KPMG

Nigerian Startup Act

An exciting dawn for Nigerian startups ecosystem

October 2022

His Excellency, President Muhammadu Buhari, GCFR, signed the Nigeria Startup Act, 2022 ("the Act") into law on 19 October 2022, following its passage by the National Assembly. The Act provides the legal and institutional framework for the development and operation of startups in Nigeria, positioning Nigerian startup ecosystem as the leading digital hub in Africa and fostering the development of technology-related talent in the country.

The Act is divided into ten (10) parts, which address four (4) key areas that technology entrepreneurs contend with: capital, regulations, infrastructure and talent. Importantly, the Act avoids the issue of applicability and coverage by clearly delineating the requirements for registration and licensing or labelling of startups, eligible to enjoy the stipulated wide-reaching incentives.

In addition, the Act introduces specific provisions aimed at reforming identified onerous legal, regulatory, tax and administrative bottlenecks which have hindered the operations of startups in Nigeria. This should encourage the inflow of investment into the sector, improve the Nigerian business and economic landscape, and serve as a big boost to the Ease-of-Doing-Business campaign of the Federal Government.

We have highlighted below some of the key provisions of the Act along the thematic areas for ease of understanding:

1. Establishment of the National Council for Digital Innovation and Entrepreneurship

Section 3 of the Act establishes the National Council for Digital Innovation and Entrepreneurship ("the Council"), consisting of the President as the chairman, the Vice-President as the vice-chairman, the Minister for Communications and Digital Economy, who will preside over the Council in the absence of the President and the Vice-President. The other members of the Council include the Minister of Finance, Budget and National Planning, the Minister for Industry, Trade and Investment, the Minister for Science, Technology and Innovation, the Governor of the Central Bank of Nigeria, four (4) representatives of the Startup Consultative Forum, and one representative each from the Nigeria Computer Society and Computer Professionals (Registration Council of Nigeria). The Director of the National Information Technology Development Agency will serve as the Secretary of the Council. The tenure of members that are not ex officio is 2 years and this is renewable for another term of 2 years only.

The Council, which shall be a body corporate, will be responsible for formulating and providing policy guidelines for the realization of the objectives of the Act. The Council will also approve programs, monitor the implementation of its policies and programs, and provide support to individuals, universities, and research institutions carrying out postgraduate research in the areas of science, technology and innovation. It is empowered to appoint an Agent that will carry out its general or specific directions and provide it with quarterly monitoring and annual reports with respect to the program being implemented pursuant to the Act.

2. Secretariat of the Council

Section 9 of the Act designates the National Information Technology Development Agency (NITDA) as the Secretariat of the Council ("the Secretariat"), to be headed by the Director General of NITDA.

The functions of the Secretariat include:

i. Managing the process of labeling startups, maintaining directory of startups, incubators, and accelerators, and establishing platforms (online or otherwise) to provide necessary information

on startups, incubation, acceleration, and other programs.

ii. Collaboration and partnership with Government Ministries, Departments, and Agencies, local and international business incubators, accelerators, digital innovation hubs, angel investors, venture capital firms, private equity firms, financial institutions, and other financial bodies to facilitate and promote digital technology and startups in Nigeria.

iii. Supporting local digital technology research, financing and commercialization. In this instance, the Secretariat will collaborate with the National Universities Commission, National Board for Technical Education and other Technical Education and tertiary institutions regulatory bodies to promote innovation and provide adequate facilities for digital technology research in Nigerian Universities, Polytechnics, and research institutes.

iv. Ensuring the implementation of the National Digital Innovation, Entrepreneurship and Startup Policy (NDIESP).

v. Developing guidelines and incentives for establishing digital technology innovation hubs, digital technology parks and community enterprise hubs in Nigeria.

vi. Reviewing proposals, policies and programs on behalf of the Council and advising it on issues affecting startups, digital technology innovation entrepreneurship, and other matters relating to the Act.

