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A DIAGNOSTIC APPRAISAL OF THE TAX ASPECTS OF THE TREASURY MANAGEMENT IN THE NIGERIAN BANKING SECTOR

By

Dr. Olokooba Saka Muhammed*

Presently under the Nigerian law, there is no strict tax deduction guideline on most of the swap products; hence the problem associated with arrangement fee on such products in the Nigerian banking sector. This paper therefore examines the treasury management activities in the Nigerian banking sector with particular reference to their tax aspect. The paper further appraises the tax implications of different categories of swaps in which Nigerian Banks are actively involved. In the final analysis, the paper recommends for a general overhauling of the Nigerian tax law with regards to arrangement and intermediary fees in the bank's treasury management activities.

1.0 INTRODUCTION

Bank is the major organisation saddled with the responsibility of managing the treasury of both individual as well as corporate organisations via acceptances of saving and disbursement of same when applied for. In any economy, be it developed or developing, banks are at the fore front of business financing and treasury management, especially by ways of giving loan facilities and selling of hedging instruments for the bail out of any business in debt.

When it comes to the issue of treasury management, the role of the banking sector can never be over-emphasised. Bank treasuries are the place where funds meant for both private and public are kept. Not only that, treasury management also involves the process of managing the bank's funds, assets and liabilities in line with achieving the desired objective of the bank. In the process, treasury will be vested with maintaining a balance of ensuring that the bank is liquid, that is, the bank has enough funds to meet the day to day demands of the depositors and others.¹

In business as well as trade financing, debt and borrowing are a common phenomenon and practice. The two primary objectives of a business promoter, while negotiating for loan, are to obtain the best rate possible and to minimize their exposure to market movements in interest rates². Therefore, even while

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¹ 'Treasury Management in the Post-consolidation Era' <www.proshareng.com/./singleNews.php> accessed on the 26th August, 2011.

² Abdulrazaq M.T. 'Treasury Management' Unpublished working paper(n.d)

going for borrowing, any business promoter would have at the back of his/her mind, making possible gain and achieving positive treasury management of their fund. In any organization, it is the treasury department that is charged with the responsibility of managing the finances of organizations for liquidity and profitability with minimal risk.

Furthermore, expertise and proper application of fund to profitable areas also entails good treasury management. However, in doing this, there may be some inherent risks which require mitigation and proper management. The treasury coordinates the asset and liability management of the bank³. Therefore, since treasury handles funding, it is expected that treasurers will play a strategic role in determining the price of a bank⁴.

In Nigeria, though equity financing is more accessible to firm than debt financing, but due to the expansion of the financial markets in the contemporary Nigeria, the expected role of treasury has expanded and holds tremendous threats or hopes for liquidity and profitability too.⁵ Treasury management involves activities of how trading in bonds, currencies, financial derivatives and associated financial risk management⁶. Treasury management is part and parcel of banking services that has to do with the management of an enterprise's holding. Where business operates internationally, there is the further dimension of foreign exchange to consider. In this regard, particular care must be taken in hedging foreign exchange; this is because of the significant impact which an unmatched position could have on the balance sheet⁷.

Unlike in corporate treasury management, bank treasury management plays a more demanding and diversified role. In the corporate treasury management, everything centres and concentrates only on asset instruments; while in banks, instruments to be managed include asset and liability instruments. Therefore, treasury management in the banking sector is prone to higher risk. Amongst the risk banks are exposed to in treasury management are funding of assets by liability and liquidity risk, especially risk associated with the inability to meet the obligations, leverage or capital risks, that is, risk associated with the amount of capital cushion a bank has for the protection of its depositors and borrowers from decline in asset values⁸.

³ <www.proshareng.com/./singlenews.php> accessed on the 26th August, 2011.

⁴ Ibid.

⁵ Ibid.

⁶ <www.eurojournals.com> accessed on the 20th August, 2011.

