duties. A detailed understanding tailored to the transaction's characteristics can guide the decision-making process.

Firstly, it is important to recognize that merger and acquisition (M&A) activities typically catalyze the transfer of assets, shares, and businesses. To fully comprehend the tax implications of recapitalization through M&A, it is imperative to examine the tax consequences associated with these transfers. Detailed analysis are provided below:

i. **Tax implication for transfer of asset**
   Asset transfer which generally involves disposal of asset would create CIT, CGT, VAT and Stamp duty implications, these implications are:
   a. CIT – Balancing adjustments (charges/allowances): This would arise on assets upon disposal of same. It is applicable on asset which capital allowances have been previously claimed and calculated by comparing the sales value to the tax written down value of the assets disposed; balancing charges at 30% should arise where the sale proceeds exceed the TWDV (i.e., clawing back excess allowances), whilst balancing allowances create additional deductions (which can be offset against wider taxable income) where the TWDV exceeds the sales value.
   b. CGT – This is applicable at 10% on gains (if any) derived from the disposal of asset
   c. Stamp duties – This is applicable at 1.5% on the value of the assets transferred.
   d. VAT – This is only applicable to VATable assets and should be applicable at 7.5%.

ii. **Tax implication for transfer of shares**
   Gains on transfer of shares of a Nigerian entity should be subject to tax at 10% except where the aggregate value of the share disposal is less than NGN100,000,000; and the proceeds from the sale of such shares are re-invested during the same year in the acquisition of the shares of any Nigerian company. It is important to state that CIT and VAT are not applicable, and transfer of shares should not be subject to Stamp duty. However in practice, a nominal fee of N500 should apply on the document embodying the transfer.

... it is important to recognize that merger and acquisition (M&A) activities typically catalyze the transfer of assets, shares, and businesses...
iii. Tax implication for transfer of business

The taxation consequences of transferring a business from a company to a Nigerian company are laid out in section 29 (9) of the Companies Income Tax Act (CITA), Section 42 of the Value Added Tax Act and Section 32 of the Capital Gains Tax Act. This transfer, done for better business organization or shifting its management to Nigeria, may qualify for specific concessions provided several conditions are met. These conditions include:

a. The transferred business must be from a company to a Nigerian company.
b. The transfer aims to better organize the transferred business.
c. The companies must demonstrate mutual control or belong to the same group of companies.
d. The company relationship must have lasted continuously for at least 365 days before the business transfer.
e. The companies must obtain written consent from the Federal Inland Revenue Service (FIRS).

Once these conditions are satisfied, companies may be eligible for the following FIRS-approved concessions:

a. The provisions of the CITA on commencement and cessation rules for tax computation should not apply.
b. The relevant assets of the transferor company should be deemed transferred at Tax Written Down Value (TWDV).
c. Capital Gains Tax (CGT) should not apply to the transferred assets.
d. Value Added Tax (VAT) should not apply to the transferred assets.

Additionally, the assets acquired, in relation to which the aforementioned tax concessions have been granted, should not be disposed of within 365 days of the reorganization. Such a disposal would trigger a withdrawal of all granted concessions, and the involved parties would be required to pay the applicable taxes. This will be the case as if the concessions had never been granted and would also include the payment of penalties and interest.

Typically, a merger or acquisition process could culminate in one of three scenarios:

• The formation of an entirely new company.
• The cessation of business by the other merging parties.
• The continuation of the consolidated business by one of the merging parties, either under its pre-existing name or a new name

However, according to Section 29 (9) of the Companies Income Tax Act (CITA), some ramifications arising from mergers and acquisitions might be exempted. A detailed explanation of this provision is presented below:
1. Formation of a new company

In the event a merger process results in a new company, it is expected that this newly formed entity will file its returns according to the provisions of Section 55(3)(b) of the Companies Income Tax Act (CITA). CITA does provide for instances where a business carried on by a company is sold or transferred to a Nigerian company. If the Federal Inland Revenue Service (FIRS) is satisfied that one company has control over the other, or that both are controlled by some other person or constitute recognized group of companies, the FIRS may choose to suspend the application of the commencement rule under its discretionary powers.