The Secretariat, with the approval of the Council, will setup a *"Startup Support and Engagement Portal"* to register startups with the relevant ministries, departments, and agencies (MDAs). The portal will provide access to permits and licences, funding programs, government contracts, information exchange, resources and relevant training programmes, registration of local and international intellectual property for startups and assistance in case of legal actions on infringements.

Further, the Secretariat is charged with the responsibility of establishing a *"Startup Consultative Forum"* made up of Labelled Startups, venture capitalists, angel investors, the Nigeria Computer Society, civil society organizations involved in advancement of technology and innovation, and incubation, accelerators, and innovation hubs. The forum will provide startups with necessary information required to carry out their business and take advantage of government incentives.

3. Registration of Labelled Startups

Section 13(2) of the Act defines *"Labelled Startups"* as registered limited liability companies with less than 10 years from incorporation, or registered sole proprietorships or partnerships involved in innovation, development, production, improvement and commercialization of digital technology products or processes. The Act also requires that 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.

Further, eligible sole proprietorships or partnerships will be granted a pre-label status for a period of six (6) months to allow them time to incorporate. Failure to do this will result in the withdrawal of the pre-label status.

Eligible entities are required to apply for labeled status on the startup portal in a prescribed form and pay the fee prescribed by the Secretariat. Upon the approval by the coordinator of the startup portal ("the Coordinator") that the relevant information and conditions have been fulfilled, the applicant will be issued a "startup label" and included in the register of startups held with the Secretariat. The startup label shall be valid for a period of 10 years from the date of issuance.

A Labelled Startup is required to comply with Nigerian business laws, including providing information on human resources, total assets, annual turnover and advancements made as a result of incentives received. Other obligations include maintaining proper books of accounts, notifying the Coordinator of changes to its business structure and/or composition within a month of the change, and other information as maybe be required by the Secretariat for startups.

On notification of any default by the Coordinator, the defaulting startup has 30 days to rectify the issue, failing which the Secretariat will withdraw the startup's labelled status pending the resolution of the noted issue. Thereafter, the defaulting startup may re-apply to the Secretariat to re-issue the startup label.

4. General Incentives for Startups

i. Financing of Startups

Based on the provisions of Section 19 of the Act, a *Startup Investment Seed Fund ("the Fund")* will be established by the Council, to be managed by the Nigeria Sovereign Investment Authority (NSIA or "the Authority"). The Act provides that the Council shall finance the Fund annually with at least ₦10 billion from sources to be approved by it.

The Fund Manager will provide regulations on the modalities for funding, managing and accessing the Fund, and creating an innovation grant budget and management framework to support research and developmental projects.

Further, Section 28 of the Act requires the Secretariat to set up a *Credit Guarantee Scheme* to provide access to financial and credit support to Labelled Startups.

Separately, the Act mandates the Secretariat to ensure that Labelled Startups have access to Government grants, loans and facilities administered by the Central Bank of Nigeria (CBN), the Bank of Industry (BOI) or other bodies statutorily empowered to assist small and medium scale enterprises and entrepreneurs.

ii. Protection of Intellectual Property Rights The Act provides for a section of the startup portal to be designated to ease local and international registration of intellectual property for startups and provide startups with necessary assistance in case of legal actions on infringements. In addition, the Secretariat is required to put measures in place to prevent the infringement of the intellectual property rights of Labelled Startups and ensure their commercialization and internationalization.

iii. Transfer of Foreign Technologies

The Act mandates the National Office for Technology Acquisition and Promotion (NOTAP) to prioritize applications from Labelled Startups, grant discounts to Startups on their registration fees and provide technical assistance to them to commercialize their research results.

iv. Listing of Startups

Section 36 of the Act requires the Council to provide all necessary assistance to Labelled Startups to enable them meet up with the eligibility requirement to become listed on the Nigerian Exchange Limited (NGX), or on similar stock and commodity exchanges operating in Nigeria.

v. Repatriation of Capital and Profits

Section 37 of the Act requires the Secretariat to collaborate with the CBN to guarantee repatriation of investments by foreign investors in a Labelled Startup through authorised dealers. The rate of conversion will be the official rate, provided that the investor presents a Certificate of Capital Importation evidencing that the initial investment fund was brought into Nigeria through official channels.

vi. Establishment of Technology Development Zones

Section 42 of the Act provides for collaboration between the Secretariat and the Nigeria Export Processing Zones Authority to establish a Technology Development Zone ("the Zone") to spur the growth and development of startups, accelerators, and incubators.