⁷ Abdulrazaq, M.T. *op.cit*

⁸ Statement of Mr. Bolaji Shenjobi, the President, Money Market Association of Nigeria <www.proshareng.com/./singlenews.php> accessed on 26th August, 2011

Since banks have been at the fore front of the development of treasury management techniques both because of their own particular needs and because of their active involvement in advising businesses on treasury matters and selling hedging instruments to them,⁹ it is therefore apposite to consider the tax aspect of the common treasury transactions, derivative products and instruments in which a bank may typically be involved. This is done in five chapters with meaning of treasury management and treasury management through swaps in the banking sector following this introduction. The third chapter is on Tax Aspects of Swaps and Transactions in Treasury Management. Forward Rate Agreement is discussed in chapter four and conclusion drawn in chapter five.

2.0 MEANING OF TREASURY MANAGEMENT

Treasury management, according to Wale Adeyemi,¹⁰ is a centralised form of cash and funds management which is concerned with the continuous funding of the assets and liabilities of banks and other financial institutions. Treasury management refers to a management of enterprises, holding in trading in government and corporate bonds, currencies, financial future options and derivative payment systems and the associated financial risk management¹¹.

Treasury management and treasury operation are further defined in Wikipedia¹² as signifying the management of an enterprise's holding, trade activities in bonds, currencies financial derivatives, and associated financial risk management.

According to Bolaji,¹³ treasury management functions in management of cash flows in all currencies, managing balance sheet, the foreign position and trading for profit as well as marketing for mobilizing deposit for the bank. Therefore, risk exposure management and asset liability management are the two major areas of treasury management.

Under risks management, banks are exposed to risk of credit with counter parties' inability to meet their obligation coupled with other risks associated with volatility of interest rates due to the instability in the interest on loan facilities.

⁹ Christopher, F. And Miles, W. *Taxation and Banking*, (London, Sweets and Maxwell, 1990), p.169.

¹⁰ The Chairman Chartered Institute of Bankers of Nigeria, Lagos branch <www.proshareng.com/./singlenews.php> accessed on 26th August, 2011.

¹¹ <www.investordictionary.com> accessed on 25th August, 2011.

¹² <en.wikipedia.org/wiki/Treasury_management> accessed on 25th August, 2011.

¹³ Bolaji S. <www.proshareng.com/./singlenews.php> accessed on 26th August, 2011.

2.1 TREASURY MANAGEMENT THROUGH SWAPS IN THE BANKING SECTOR

The importance and value of a business, in adequately managing its interest rate and foreign currency exposure, has been recognized in recent years by the emergence of a treasury function within many international businesses, including banks¹⁴. Interest rate swaps agreement, currency swaps amongst which are currency gain and losses; trading and non trading transactions are amongst the commonest issues in the treasury management in the banking sector. While some of these treasury management activities are taxed based on charge on income, others are taxed based on trading expense.

2.1.1 Categories of Swaps

a) Basis Swap

A basis swap is an interest rate swap which involves the exchange of two floating rate financial instruments. A basis swaps function as a floating interest rate swap under which the floating rate payment are referred to different bases¹⁵. The major characteristic of this type of swap is the combination and exchange of two financial instruments for the calculation of the interest rate.

b) Conditional Variance Swap

A conditional variance swap is a type of swap derivative finance product that allows investors to take exposure to volatility in the price of an underlying security only, while the underlying security is within a pre-specified price range¹⁶. In essence, conditional variance swap encourages easy hedging and therefore very attractive in treasury management.

c) Constant Maturity Swap

Since duration of received flows on swap constantly affects the yielding curve of interest rate, constant maturity swap most times allows the purchaser to fix the duration of received flows on a swap. This is also an interest rate swap where the interest rate on one leg is reset periodically, but with reference to a market swap rather than LIBOR. Constant maturity swap can either be single currency or cross currency swaps¹⁷.

d) Correlation Swap

This is an over-the-counter financial derivative that allows one to speculate on or hedge risks associated with the observed average correlation of a

¹⁴ Abdulrazaq, M.T. *op.cit*

¹⁵ <en.wikipedia.org/wiki/currencyswap> accessed on 20th August, 2011.

¹⁶ Ibid.

