Analysis of the Nigeria Startup Act 2022

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Introduction

With the increase in foreign investments in technology and innovation driven startups, Nigeria has become a force in Africa's technology startup space. The Nigerian technology and startup ecosystem has experienced a significant boom, with funding coming from angel investors, private equity investors, and venture capitalists. With a large youth population, it is reasonable to project that Nigeria will continue to be influential in the African technology startup space for a while yet.

According to The Nigerian Startup Ecosystem Report 2022, at least 481 Nigerian technology startups are in operation in the country.[1] The majority of these technology startups are based in Lagos, which is Nigeria's commercial centre. These startups are supported by a strong investment ecosystem, with at least 383 individual Nigerian technology startups having raised a combined US$2,000,000,000 (Two Billion United States Dollars) in funding between January 2015 and August 2022. In the past 7 years, Nigeria has been the most popular investment destination in Africa as it has attracted the most investors in the startup space.[2] For example, Flutterwave, Jumia, Opay, Andela, Interswitch, Moove, Chipper Cash, and Trade Depot, among others, are some of the Nigerian startups that have been recognised in this respect. Google also recently announced that 60 African tech startups were shortlisted to receive funding from its US$4,000,000 (Four Million United States Dollars) Black Founders Fund (BFF), with 23 of them being Nigerian startups.[3]

In spite of these successful achievements, several Nigerian startups have failed for a variety of reasons. These reasons range from insufficient access to funding, lack of consistency in government policies at federal and state level, to infrastructural challenges. The *Nigeria Startup Act 2022* (the "**Act**") has been enacted to address some of these issues. We analyse the adequacy or otherwise of key provisions in the present piece.

Key Provisions in the Act

In terms of what the Act does, it creates a startup labelling process,[4] provides incentives for labelled startups,[5] and access to funding.[6] The Act also aims to create an enabling environment for startups through the establishment of a legal and institutional framework to drive policy in the startup ecosystem.[7] In particular, the Act establishes the National Council for Digital Innovation and Entrepreneurship (the "**Council**"). The Council, among other functions, will be responsible for formulating and providing general policy guidelines as it pertains to the administration of the Act, in addition to the harmonisation of laws and regulations that affect startups.[8] The National Information Technology Development Agency ("**NITDA**") is to serve as the Secretariat to the Council.[9]

The Act is applicable to all companies incorporated under the *Companies and Allied Matters Act 2020* ("**CAMA**") which have been granted the startup label under the Act. It also applies to every organisation and establishment whose activities affect the creation, support, and incubation of labelled startups in Nigeria.

Definition and Eligibility of Startups

The Act defines a startup as a company which has been in existence for not more than 10 years, with its objectives being the creation, innovation, production, development, or adoption of a unique digital technology innovative product, service, or process.[10] A startup must be labelled in accordance with the Act to benefit from the incentives and protections available under the law.[11] However, labelling is not a pre-requisite for carrying

[1] *The Nigerian Start-up Ecosystem Report 2022 & Full Start-up List* available at https://disruptafrica.gumroad.com/l/rflav.
[2] Ibid.
[3] *23 Nigerian start-upstart-ups selected for Google's Black Founders Fund cohort II*, see full list available at https://technext.ng/2022/09/06/black-founders-fund-nigeria-gets-23-in-60/.
[4] Section 13(1) of the Act.
[5] Section 13(6) of the Act.
[6] Section 19 and 27 of the Act.
[7] Section 3(1) of the Act.
[8] Section 7(1) of the Act.
[9] Section 9(1) of the Act.
[10] Section 47 of the Act.
[11] Section 13(6) of the Act.

on business as a startup in Nigeria. Upon satisfying the requirements for labelling under the Act, a startup label certificate will be issued.[12]

In order to obtain a startup label certificate, the startup must meet the following criteria:[13]

(i) It must be registered as a limited liability company under CAMA, and must have existed for a period not more than 10 years from the date of its incorporation;
(ii) Its objects must be innovation, development, production, improvement, and commercialisation of a digital technology innovative product or process;
(iii) It is a holder or repository of a product or process of digital technology, or the owner or author of a registered software;
(iv) It has at least 1/3rd local shareholding held by 1 or more Nigerians as founder or co-founder; and
(v) In the case of a sole proprietorship or partnership, it satisfies the preceding conditions in (ii), (iii) and (iv).