However, with respect to expense deductions, fees paid to statutory bodies such as the Securities and Exchange Commission (SEC), Nigerian Stock Exchange (NSE), Central Bank of Nigeria (CBN), Land Authorities, as well as to professional firms like Accountants, Stockbrokers, Issuing Houses, and Solicitors, are considered capital in nature. Therefore, they will not be allowed as deductible expenses as stated under Section 27(a) of CITA.

Furthermore, the new company should not be permitted to inherit the unabsorbed losses and capital allowances, except under the circumstance where a reconstituted company is undertaking the same business previously carried on by this company and it is proved that the losses have not been allowed against any assessable profits. In terms of allowances, a new company will only have the right to claim an annual allowance on the Tax Written Down Values (TWDV) of the transferred assets.
2. Cessation of businesses by one of the merging parties

A merger or consolidation process may lead to the cessation of business for one or more of the merging entities. In such case, the cessation rule as per Section 29(4) of the Companies Income Tax Act (CITA) may apply to any merging company that has ceased business operations permanently. However, under Section 29(9) of CITA, the Service may exercise its discretion to state that the cessation rule may not apply provided the conditions for business transfer are met.

Should the cessation rules apply, the following compliance processes would be required:

a. A notification of cessation of business should be sent to the FIRS.

b. Cessation returns should be filed in accordance with the relevant rules.

c. The notification should prompt a tax audit by the FIRS. The aim is to ensure that all outstanding filing and payment requirements have been completed before the liquidation process is finalized.

d. Any profits distributed to shareholders (whether in cash or other forms) should be subject to a 10% withholding tax. This is applicable to the extent of undistributed retained earnings and current profits for the year of liquidation.

3. Continuation of the consolidated business by one of the merging parties, in its name or under a new name

In a merger, it's probable for one of the merging companies to survive by inheriting the assets, operations, and liabilities of the other entities. This situation could occur under its previous name or a new one. The surviving firm must abide by the provisions of the tax laws:

a. It must file returns as per section 55(3)(a) of CITA.

b. Commencement rules (section 29(3) of CITA) won't apply; it'll be seen as an existing company.

c. It can't claim investment or initial allowance on transferred assets.

d. It may claim an annual allowance only on the tax Written Down Values (TWDV) of transferred assets.

e. It may not use the unabsorbed losses and capital allowances of the merged entities unless it proves to be a reconstituted company.

f. All merger-related fees are subject to VAT and WHT.
It is important to note that the debt obtained by the holdco to finance this transaction would essentially accrue interest as its cost. Therefore, the interest paid on the funded debt should be subject to a withholding tax of 10%.

Also, the equity investment into the Bank would definitely lead to an increment in the Bank’s authorized share capital. Thus, there might be stamp duty implications on the additional equity capital injection at 0.75% of the additional capital injected. Also, certain documents related to the Recapitalization option, such as loan agreements, share transfer documents, or other relevant legal instruments should be subject to stamp duty. The holdco entity and the Bank being related party entities are expected to document this with the transfer pricing returns as there would be a change in the Bank’s percentage ownership.
1. **Tax implication of private placement, right issues or IPOs**

Generally, stamp duties should be applicable where there is a need to increase the company’s authorized share capital in process of the capitalization through private placement, right issues or initial public offers. In this instance, stamp duty should be applicable at the ad valorem rate of 0.75% on the value of the increase.

2. **Tax implications of recapitalization through undistributed profit**

Pursuant to section 9 (3)(a) of the Companies Income Tax Act (CITA), dividend, for a company not in liquidation, means any profits distributed, whether such profit are a capital nature or not, including an amount equal to the nominal value of bonus shares, debentures or securities awarded to the shareholders.

Retained earnings represent the profits of the company, accordingly distributions from retained earnings should be considered as dividend, and as such the tax implications applicable on dividends distribution should be applicable on issue of bonus shares from (retained) profits.

Generally, in accordance with the provisions of the CITA and the Withholding Tax Regulations, a company distributing dividends is obliged to deduct WHT at the applicable rate of 10%.

In accordance with the provisions of the Finance Act 2020, excess dividend tax should not apply on dividend distributed from retained earnings since it should have been previously subject to tax, as retained earnings represent some or all of the company's after-tax profit.

Furthermore, pursuant to the provisions of the Stamp Duty Act, there should be no stamp duty applicable on a transfer or a sale of shares. However, in practice a nominal fee of N500 should be applicable on the document embodying the instrument of allocation of the bonus shares to the shareholders.

Stamp duties should be applicable where there is a need to increase the company’s authorized share capital in process of the capitalization of the retained earnings. In this instance, stamp duty should be applicable at the ad valorem rate of 0.75% on the value of the increase.
Accounting Considerations of Recapitalisation Options
The CBN's proposed bank recapitalisation exercise will have significant financial reporting implications for commercial banks in Nigeria. Generally, businesses raise capital via issuance of debt, equity or a hybrid of both debt and equity instruments. However, it is unlikely that any form of capital expansion other than ordinary equity shares will be permissible for the CBN recapitalisation objective.

Below are the accounting and financial reporting implications for the various recapitalisation options and strategies available to the banks within the reporting framework of the International Financial Reporting Standards (IFRS).

1. Mergers and acquisitions (M&A) under IFRS 3: Business Combinations

Banks not meeting the new capitalisation threshold proposed by CBN may consider being acquired or merged with another bank. IFRS 3 guides accounting for business combinations, necessitating the identification of the acquirer, determining the acquisition date, recognizing and measuring assets, liabilities, and goodwill.

IFRS 3 also highlights the accounting recognition of acquisition-related costs as expenses in the periods in which the costs are incurred and the related services are received with the exception of the costs of registering and issuing debt and equity securities that are recognised in accordance with IAS 32 Financial Instruments: Presentation and IFRS 9: Financial Instruments. Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder’s fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. An acquiring Bank is required to disclose comprehensive information about the business combination in the financial statements.

2. Rights issues, IPOs or private placements as a means of capital expansion

Banks that would seek to raise capital via rights issues, IPOs or Private Placements would need to comply with the accounting guidance provided by International Accounting Standard (IAS 32 Financial Instruments: Presentation), which includes disclosing information about the additional capital raised, issue price, impact on equity, the impact on current and prior period earnings per share (EPS) in line with IAS 33 Earnings per Share, as well as the relevant terms and conditions for the rights issue.

Rights Issues, IPOs, and Private Placements: Transaction costs

Entities typically incur various costs in the process their rights issues, IPOs and private placements. Those costs might include business valuation fees paid to professional valuers, registration and other regulatory fees, fees paid to underwriters, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. Legal fee is one of the usual costs that is typically incurred as part of this process.

IAS 32.37 prescribes that transaction costs of an equity transaction should be accounted for as a deduction from equity to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. Management would need to carry out a careful analysis of the various costs they would incur the process of raising capital to ascertain the incremental costs that are directly attributable to the and would have been avoided save for issuance of the additional shares. Only such costs qualify as transaction costs for the purpose of raising capital and are deductible from equity under the IFRS reporting framework.
3. Going concern considerations

While recapitalisation aims to strengthen a bank's financial position, the process itself can raise questions about its future viability and ability to continue to be in operation for the foreseeable future. This is particularly the case for banks that would be unable to meet the new CBN capitalization threshold and may either enter into arrangement to be merged with or acquired by another bank. Financial statements are normally prepared on the assumption that the reporting entity will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to enter liquidation or to cease trading.

Banks that would need to enter liquidation or cease trading due to their inability to meet the new capital base would need to prepare their financial statements using a basis different from the going concern. Where this is the case, the financial statements should describe the basis used. Banks are also expected to make a disclosure of the events that has resulted in them ceasing to be going concerns.
Implications of CBN’s Proposed Recapitalisation Exercise   |   February 2024

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