¹⁷ Ibid.

collection of underlying products, where each product has periodically observable prices, as with a commodity exchange rate, interest rate, or stock index¹⁸.

e) **Credit Default Swap**

In some circumstances, a default may occur on the part of a buyer or receiver of a loan facility from a bank. In order to guard against this, the law allows a credit default swap, once there is an insured buyer. Therefore, a credit default swap is a form of insurance that protects the buyer of the credit default swap in the case of a loan default. If a borrower defaults, the lender, who has sought traditional insurance, can exchange or 'swap' the defaulted loan instrument for money, usually the face value of the loan. In this wise, the buyer of the credit default swap makes a series of payments to the seller and, in exchange, receives a payoff if the loan or any credit instrument named in the contract or bond defaults, creating a credit event¹⁹.

f) **Dividend Swap**

This is an over-the-counter financial derivative contract. It consists of a series of payments made between two parties at defined intervals over a fixed term (e.g., annually over 5 years). One party, the holder of the fixed leg, will pay its counterparty a pre-designated fixed payment at each interval. The other party, the holder of the floating leg, will pay its counterparty the total dividends that were paid out by a selected underlying which can be a single company, a basket of companies or all the members of an index. The payments are normally multiplied by a national number of shares²⁰.

g) **Equity Swap**

Equity swap is a financial derivative contract where sets of future cash flows are agreed to be exchanged between two counter parties at set date future. The two cash flows are usually referred to as legs of the swap. One of these legs is usually pegged to a floating rate such as LIBOR. This leg is also commonly referred to as the floating leg. The other leg of the swap is based on the performance of whether a share of stock or a stock market index. This leg is commonly referred to as equity leg. Most equity swaps involve a floating leg against an equity leg, although some exist with two equity legs. An equity swap involves a national principal; a specified tenor and pre-determined payment intervals. Equity swaps are typically traded by Delta one trading desk²¹.

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ <en.wikipedia.org/wiki/currency.swap> accessed on 20th August, 2011.

²¹ Ibid.

h) Forex Swap

Forex swap is a simultaneous purchase and sale of identical amount of currency for another with two different value dates. A forex swap consists of two legs, that is, a spot foreign exchange transaction and forward foreign transactions.²² Invariably, two currencies are being purchased and swapped in forex swap exercise.

i) Inflation Swap

Inflation swap is the linear form of inflation derivate and over-the-counter and exchange traded derivatives that are used to transfer inflation risk from one counter party to another.²³

j) Total Return Swap

It is a financial contract that transfers both credit risk and market risk of an underlined asset. One of the advantages of total rate swap is that it allows one party bank (B) to derive the economic benefit of owning an asset without putting that asset on balance sheet, and allow the other bank (A) which does retain that asset on balance sheet to buy protection against loss in its value²⁴. The simple implication of this is that while the one party bank benefits from the asset without necessarily putting such asset on their balance sheet, the other party also benefits due to the protection it has against the loss in the value of the asset.

k) Variance Swap

Variance swap is an over-the-counter financial derivative that allows one to speculate on or edge risk associated with the magnitude of movement, i.e., volatility of some underlined products like an exchange rate, interest rate or stock index²⁵.

l) Volatility Swap

Volatility swap is a forward contract on the future realized volatility of a given underlined asset. Volatility swap allows investor to trade the volatility of an asset directly much as they will trade a price index unlike a stock option whose volatility exposure is contaminated with its stock price dependence. These swaps provide pure exposure to volatility alone²⁶.

m) Interest Rate Swap

An interest rate swap is a derivative in which one party exchanges a stream of interest payments for another party's stream of cash flow. Interest rate swaps can be used by hedgers to manage their fixed or floating assets and

²² Ibid.

²³ Ibid.

²⁴ Ibid.

²⁵ Ibid.

²⁶ Ibid.

liabilities. They can also be used by speculators to replicate unfunded bond exposures to profit from changes in interest rates. Interest rate swaps are very popular and highly liquid instruments²⁷.

n) Currency Swap

A currency swap is a foreign-exchange agreement between two parties to exchange aspects (namely, the principal and interest payments) of a loan in one currency for equivalent aspects of an equal-in-net present value loan in another currency²⁸. A currency swap is motivated by comparative advantages. Furthermore, currency swaps are over-the-counter derivatives, and are closely related to interest rate swaps. However, unlike interest rate swaps, currency swaps can involve the exchange of the principal.²⁹

Transactional Analysis of Currency Swaps

Currency swap is a process whereby an effort is made to have access to the cheapest sources of fund in the market. The major commercial basis for a currency swap is that it gives room to the accessibility of the cheapest sources of funds for the swapping exercise in the market place.

