ABCs OF REGULATORY COMPLIANCE FOR CREATIVE AND INFORMATION TECHNOLOGY START-UPS IN NIGERIA

by Yewande Ogunajo[1]

INTRODUCTION

The Nigerian economy has witnessed an influx of funding and the resultant growth in the creative and information technology (CIT) industry. In 2017, the rise of activity in the Nigerian tech space attracted Mark Zuckerberg,[2] the Chairman and Chief Executive Officer of Facebook. In April 2018, the Vice President[3] of Nigeria visited a number of leading start-ups in the technology and innovation sector.

The National Bureau of Statistics in its Nigerian Capital Importation (Full Year 2017) Report stated that total capital imported into Nigeria in 2017 was $12, 228,600,000 (Twelve Billion, Two Hundred and Twenty Eight Million, Six Hundred Thousand United States Dollars), a 138.7% increase from the figure recorded in 2016.[4] While share capital investment and the banking sector attracted the highest amount of capital inflow especially in the last quarter of 2017, the information and communications sector witnessed a consistent increase. Leading consulting giant, KPMG, reported that virtually all sectors of the Nigerian economy were in a recession in 2016 except for the agriculture and information & communications sectors.[5] This trend has been sustained by the increased international focus on start-ups in the CIT industry.

In spite of the above positive trend, it is relevant to note that unincorporated or newly incorporated CIT entities face common challenges concerning regulatory compliance. Entities in this industry are peculiar because of the unconventional funding procedure and lean organisational setup. Depending on financial strategy and long-term goals, CIT start-ups generate funding through angel investors, venture capitalists, incubators, accelerators, private equity, loans or crowdfunding.

---

[1] Associate, ÆLEX

[2] Mr Zuckerberg visited Co-Creation Hub, Landmark Centre, Andela, and Afrinolly Creative Hub in August 2017.

[3] Prof. Yemi Osinbajo, SAN.

[4] NBS Report for Q4 and Full Year 2017 published February 2018 at http://www.nigerianstat.gov.ng/download/733 and accessed on 12 June 2018.

[5] KPMG National Budget 2017 published in February 2017 at https://assets.kpmg.com/content/dam/kpmg/ng/pdf/ng-national-budget-2017.pdf and accessed on 11 June 2018.

The mode of financing, which may be by local or foreign sources, mostly impacts the reporting requirements and compliance standards of such entities.

Other common challenges ranging from corporate governance procedures to employee management, (non-existing) partnership agreements to misunderstandings with investors, all of which could have been contractually prevented or managed, threaten the start-up before it stabilises and begins to achieve its goals and potential.

This article is therefore written to provide an exposition on how CIT start-ups can navigate the web of regulatory compliance under Nigerian law. For this article, a fictitious CIT start-up called NewCo will be used as a case study.

NewCo, founded by 3 (three) undergraduates of a Nigerian university, has commenced pre-launch operations but is yet to be incorporated. It is negotiating funding options with local and foreign incubators, accelerators, angel investors and venture capitalist firms and hopes to get a grant from an international body through a competition it believes it has high chances of winning.

PRELIMINARY CONSIDERATIONS

Before its launch and incorporation, NewCo must consider issues such as shareholders' agreements, partnership agreement (terms of which will be agreed among the 3 founders), employment contracts, the structure of the business, funding through debt, equity or available grants, to a name a few.

It may decide to register as a private/public limited liability company or a business name under Part A and B of the Companies and Allied Matters Act[6] (CAMA).

Whatever NewCo decides, the incorporation and compliance requirements will vary considerably. For this article, we will assume the founders of NewCo have agreed to register as a private limited liability company.

INCORPORATION CHECKLIST

Following an agreement regarding the structure and operating procedure, the company must now take steps to undergo incorporation with the Corporate Affairs Commission (CAC).

NewCo's application will include its registered company address, statement of authorised share capital, particulars of its company secretary, subscribers and first directors, accompanied by its Memorandum and Articles of Association and means of identification of the company secretary, subscribers and directors.

Where there is foreign shareholding held by venture capitalists, angel investors, etc., NewCo must note that it ought to have a minimum share capital of ₦10, 000, 000 (Ten Million Naira). This means it will be classified as a large company for

[6] Cap. C20 Laws of the Federation 2004

incorporation purposes. Official fees to be paid to the CAC will depend on the authorised share capital of the company.