Given all the foregoing, it is clear that the startup label certificate will only be issued to companies which use digital technology to solve problems. This means that companies which do not use digital technology to provide solutions to problems are not eligible for a startup label certificate. In respect of sole proprietorships and partnerships, a 'pre-label status' will be granted for a period of 6 months to ensure ample time for compliance with the labelling requirements. This means that existing startups in the form of sole proprietorships and partnerships will be required to incorporate a company before they can be granted the startup label certificate. Where they fail to incorporate a company at the end of the 6-month period, the pre-label status will be revoked. It is not compulsory for the company to be wholly Nigerian-owned, as it is sufficient for a Nigerian founder or co-founder to own at least 1/3rd of the shareholding in a startup.

Institutional and Regulatory Framework

In addition to the Council which was established to formulate policies that affect startups, *inter alia*, and the empowerment of NITDA to function as the Council's Secretariat, the Act further mandates NITDA to set up a Startup Support and Engagement Portal (the "**Startup Portal**"), which is to serve as a platform through which startups can complete registration with relevant government agencies.[14] NITDA is also mandated to appoint a coordinator of the Startup Portal that will be responsible for maintaining the register of labelled startups and keeping their relevant documents and records. The Act also empowers NITDA to, on the directive of the Council, establish a Startup Consultative Forum,[15] whose composition shall comprise labelled startups, venture capitalists, angel investors, incubators, accelerators, and innovation hubs.

NITDA and the Corporate Affairs Commission (the "**CAC**") are required to collaborate and ensure that, in its design, the Startup Portal contains a platform through which labelled startups will be able to gain access and initiate transactions and filings with the CAC.[16] This collaboration between NITDA and the CAC further extends to ensuring that transactions and filings being carried out at the CAC are effected timeously.[17] NITDA is also mandated to liaise with the Trademarks, Patent and Design Registry, the Nigerian Copyright Commission, and the National Office for Technology Acquisition and Promotion (NOTAP) in ensuring that startups are able to easily process filings for relevant intellectual property and technology transfer rights through the Startup Portal.[18]

Where the business activities of a startup involve the use of financial technology or any other form of business activity that subjects them to the regulatory oversight of either the Central Bank of Nigeria (**"CBN"**) or the Securities and Exchange Commission (**"SEC"**), such startups are given the opportunity to jointly interact with these bodies through the Startup Portal. The Act also mandates the Council to collaborate with the CBN and SEC to ensure that new rules are brought to the notice of startups.[19]

[12] Section 13(1) of the Act.
[13] Section 13(2) of the Act.
[14] Section 10 of the Act.
[15] Section 12 of the Act.
[16] Section 30(1) of the Act.
[17] Section 30(2) of the Act.
[18] Section 31 and 33 of the Act.
[19] Section 34(2) of the Act.

Regulatory Compliance

Once labelled, the startup will be required to comply with the following conditions:[20]

(a) Compliance with all the extant laws governing businesses in Nigeria, and any other obligations issued by the coordinator of the Startup Portal after grant of startup label;

(b) Providing information annually on the number of human resources, total assets and the annual turnover achieved from the period the startup label was granted;

(c) Maintenance of proper books of accounts;

(d) Providing an annual report on incentives received and advancements made by virtue of the incentives;

(e) Notification of change in structure, composition or objects to the coordinator of the Startup Portal within a month of the change; and

(f) Such other obligations as may be set out by the coordinator of the Startup Portal after the issuance of the startup label.