One of the ways currency swaps can exchange loan is where only the principal is exchanged with the counter party in the future rate at a specified rate agreed present. This type of agreement performs a function equivalent to a forward contract or futures³⁰. Not only that, currency can be swapped if there is a combination of the exchange of loan principal with an interest rate swap. In such a swap, interest cash flows are not meted before they are paid to the counterparty (as they would be in vanilla interest rate swap) because they are denominated in different currencies. This type of swap is also known as a back-to-back loan³¹.

Furthermore, at times, only interest paid for cash flow on loans of the same size and term may be swapped, for example if there is an exchange of a fixed rate of US dollar interest payment for floating rate interest payment of Naira, this clearly between different denomination and it's called a cross currency interest rate swap.

Chiefly amongst the reasons for currency swap are to secure and have access to cheapest source of funds in the market place. In other words, currency swap is an effort to secure cheaper debt by borrowing the best available rate, regardless of currency and then swapping for debt in desired currency using a

²⁷ Ibid.

²⁸ <<http://www.finpipe.com/cutrrswaps.htm>> accessed on 20th August, 2011.

²⁹ Ibid.

³⁰ <<http://www.finpipe.com/cutrrswaps.htm>> accessed on 20th August, 2011.

³¹ Ibid.

back-to-back loan and to have the opportunity of hedging against (procedure exposure to) exchange rate³².

3.0 TAX ASPECTS OF SWAPS AND TRANSACTIONS IN TREASURY MANAGEMENT

i. Swaps

At times, swap transaction can be complicated because of series of counter parties involved and, or due to the tax jurisdictions. However, in an effort to exploit different interest rates across markets and between the fixed and floating rates as well as across borrowers and between different types of borrowing, a contractual arrangement for exchange of interest cash flows, relating to a notional principal sum for a fixed period of time, is usually entered into. This exercise, according to Abdulrazaq,³³ can significantly reduce the finance cost of the counter parties to the swap.

Under the rate swap, there are two basic ways of obtaining reliefs. The first way is by obtaining on the basis that the rate swap payment is a charge of income. Alternatively, relief can also be sought on the basis that the swap payment is a trading expense. To get relief in the former, the payment must be contractual recurrent. In essence, such finance must be incurred not for the purpose of the company's trade³⁴. And to secure relief in the latter form, the payment must have been incurred by a trading company in the course of its day to day trade before such could be allowed as a trading expense.

Tax Implications

In the circumstances where swap payments are allowed as a mere charge, the withholding tax must be deducted from the payment made. However, in a situation where the payment is either paid by or to Nigerian bank acting as principal in the ordinary course of its banking business or a Nigerian swaps dealer, acting as principal in the ordinary course of its swaps dealing business, such payment may be paid grossly. In a nutshell, where swap payments are allowed as a charge, they are subject to the usual rule that withholding tax must be deducted from the payment made³⁵. Otherwise, in all other circumstances, tax should be deducted at source, unless the payor is exempted under the terms of a

³² Ibid.

³³ Abdulrazaq, M.T. *op.cit*

³⁴ Not only that, according to the Court in *IRC vs White Worth Pank Cole Co.Ltd.* 38 TC 531, the payment will constitute an annual payment.

³⁵ Abdulrazaq, M.T. 'Treasury Management'.

relevant tax treaty and the requisite clearance has been obtained from the FIRS International Tax Division³⁶.

ii. **Transactions in Treasury Management**

First, it is pertinent to know that in Nigeria today, there is no tax law that allows for the substance of transactions to override their form save there are exceptional circumstances. Therefore, as rightly observed by Professor M.T. Abdulrazaq,³⁷ in order to determine the tax implication on swapping exercise in the treasury management, a fragmentation analysis of each part of transactions will be the best option for better appreciation of the tax aspect of the businesses in the treasury management.

a) **Compensatory Payment Transactions**

Difference in interest rate is vital to the computation of compensatory payment between the counterparties. The compensatory payments are usually regarded as trading deductions or charges since they are not made in respect of an underlying debt of the payor and therefore, do not therefore constitute payments of interest for tax purposes³⁸.

b) **Currency Gains and Losses Transactions**

At the onset of a currency swap, what counterparties did was merely to swap their debt obligations; therefore, there is no currency effect. But if it is on the reversal of swap, then a foreign currency gain or loss may be realized. A borrowing is only treated as having effectively been converted into a liability in the second currency for the duration of the swap. However, on maturity, if the currencies are swapped back at the spot rate of exchange prevailing at the commencement of the swap, and a currency other than naira is acquired and used to repay a currency borrowing, there will be a gain or loss on the disposal of the currency acquired in repaying the currency borrowing.³⁹

Therefore, for the duration of the swap, the Federal Inland Revenue Service will usually accept that the borrowing, which generated the currency that was swapped into another currency, gives rise to a matched position. For that, the consideration on disposal of the currency acquired for capital gains tax purposes is the current market value in naira tens of the borrowing being repaid.

³⁶ Ibid.

³⁷ Abdulrazaq, M.T. *op.cit*

³⁸ See *Re Euro Hotel (Belgravia) Ltd.* (1975) STC, 682.

³⁹ Abdulrazaq, M.T 'Treasury Management'.

3.1 OTHER FINANCIAL OPTIONS TRANSACTION

Financial options are contracts that give the right but not the obligations to purchase (call) or sell (put) an agreed amount of a financial instrument at a particular price (known as the strike price) for a particular length of time. Generally, options may be exchange traded or it may be specifically written by bank otherwise known as over-the-counter options. A good example of the option that consists of exchange traded is the Nigerian Stock Exchange, Chicago Futures Exchange and London International Financial Future Exchange (LIFFE).

Similarly, options may also be on currencies, financial futures, commodities or any other financial instrument or security⁴⁰. When an option is over-the-counter option that is written specifically by a bank, the profits or losses arising from them are normally taken into account for the purpose.

a) Trading Transaction

Whether or not a company which deals in options for profit will be assessed on its profit or will depend on whether its dealings amount to a trade. If an option is acquired by a trader as a hedge incidental to a trading activity, the expenses of acquisition and exercise of the option may be deductible for tax purposes as a trading expense. Exceptionally, however, a bank may acquire options which are intended to hedge capital transactions. In such circumstances, the profits or losses arising on options will be taxed as capital profits or losses.

A hedge will be identified with an underlying transaction where the options economically appropriate to the reduction in risk of the underlying transaction, asset or portfolio. But the price fluctuations of the option must be directly and demonstrably related to the fluctuations in value or composition of the underlying transaction, asset or portfolio, at the time the hedging transaction is initiated. Thus treatment will apply where the hedge is clearly attributable to a trading activity but the onus to prove this is upon the taxpayer⁴¹.

Where dealings in options fall to be taxed under the profit or loss should be computed on a realisation basis. This is because, for tax purposes, neither a profit nor a loss should be anticipated. On the other hand, where contracts, which are open at the end of an accounting period, are brought into account at their market value ('marked to market'), the Federal Inland Revenue Service will generally allow such unrealized and hence anticipated profits or losses to be taken into account for tax purposes. However, it will be necessary to satisfy the Federal

⁴⁰ Ibid.

⁴¹ Ibid.

Inland Revenue Service that both profits and losses are to be recognized and that the same treatment will be applied consistently from year to year⁴².

b) Non-Trading Transactions

The capital gains tax treatment of exchange traded and other qualifying options is as follows:

1. If the option moves out of the money, it will not be exercised and its holder will be treated as abandoning it on the last possible exercise date. This gives rise to an allowable loss equal to the premium paid for the option, together with any other incidental cost and indexation allowance⁴³.
2. If, on the other hand, the option is exercised, the acquisition of the option and the transaction entered into on its exercise are treated as a single transaction. Thus, relief for the premium paid for the option is given only when the underlying transaction is closed out⁴⁴. Thus, the costs of a call option, say, on equity, will be added to the cost of the shares. It will be allowed when the shares are ultimately disposed of.