ADDITIONAL REQUIREMENTS

Tax Registration and Opening of a Bank Account

NewCo is expected to register with the Federal Inland Revenue Service (FIRS) for Companies Income Tax and Value Added Tax (VAT) within 6 months of incorporation.[7] The tax identification number (TIN) issued after registration is a unique number allocated and used to identify a person (individual or company) as a duly registered taxpayer in Nigeria and is to be used by that taxpayer alone. This TIN must be inserted on all company invoices and used at the point of filing tax returns. With the recently implemented Ease of Doing Business initiative in Nigeria, within a few days of incorporation of a company by the CAC, the TIN is automatically generated and electronically issued to the company using the email address used for incorporation of the company.

Where NewCo fails to register with the FIRS for tax purposes, it will not be able to withhold tax from its foreign partners, investors and clients. Further, it will not be able to file tax returns and obtain tax clearance certificates (TCC). NewCo will also be liable to payment of penalty for its failure to register with FIRS and comply with filing requirements within the stipulated timeline.

NewCo will require a corporate bank account in Nigeria for business exigency.

NewCo may also be eligible to pay the information technology tax which is imposed on companies in the information communication technology sector. The tax payable is 1% of the total profits before tax[8] but is payable only by companies with a turnover of ₦100, 000, 000 (One Hundred Million Naira) and above. The National Information Technology Development Agency (NITDA) Act provides explicitly for telecommunications and cyber companies, amongst other eligible entities.[9]

The Nigeria Investment Promotion Commission and the Ministry of Interior

Where NewCo intends foreign investors to participate in the business by way of shareholding, offer of loan facilities or the likes, it will need to register with the Nigeria Investment Promotion Commission[10] (NIPC) and obtain a Business Permit from the Ministry of Interior, after incorporation but before commencing business.

National Office for Technology Acquisition and Promotion (NOTAP)

---

[7] Section 8 Value Added Tax Act Cap V1 Laws of the Federation 2004
[8] Section 12(2)(a) National Information Technology Development Act (NITDA) 2007
[9] Schedule III NITDA Act 2007
[10] Section 20 NIPC Act Cap. N117 Laws of the Federation 2004

As part of its negotiations, NewCo might agree with a foreign investor for the transfer of technology, use of intellectual property rights or for the provision of managerial/supervisory assistance, etc. NOTAP is tasked with the responsibility of ensuring that all contracts and agreements entered into for the transfer of foreign technology to Nigerians are registered and in line with the acceptable purposes provided for in the National Office for Technology Acquisition and Promotion Act.[11]

NewCo will therefore be required to register the relevant agreement with NOTAP who has the discretion to accept or reject such contract per the provisions of the Act.[12] In granting the certificate of registration, the Director of NOTAP is guided by the provisions of Section 6(2) of the Act which sets out the specifications that should not be contravened by an applicant before a certificate can be issued. These include that the technology must not be existent in Nigeria, only fair consideration must be made for the transfer, lack of onerous limitations or restrictions on the transferee, lack of excessive privileges to the transferor, etc.

Certificate of Capital Importation (CCI)

The Foreign Exchange (Monitoring and Miscellaneous Provisions) Act[13] (the FEMM Act) provides regulations on capital importation into Nigeria. Capital is defined in the FEMM Act as all cash contributions, plant, machinery, equipment, building, spare parts, raw material and other business assets, other than goodwill.

The FEMM Act provides explicitly that a person may invest in any enterprise or security, with foreign currency or capital imported into Nigeria through an Authorised Dealer either by telegraphic transfer, cheques or other negotiable instruments and converted into Naira.[14]

All capital imported into Nigeria must be received through an Authorised Dealer, and a Certificate of Capital Importation(CCI) must be obtained from the Central Bank of Nigeria (CBN) through the Authorised Dealer. This requirement will also apply to grants NewCo receives from international bodies, provided the funds are in foreign currency. Approved commercial banks in Nigeria are registered as Authorised Dealers with the CBN. The capital received must also be converted per the provisions of the FEMM Act and CBN Regulations published from time to time.

---

[11] NOTAP Act Cap. N62, Laws of the Federation 2004

[12] Section 4(d)(i-vi) NOTAP Act provides that contracts or agreements, wholly or partly for or in connection with any of the following are registrable:

(i) The use of trademarks;
(ii) The right to use patented inventions;
(iii) The supply of technical expertise in the form of the preparation of plans, diagrams, operating manuals or any other form of technical assistance of any description whatsoever;
(iv) The supply of basic or detailed engineering;
(v) The supply of machinery and plant; and
(vi) The provision of operating staff or managerial assistance and the training of personnel.