Startups, accelerators, or incubators situated in the Zone will be entitled to existing incentives provided under the Nigeria Export Processing Zones Act including tax exemption for life, non-applicability of the FX regime administered by the CBN, exemption from import duties, etc.

vii. Access to Export Facilities

Labelled Startups involved in the exportation of products and services deemed eligible under the Export (Incentives and Miscellaneous Provisions) Act, will be entitled to export incentives and financial assistance from the Export Development Fund, Export Expansion Grant and the Export Adjustment Scheme Fund.

viii. Collaboration amongst Regulatory Bodies and Startups

To optimize the regulatory hurdles encountered by Startups, Sections 30 to 37 of the Act provide for collaboration between the Secretariat and agencies of government such as the Corporate Affairs Commission to optimize business registration process, the Nigerian Copyright Commission, Trademarks, Patent, and Design Registries to protect the copyrights of Labelled

Startups, and NOTAP to ease technology transfer process.

Collaborations with CBN and Securities and Exchange Commission will also assist in easing crowdfunding process, facilitate licensing for Financial Technology Startups, and repatriation of capital and profits for startups with foreign investment.

ix. Provision for Accelerator and Incubation Programs

Section 38 of the Act provides for the establishment of National accelerator and incubator programs that will grow the startup ecosystem. These incubators will help startups to resolve operational challenges and serve as breeding hubs for the startups. The Act requires the Secretariat to develop standards and guidelines to regulate the interactions and collaborations between startups, accelerators and incubators. The Secretariat will also maintain a register of active accelerators and incubators who shall be entitled to grants under the NDIESP

x. Training, Capacity Building and Talent Development

Sections 21 and 22 of the Act provide for training, capacity building and development of Labelled Startups by establishing digital technology acquisition centres across the six geopolitical zones in Nigeria. These centres will assist with talent development through collaboration with relevant agencies, the private sector, and supporting the activities of related academic research institutions.
The Act also mandates the Secretariat to partner with the Industrial Training Fund (ITF) to facilitate training programs for startup entrepreneurs and their employees.

5. Tax and Fiscal Incentives

a. Pioneer Status Incentive

Labelled Startups operating in eligible industries under the Pioneer Status Incentives (PSI) Scheme may apply through the Secretariat to the Nigerian Investment Promotion Commission (NIPC) for grant of tax reliefs and incentives under the PSI. If granted, this would entitle the Labelled Startup to a tax holiday for an initial period of three years, which may be extended for an additional two years. The effective date for the PSI reliefs and incentives will be the date of issuance of the startup label.

b. Exemption from Contribution to ITF

Section 25(5) exempts Labelled Startups from contributions to ITF in respect of in-house training provided to their employees for the duration of the startup label.

b. Other Stakeholder-related Incentives

i. Investors

Angel investors, accelerators, and venture capitalists are entitled to an investment tax credit equivalent to 30% of their investment in a startup. The credit 'shall' be applied on any gains on investment, which are subject to tax. Interestingly, the Act specifically amends only the Companies Income Tax Act in this regard, leading to a presumption that angel investors who invest without using a company may not be eligible to enjoy this incentive.
The Act also exempts angel investors, venture capitalists, private equity fund, accelerators or incubators from capital gains tax when they dispose of their investment in a Labelled Startup provided that the assets have been held for a minimum of 24 months. Since this is a specific and a later-in-time provision, the ₦100m threshold imposed by the Finance Act, 2021 will not apply. However, where the investment is sold within 2 years, the capital gains tax payable shall be reduced by the amount of investment tax credit.