Similarly, the cost of a put option will be regarded as an addition to the allowable expenditure on the shares sold under the put option at the option's strike price. The strike price will be the sales consideration on disposal. In each case, the capital gains tax indexation allowance will run on the option premium from the date of acquisition of the option and will also run on the acquisition cost of the underlying asset from the date the asset is acquired⁴⁵.

Where, exceptionally, an option is written otherwise than as part of the grantor's trade, the grant of the option will rank as a disposal giving rise to a gain equal to the premium received less the incidental cost⁴⁶. Therefore, if the option is not exercised, no further gain or loss will arise. If the option is exercised, its grant and its exercise must be treated as a single transaction and the premium received on the grant will be brought into the computation of the gain or loss arising when the acquired asset is ultimately disposed of⁴⁷. Any tax previously paid in respect of the grant of the option may be repayable⁴⁸.

⁴² Ibid.

⁴³ See Capital Gains Tax Act, 1979.

⁴⁴ Ibid.

⁴⁵ Abdulrazaq, M.T. 'Treasury Management'.

⁴⁶ See Capital Gains Tax Act, 1979.

⁴⁷ Abdulrazaq, M.T. *op.cit*

⁴⁸ See Capital Gains Tax Act, 1979.

4.0 FORWARD RATE AGREEMENT

Forward rate agreement is a form of contract with a bank in order to provide for a compensatory payment to be made calculated according to a notional amount of principal at a fixed interest rate for a fixed period. In other words, Forward Rate Agreement is simply an interest rate management technique.

The logic behind forward rate management is to protect either parties from unexpected increase or decrease in interest rates. So, if at the beginning of the relevant future period, prevailing interest rates have increased beyond the agreed interest rate for a borrowing, the seller of FRA will compensate the purchaser for the excess and if, however, interest rates fall below the agreed rate, the purchaser will compensate the seller for the shortfall.⁴⁹

Tax Implication

There is no indebtedness between the parties to an FRA, compensatory payments under tax implication, although computed by references to interest rates are not themselves interest. Neither FRAs are generally short-term agreements, nor are they annual payments. Banks and other financial institutions will normally treat FRA compensatory receipts payment as trading items for tax purposes. This is because they will either have sold the FRA in the course of their trade or used the FRA as a tool of interest rate risk management.

Similarly, non-financial trades will generally be able to treat FRA compensatory payments and receipts as trading items where the FRA is used to hedge the cost of circulating capital. The same criteria as those for futures and options are applied to establish whether or not a hedge exists. This means that there must be a direct and demonstrable relationship between the FRA and the circulating capital being hedged. In other circumstances, FRAs will generally be taxed under the capital gains tax regime.⁵⁰

⁴⁹ For example, assuming that on January 1, a company knows that it will need to borrow N 10 million for 6 months from July 1 it wishes to protect itself against any rise in interest rates between January 1 and July 1 beyond the prevailing level of 13 %. It therefore purchases an FRA from a bank for a period of six months commencing on July 1, based on a notional principal of N10m and an agreed interest rate of 13%. On July 1, the company will borrow N10m required and will not necessarily borrow from the seller of the FRA because the FRA is entirely independent of the unending debt. If the prevailing interest rate is then 14%, per annum, the seller of the FRA will pay the company an amount equal to the excess interest (1% per annum) on the notional FRA principal N10m for the agreed period (6 months). In this case a compensatory payment of the present value of N50,000 will be received by the company on July 1. If, on the other hand, the interest rate prevailing on July 1 is 12%, the company will pay compensation to the seller of the FRA, amounting to the present value of N50,000 at July 1.

⁵⁰ Christopher, F. and Miles, W. *Taxation and Banking*, (London Sweet and Maxwell, 1990). p. 182.

4.1 INTEREST RATE GUARANTEES

An Interest Rate Guarantee is an 'over-the counter' agreement made between a bank and its customer to hedge against an unfavourable movement in interest rates but without fixing any particular rate. In substance, such a guarantee is an interest rate option.⁵¹

Tax Implication

The tax treatment of interest guarantees is similar to the FRA. Therefore, where the company concerned is a bank or other financial institution, any profit or expenditure will surely be of trading nature. For other circumstances, the tax treatment will depend on the specific circumstances and the reasons for the transaction. Thus, if an IRG is used to hedge a particular transaction, asset or portfolio, the tax treatment of the IRG will follow that of the transaction, asset or portfolio concerned.