[13] Cap F34 Laws of the Federation 2004

[14] Section 15 (1) FEMM Act

The CCI is essential primarily for the investors (venture capital firm, angel investor, private equity company, incubator, etc.) as it allows them to repatriate profits, dividends on imported capital, loan servicing payments and remit payments in the event of the disposal of their shares or liquidation of NewCo.[15]

COMPLIANCE CHALLENGES

Corporate Affairs Commission

NewCo, like most CIT start-ups, resulted from the successful experimentation of an idea. To be able to pitch to investors and international agencies, the entity has adopted a brand name in traditional and social media which is gradually gaining traction. The danger in failing to incorporate the name early enough is that the CAC may reject it because it is a prohibited name or similar to an already existing name.[16] NewCo will then be forced to adopt a different name for incorporation, thereby disrupting its existing branding efforts.

Furthermore, NewCo shall have the statutory obligation to make and file annual returns and its audited accounts at least once every year.[17].

The annual returns are required to show that the company is a going concern and also provide updated records to the CAC. However, NewCo will need not file annual returns in the year of its incorporation or the following year so long as it holds its first Annual General Meeting (AGM) within 18 months of incorporation. If NewCo fails to comply with this requirement, it may be liable to the imposition of fines and its investors may institute an action against it. Also, the CAC could strike off NewCo's name from the register of companies as a defunct company.

Once NewCo achieves stability and significant valuation, the local or foreign investors will begin to sell off their equity holding. NewCo will be required to process the transfer of shares[18] and make necessary filings with the CAC. NewCo must keep a register of members and regularly update this when there is an allotment or transfer of shares.

Tax and Repatriation of Dividends and Profits

In addition to registering for a TIN with FIRS, NewCo must withhold tax at the rate of 10% on all profits and dividends paid to its investors. If NewCo fails to withhold tax, it will bear the burden of taxation in that respect. In other words, NewCo will pay the tax from its profits, instead of deducting from its investors' profits. This will diminish its initial profits which ought to be ploughed back into the business.

[15] Section 15(4) FEMM Act
[16] Section 30(1) CAMA
[17] Section 370 CAMA
[18] Section 151 – 153, 157 CAMA

Further, failure to deduct and remit all applicable taxes when due attract penalties in the form of interest on outstanding tax, fines and imprisonment of responsible company officers.

Also, where a CCI was not obtained at the point of capital importation, the foreign investors will not enjoy free repatriation of their dividends, profits and proceeds in the event of liquidation. This poses a considerable challenge for investors whose primary interest is to make returns on their investments within the shortest time possible.

NOTAP

Where NewCo fails to register a contract/agreement for technology transfer or fails to make, or makes false returns in contravention of the NOTAP Act, every director, manager, secretary or other similar officer of the company, or person concerned in the management of the affairs of the company, or person purporting to act in such capacity will be severally guilty of an offence and liable to be proceeded against personally, except (s)he can prove that the act or omission constituting the offence took place without his knowledge.[19]

Also, the person or entity who transferred the technology or provided service will not be able to repatriate his fees.

CONCLUSION

The rise of Nigerian CIT companies in recent times is laudable, especially for an emerging industry. However, given the peculiarities of these start-ups, careful attention must be paid to ensuring timely compliance with all legal requirements and procedures.

Non-compliance with the requirements above will result in sanctions by the regulatory authorities. This situation would be particularly risky for CIT companies who rely heavily on external funding. Many investors have a contractual agreement for instalment funding meaning that the capital will be released in instalments based on the performance of the CIT company per milestone.

Engaging qualified personnel to manage the company's incorporation and compliance obligations will eliminate or mitigate these challenges and enable founders and investors to focus on achieving optimal performance and business productivity.

[19] Section 17 NOTAP Act

ÆLEX is a full-service commercial and litigation law firm. It is one of the largest law firms in West Africa with offices in Lagos, Port Harcourt and Abuja in Nigeria and Accra, Ghana.

Contact us at:
4th Floor, Marble House,
1 Kingsway Road, Falomo Ikoyi,
Lagos, Nigeria
Telephone: (+234-1) 4617321-3, 2793367-8, 7406533, E-mail: lagos@aelex.com
To see our other office locations, please click **HERE**

You may also visit our social media pages: