

REGULATORY DEVELOPMENTS FOR STARTUPS IN NIGERIA: A 2023 OUTLOOK

BY: CIRCLE LLP





KEY TAKEAWAY

Despite the economic headwinds, and low funding raised, through 2022, Nigerian startups continue to be the focal point of attraction for venture capital investment across Africa.

Certain key regulatory spillovers such as the establishment of the Nigeria Startup Act, and newer developments such as the launch of CBN's first regulatory sandbox project, and a possible relaxation of cryptocurrency transaction restrictions under the Finance Bill, point towards an eventful 2023.

Expectations must still be tempered as Nigeria heads to the polls in Q1 2023. This sets a watch-and-wait tone for regulatory activity in the course of the year.

CBN SANDBOX IMPLEMENTATION 2023

On January 12, 2021, the Central Bank of Nigeria ("CBN") issued the Framework for Regulatory Sandbox Operations. Very recently, on December 18, 2022, the CBN published a Call for Expression of Interest, from intending applicants interested in its Regulatory Sandbox, with a deadline for application on February 1, 2023.

The purpose of the CBN Regulatory Sandbox is to aid the testing of innovative financial products, services, and business models, in a controlled environment, under regulatory oversight, and subject to appropriate conditions and safeguards. There are a few considerations for startups who are interested in applying for the CBN Regulatory Sandbox Programme 2023.

Eligible Applicants

The Regulatory Sandbox is open to all local Nigeria-registered companies (including existing CBN licensees (financial institutions with FinTech initiatives), and other local companies (non-financial sector institutions or technology and telecom companies intending to test an innovative payment product or service).

Eligible Products & Services

A proposed product, service or solution must meet certain thresholds of the CBN, to be accepted into the Sandbox programme.

Under the Framework, the CBN indicates all financial products, services and solutions that are innovative, will be considered for entry into the Regulatory Sandbox. However, activities that are outrightly unlawful will not be accepted into the Regulatory Sandbox. Other non-regulated financial products and services using emerging technologies will also be considered.

Timelines of Sandbox Programme

While the Framework for the Regulatory Sandbox Operation do not provide a clear duration limit for each Regulatory Sandbox cohort, it provides that each Applicant may indicate in their application, the estimated start and end date of their testing timelines. The Framework also permits applicants to apply for the extension of testing timelines during the Sandbox programme, subject to the approval of the CBN.

Documentary, Filing and Operational Requirements

The Framework for Regulatory Sandbox Operations provide for an exhaustive documentary, filing and operational requirements, that Applicants must provide at the stage of applying and during the course of the Regulatory Sandbox. We have highlighted a few of the requirements below:

Documentary Checklist (Before Approval)

Application via the Regulatory Sandbox website.	Application must be accompanied by a cover letter signed by an authorized signatory of the entity and addressed to the Director, Payments System Management Department, Central Bank of Nigeria, Abuja.	Board Approval (where applicable)
Certificate of Incorporation	Company profile and functional contact: e-mails, telephone numbers, office, and postal addresses	Memorandum of Association/ Shareholding Structure of the Company

Forms CAC 1.1 (Application for Registration)	CVs of Board and Management of the Company	Organogram of the Company
Project Plan alongside a detailed Business Proposal	Key Outcomes that the testing is intended to achieve	Memorandum of Information that outlines the strategy of the sandbox trials including current and potential engagements, geographical spread, and benefits to be derive.
AML/CFT Policy	Evidence of patent certificates or registration of patent rights, where applicable	All other information that the CBN may require from time-to-time

Further filing and operational requirements to be considered before applying to the Regulatory Sandbox include:

A proposed innovation must also be intended to improve security, quality, and efficiency in the provision of financial services. Applicants are expected to have conducted a comprehensive assessment to demonstrate the usefulness and functionality of the proposed innovation and identified the associated risks - which should be devoid of adverse effect to existing structures and consumer experience, before applying. The Applicant is expected to draw up a business plan to show that the proposed innovation can be successfully deployed, after exit from the Regulatory Sandbox.

It is also advisable that the application provides for steps proposed to safeguard participating customers, such as indicating the limit of the testing period (a maximum of six (6) months except an extension is applied for), adequate disclosure of risks to customers, obtaining of informed consent, and providing redress mechanisms, etc. Some further information that should be provided along these included the regulatory flexibilities requested and frequency of reporting to the CBN, as the supervising institution.