If, on the other hand, the IRG was purchased to protect the company against adverse interest rate movement pending a bond issue, or as part of a change in its investment strategy, the IRG would be taxed as a capital transaction even though it is not a hedging transaction. Where, however, the company used IRG incidental to its trading activities, profit or loss on the IRG will form part of its profits or losses⁵².

4.2 CURRENT NIGERIAN BANKING SITUATION

The Nigerian banking institution doubles as the intermediary in the treasury management activities and certain fees are laid down to be paid to the bank and even other players engaging in the setting up of swap transaction which will constitute trading income in their hand and which must be taxed accordingly, however, the recent trends as regards the law and practice on swapping rates in Nigeria did not adequately provide for the benefit of the players, especially the intermediaries in the swapping business. This is so because presently, there is no strict tax deduction guideline on most of the products. The solution to this

⁵¹ For example, in consideration of a premium received, a bank may guarantee that a future borrowing rate will not exceed 23%. If the rate does exceed 23% at the guarantee date, the bank will pay the customer the payment value of the difference. If the rate is below this at the guarantee date, the customer will abandon the guarantee and borrow at the lower rate. Hence, the contract is an interest rate option. Sometimes, these contracts are called interest rate caps if they are for long periods. Equally, a customer may purchase a guarantee that interest rates will not fall below a set level (a floor agreement) or by combining cap and floor agreements, the customer may obtain a guarantee that interest will stay within a predetermined band. Such a combination of options is called a 'collar'. See Christopher, F. and Miles, W. *Taxation and Banking*, (London Sweet and Maxwell, 1990), p.182, it is also imperative to note that, Swaps, FRAs and IRGs are independent of the financial arrangements to which they relate. They need not be purchased from banks involved in the underlining transactions.

⁵² Christopher, F. and Miles, W. *Taxation and Banking*, (London Sweet and Maxwell, 1990), pp.182-183.

according to M.T Abdulrazaq is to remunerate the swap intermediary in some other way for its role in the swap business in order to obtain the necessary taxable deductions.⁵³

5.0 CONCLUSION

Adequate fund management and control of cash is the zenith reason for Treasury Managements. However, since this activity is tantamount to financial transaction, there is the need for tax deduction. Unfortunately, presently in Nigeria, strict tax deduction guidelines on most of the products are not available; hence, the problem associated with arrangement fee on the swap products. Due to lack of clear guidelines, both the bank and some other intermediaries are not adequately compensated. The resultant effect of all these are loss of revenue generation to the nation, impunity breach of the law and series of ambiguous charges by banks while engaging in the treasury-management activities.

Furthermore the fragmentation analysis of some of the trading and non-trading swapped transaction done in this paper clearly shows that if a company deals in options for profit, such company will be assessed on its profit. Alternative, if an option is acquired by a trader as a hedge incidental to a trading activity, the expenses of acquisition and exercise of the option may be deductible and exercise of the option may be deductible for tax purposes as a trading expense. Exceptionally, however, if a bank acquired options, which are intended to hedge capital transactions, the profits or losses arising on options will be taxed as capital profits or losses.

On non trading transaction, the paper argues that, if the option moves out of the money, it will not be exercised and its holder will be treated as abandoning it on the last possible exercise date, but if, on the other hand, the option is exercised, the acquisition of the option and the transaction entered into on its exercise are treated as a single transaction and the relief for the premium paid for the option is given only when the underlying transaction is closed out. Similarly, if the option is exercised, its grant and its exercise must be treated as a single transaction and the premium received on the grant will be brought into the computation of the gain or loss arising when the acquired asset is ultimately disposed of. This will allow for any tax previously paid in respect of the grant of the option to be repayable.

In conclusion, for easy and clear determination of the fee and remuneration of the intermediaries and other players in the treasury management and swap activities, it is high time the Nigerian banking legislation and the

⁵³ Abdulrazaq, M.T. *op.cit*

Companies Income Tax law be overhauled to provide specific percentage of chargeable fee as a clear remuneration for the intermediaries in the swapping activities in the Nigerian banking industry.