The Startup Act series

Fiscal incentives available to startups under The Startup Act, 2022

Grow | Protect | **Operate** | Finance

November 2022

Introduction

With about 383 tech startups raising a combined total of US$2,068,709,445 between 2015 and 2022 - a higher total than any other country in Africa, Nigeria benefits greatly from the economic contributions of startups[1]. The passing of the Startup Act therefore marks the dawn of a new dispensation for startup ventures in Nigeria.

In the first part of our Startup Act series, we provided an overview of the recently enacted Startup Act, 2022. In this second part, we discuss the incentives provided for under the Startup Act which will be beneficial to startups.

1. The Nigerian Startup Ecosystem Report, 2022 by Disrupt Africa.

Administration of Fiscal Incentives and Startup Labelling

One of the essential contributions of the Startup Act to the startup ecosystem is bringing clarity to the types of business ventures that qualify as startups. For a startup to benefit from the incentives provided under the Startup Act, such a startup must be a "labelled startup". The main purpose of startup labelling is to ensure ease of regulating startups in Nigeria.

From the joint reading of the provisions of the Startup Act, startup labelling is the process of distinguishing and categorizing startups from other types of business enterprises. Startup labelling is achieved through the issuance of a startup label[2] - a certificate issued by the National Information Technology Development Agency (NITDA)[3], upon the fulfillment of the following conditions:

- Establishment in accordance with the provisions of the Companies and Allied Matters Act, 2020, either as a limited liability company, a sole proprietorship or a partnership.

2. A Startup desirous of being granted a label under the Act shall apply via the Startup Portal in the prescribed form and with the documents prescribed by the Secretariat.
3. The Secretariat of the National Council for Digital Innovation and Entrepreneurship.

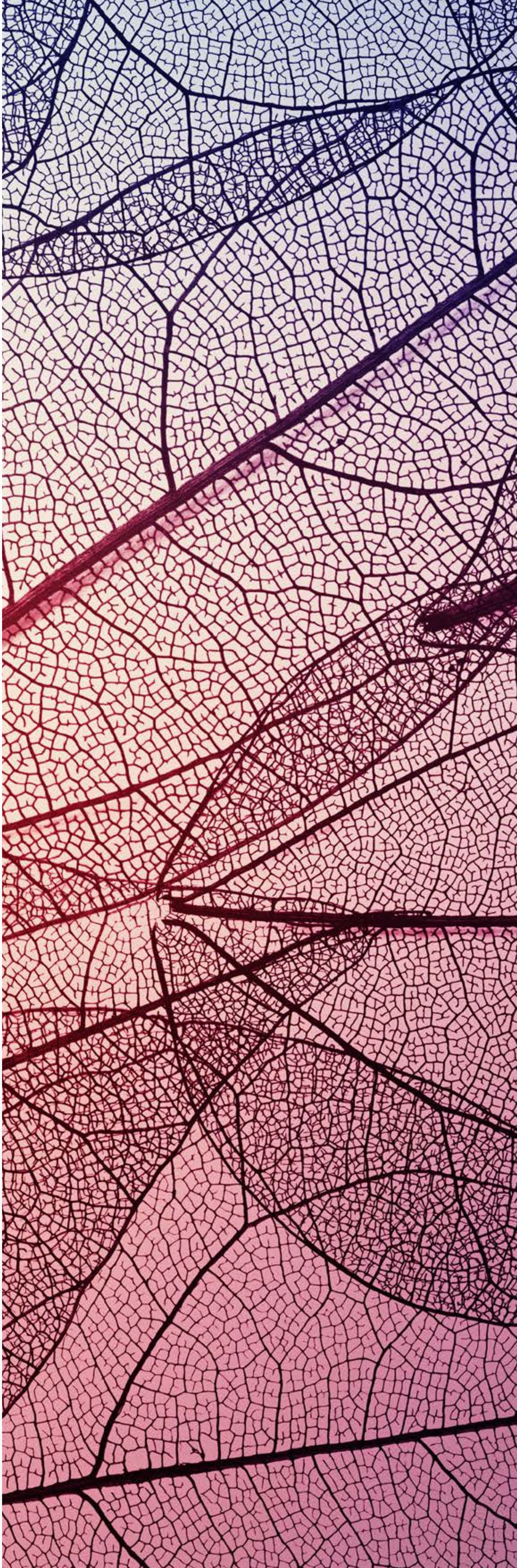
- Where the startup is a limited liability company then it must have been in existence for a period of not more than 10 years from the date of incorporation.
- The business objects of the startup must include innovation, development, production, improvement, and commercialization of a digital technology innovative product or process.
- The startup must be the holder or repository of a product or process which imbibes digital technology or be the owner or author of a registered software.
- A labelled startup should have at least one-third local shareholding, which should be held by one or more founders/co-founders who are Nigerians and must share from the profit or revenue from the sale of shares.

Tax and Fiscal Incentives

Tax and fiscal incentives available to labelled startups under the Startup Act include the following:

- **Pioneer Status**: Labelled startups operating within industries captured under the Pioneer Status Incentives (PSI) Scheme[4] are permitted to apply for tax reliefs and incentives and the approvals for such applications will be processed expeditiously.
- **Exemption from Income Tax**: The Companies Income Tax Act ("**CITA**")[5] mandates companies to pay income taxes at rates ranging from 0% to 30%, depending on whether such company is classified as a small, medium sized or large company. Companies with an annual turnover of more than 100 million Naira are classified as large companies and are assessed for tax at the rate of 30%. Medium-sized companies with an annual turnover exceeding 25 million Naira but less than 100 million Naira are assessed at the rate of 20% and small Companies with a gross turnover of 25 million Naira or less have been exempted from the payment of income taxes by the Finance Act, 2019.

4. Industries captured under the PSI Scheme are Agriculture, Mining and Quarrying, Manufacturing, Electricity and Gas Supply, Waste Management, Construction, Trade, Information and Communication, Professional Services, Financials, and Administrative Services.
5. Companies Income Tax Act, Cap C21, LFN 2004 (as amended).



Under the Startup Act, labelled startups are entitled to tax relief in accordance with the Industrial Development (Income Tax Relief) Act[6]. As such, regardless of the size of turnover, a startup may be entitled to exemption from the payment of income tax or any other tax chargeable on their income or revenue for period of 3 years and this tax relief may continue for a further period of 2 years if the company is still categorized as a labelled startup. The commencement date of such tax relief shall be the date of the issuance of a startup label certificate to the startup.

- **Export Incentives**: Where a labelled startup is involved in the exportation of products and services, which are deemed eligible under the Export (Incentives and Miscellaneous Provisions) Act[7], such startup will be entitled to export incentives and financial assistance from the Export Development Fund[8], Export Expansion Grant[9] and the Export Adjustment Scheme Fund.
- **Access to Grants and Loans**: Labelled startups are also guaranteed access to grants and loan facilities administered by the Central Bank of Nigeria, the Bank of Industry or other bodies statutorily empowered to assist small and medium scale enterprises and entrepreneurs. Also, a Credit Guarantee Scheme is to be established to provide accessible financial support to labelled startups.
- **Research and Development Deductions**: Expenses on research and development which are wholly incurred in Nigeria will be fully deducted and restrictions placed by CITA[10], with respect to deductions for expenses on research, will not be applicable to labelled startups. The CITA provides that deductions for expenses on research and development shall not exceed a sum equal to 10% of the total profits of that company for that year.
- **Exemption From Contribution to Industrial Training Fund:** The Industrial Training Fund (Amendment) Act, 2011, mandates employers to remit 1% of their annual payroll to the Industrial Training Fund. This statutory obligation is only applicable to employers with 5 or more employees or having less than 5 employees with an annual turnover of over 50 million Naira. Under the Startup Act, labelled startups would be exempted from contributions to the Industrial Training Fund where they provide in-house training to their employees for the duration of the startup label.

Conclusion

The provisions of the Startup Act are indicative of the Federal Government's intentions to work alongside private sector stakeholders to cement Nigeria's position as the hub of startups in Africa. The innovations introduced by the Startup Act for the regulation of startups as well as the introduction of fiscal incentives to Startups are laudable.

However, there are some uncertainties as to the practical application of some of the provisions of the Startup Act. One of the major effects that the Startup Act may have on startups is with respect to the local content requirement tied to being a labelled startup (i.e., the requirement for a startup to have one-third local shareholding). This shareholding requirement may have an impact on the corporate arrangements for foreign-funded Nigerian startups and as such preclude certain startups from being labelled as startups in accordance with the Startup Act. This would inevitably mean that certain startups are left to choose whether to maintain a one-third local shareholding structure in order to benefit from the incentives available under the Startup Act or open themselves up to equity investment from foreign investors.

6. CAP. I17 Laws of the Federation of Nigeria 2004.
7. Cap. E19 Laws of the Federation of Nigeria 2004.
8. The Export Development Fund will provide support for eligible exporters to cover their initial expenses in respect of export promotion activities as prescribed by the Nigerian Export Promotion Council.
9. The Export Expansion Grant for eligible exporters ranges from 5% to 15% of their annual export value, depending on exporters' product category. Successful exporters are paid through an Export Credit Certificate which be applied to prescribed activities.
10. Section 26(2) of the CITA.

CSBrand-104254-The-Startup-Series-II flyer — 21/11/2022