All such required information may be fully described in a Memorandum of Information, addressed to the CBN alongside the application.

How to Apply

Application to the Regulatory Sandbox, is done through an online application platform - <https://sandbox.cbn.gov.ng/> - and email enquiries regarding the application can be directed to Sandbox@cbn.gov.ng.

The application is required to be submitted with a cover letter signed by an authorised signatory of the entity, and addressed to the Director, Payments System Management Department, Central Bank of Nigeria, Abuja.

The CBN notes that approvals of applications will be effected within 60 days after the closure of the application window and a Letter of Approval will be issued to successful applicants.

NIGERIA STARTUP ACT, 2022 – TAX INCENTIVES AND FISCAL RELIEFS



One of the key highlights of the Nigeria Startup Act, 2022 (“NSA”) are some of the tax incentives and fiscal reliefs recommended to foster investment into the innovation ecosystem. It is important to note that for a startup to enjoy some of the reliefs highlighted, it must be registered as a labelled startup as defined under the NSA.

Some of the key reliefs include the suggestion under Section 25(2) of the NSA which provides that:

“In accordance with the provisions of the Industrial Development (Income Tax Relief) a labelled startup **may be entitled to exemption from the payment of income tax or any other tax chargeable on its income or revenue for a period of three years and an additional two years if still within the period of a labelled startup**, provided that the commencement date of the tax relief shall be the date of the issuance of the startup label.” (emphasis ours).

Based on the provision, a labelled startup may enjoy a potential tax relief on its companies’ income tax^[1] for a period of three years, with another possible extension of two years. However, since the National Information Technology Development Agency, appointed as the Secretariat under the NSA, is yet to launch the Startup Support and Engagement Portal, this relief has not yet become accessible.

Another possible tax relief provided under the NSA, applies to startup investors, who may be able to access an 30% investment tax credit on their investment amount into a labelled startup, applicable to chargeable gains made on such investment. Furthermore, a capital gains tax exemption is also statutorily imposed by the NSA on gains that accrue to startups and investors from the disposal of assets - such assets must have been held within Nigeria for a minimum of 24 months.

FINANCE BILL 2022 - AMENDMENT OF THE CAPITAL GAINS TAX - INTRODUCTION OF TAX ON CRYPTOCURRENCY TRANSACTIONS

The Senate on December 28, 2022, passed the Finance Bill 2022, which is yet to be signed into law by the President. In the meantime, a key change under the Finance Bill 2022, as may affect startups in Nigeria is discussed below.

Capital Gains tax is chargeable on the disposal of assets in Nigeria, at the rate of 10%.^[1] The Finance Bill 2022^[2] proposes to add digital assets including possibly cryptocurrency, as chargeable assets.

Generally, capital gains tax is payable by persons who dispose of such assets, and whom the chargeable gains from such transactions accrue to. Therefore, though the proposed change may have a measured impact on startups involved in trading cryptocurrency for profit, operating within Nigeria, it may not affect startups whose platforms act as conduits or exchanges for such transactions.

While noting these developments, it's noteworthy that banks and financial institutions are still restricted by the CBN from processing cryptocurrency or cryptocurrency-related transactions.

[1] For context, in Nigeria the respective companies' income tax for a medium company and large company under the Finance Bill 2022 are 20% and 30% respectively.

[2] Section 2(1) Capital Gains Tax Act

[3] Section 3(a) Capital Gains Tax Act

Commentary

Startups and innovation-driven regulation in Nigeria is gathering steam, as a result of spillovers from 2022, and into 2023. We have highlighted a few of the key developments which are touted to impact the startups and investing ecosystem in 2023. On the sidelines of this, is a silver lining for fintech, in view of the bullish CBN Cashless policy system, which will make even more impact on the banking system this year.

Notably, it is important to underscore the influence which Nigeria's elections in the 1st Quarter of 2023 will have on the outcomes of some of these developments. For example, some of the proposed tax reliefs under the Nigeria Startup Act, may be hinged on the political will of the new administration. Nevertheless, the outlook for the interaction between startups and regulators may take a turn for the better, based on the expected outcomes of a startup portal being established under the NSA, and the CBN Regulatory Sandbox programme.

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