Commentary

We commend the President, the National Assembly and the Nigerian technology startup ecosystem that facilitated the realisation of this initiative. The Act highlights the efficacy of sectoral advocacy in motivating business-friendly legislative changes that can improve Nigeria's competitiveness, create employment opportunities, and spur inclusive economic growth.

In addition to providing the much-needed structure required to register and regulate the players in the booming digital and technology business sector, the Act has a laudable aspiration of incentivizing startups and empowering them to realise their potential to become national, African, and possibly global behemoths. The recent successes of some homegrown firms, which have achieved unicorn status (a valuation of USD1 billion or more) without much government support, strengthen the argument that the Act would help to ensure that Nigeria produce more unicorns or even decacorns in the years ahead.

However, the ability of the Act to achieve its stated objections will depend on the effective and practical implementation of its relevant provisions. There are some provisions of the Act which may require revision to avoid repeating the same issues the Act sought to address:

i. The Council has representation from the highest levels of the Executive Branch, including the President, the Vice-President and many members of the Federal Executive Council. Whilst this may work to expedite the resolution of issues relating to the Act, it is doubtful if the members of the Council will have the time and bandwidth to effectively exercise oversight of the Secretariat. Further, the Act empowers the Council to perform any function that may ensure the efficient performance of the Secretariat and other bodies established under the Act. Hopefully, this will not result in a duplication of the responsibilities of the Secretariat or constitute an impediment to the effective implementation of the Act.
More importantly, the Ministers on the Council would have some conflict of interest as the effectiveness of the MDAs they supervise may be brought into issue during the Council's deliberations, and their presence on the Council may impede objectivity. The composition of the Council may, therefore, need to be reviewed to strengthen its governance and independence as much as possible.

ii. The Act assumes that the Executive arm of Government has the powers to harmonize the laws to give effect to the objectives of the Act, by stating this as one of the functions of the Council. This may be mistaken, as only the National Assembly has the constitutional power to harmonize laws.

iii. The Act leverages existing structures and bodies by utilizing NITDA as the Secretariat and the NSIA as the Fund Manager to optimize the cost of implementation of the Act's objectives. However, it is doubtful whether the cost and likely effectiveness of the tax and fiscal incentives have been duly evaluated. This has become more critical now
than ever before given the revenue challenge that the country is currently facing. It is, therefore, imperative that an independent body be set up, either in the National Assembly or the Ministry of Finance, Budget and National Planning, to quantify the cost of any new incentive and the implications for government revenue.

iv. Under the Act, an investor in a Labelled Startup will be entitled to an investment tax credit of 30%, "provided that such credit shall be applied on any gains on investment which are subject to tax". The only scenario where the gains on investment will be subject to tax is when the investor disposes of the investment in less than 2 years. Consequently, where the investor holds on to the investment for at least 2 years, the gains on disposal will be tax exempt. However, the Act is silent on what will happen to the investment tax credit in this regard. Perhaps, Government can consider for the tax credit to be applied against the income tax due from the investors. Otherwise, the investment tax credit will become redundant.

v. While the *Startup Investment Seed Fund* is commendable, the sources of its financing are left painfully vague. It is hoped that Government will not impose additional levy on businesses in this regard. Currently, there is a NITDA Fund in which qualifying companies remit 1% of their profits before tax on an annual basis. A proportion of the amount in the Fund can be utilized for this purpose.

The Act appears to complement the objectives of the Presidential Enabling Business Environment Council in improving the investment climate and business environment in Nigeria. As the world is becoming increasingly global in its interactions, the Act is timeous to provide a framework that enables and scales initiatives in the tech ecosystem. The financing initiatives, investment and tax incentives provided in the Act should help to facilitate inflow of investments into Labelled Startups, create employment opportunities for young graduates and help to improve science and technological research by individuals, universities and research institutes in Nigeria. It is expected that the Act, when fully implemented, will address some of the administrative bottlenecks faced by startups and herald new possibilities for players in the digital and tech business ecosystem in Nigeria. However, implementation is key. It is also important that Government determine and quantify the cost of the stipulated tax incentives for effectiveness.

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