Where the labelled startup fails to comply with the obligations set out above, it risks withdrawal of its startup label, and the relevant Ministries, Departments, and Agencies ("**MDAs**") that may have granted incentives to the startup will also be notified of such withdrawal.[21] The startup may, however, apply to the Secretariat of the Council to be reissued the startup label upon rectifying the default.[22]

Tax and Fiscal Incentives

a. *Incentives for Startups*

Once a startup has been duly labelled in accordance with the Act, it will be granted access to the incentives provided for under the Act.[23] Labelled startups are entitled to various tax and financial incentives under the Act. For example, 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 3 years and an additional 2 years under the terms of the pioneer status tax exemption scheme. However, this tax holiday only commences from the date of the issuance of the startup label certificate.[24] Where a labelled startup falls within the industries captured under the Pioneer Status Incentive ("**PSI**") Scheme,[25] it may receive expeditious approval from the Nigerian Investment Promotion Commission (**"NIPC"**) for the grant of the tax reliefs and incentives under the PSI Scheme upon application to the Secretariat of the Council.[26]

The Act further establishes a Credit Guarantee Scheme which will create a framework for credit guarantee to be extended to labelled startups, provide accessible financial support, credit information and financial management capacity building programmes.[27] Startups are also guaranteed access to grants and loan facilities administered by the CBN, the Bank of Industry, and other bodies statutorily empowered to assist Small and Medium-Sized Enterprises (SMEs) and entrepreneurs.[28]

Another way the Act seeks to provide support to labelled startups in Nigeria is through the establishment of the Startup Investment Seed Fund (the "**Seed Fund**"). The Seed Fund is to be managed by the Nigeria Sovereign Investment Authority ("**NSIA**") and at least ₦10,000,000,000 (Ten Billion Naira) is to be paid into it annually. This Seed Fund will provide early-stage finance to labelled startups and provide relief to technology laboratories, accelerators, incubators, and hubs.

[20] Section 16(1) of the Act.
[21] Section 17 of the Act.
[22] Section 18 of the Act.
[23] Section 13(6) of the Act.
[24] Section 25(2) of the Act.
[25] The PSI is designed to reduce the cost of doing business in Nigeria by providing corporate income tax relief to qualifying companies making investments in industries designated as "pioneer", thus enhancing the survival, profitability and sustainability of such companies. See *List of Pioneer Industries and Products, 2017* available at https://www.nipc.gov.ng/ViewerJS/#../wp-content/uploads/2019/01/Gazetted-List-of-Pioneer-Industries-and-Products.pdf.
[26] Section 24 of the Act.
[27] Section 28 of the Act.
[28] Section 27 of the Act.

In addition to the above, labelled startups under the Act are also entitled to:

(i) full deduction of expenses on research and development which are wholly incurred in Nigeria;[29]
(ii) exemption from contributions to the Industrial Training Fund where the startup already provides in-house training to its employees for the period where it is designated as a labelled startup;[30]
(iii) export incentives and financial assistance from the Export Development Fund, Export Expansion Grant, and the Export Adjustment Scheme Fund, where the startup exports products and services deemed eligible under the Export (Incentives and Miscellaneous Provisions) Act;[31] and
(iv) non-resident companies (NRCs) that provide technical, consulting, professional or management services to a labelled startup are subject to a 5% withholding tax on income derived from the provision of such services. This is the final tax to be paid by the NRCs.[32]

b. *Incentives for Investors*

Investors are not left out from the incentives introduced under the Act. Startups need to attract funding and raise capital to boost their growth and development. Some capital may come from angel investors, private equity funds, venture capital companies, and others from friends and family. Based on the understanding that funding is crucial for startups to scale up and boost their revenue, the Act has introduced incentives to encourage both local and foreign investors to invest in Nigerian startups.

The Act provides for the development and implementation of a national policy for incentives granted to individuals, impact investors, angel investors, companies, venture capitalists, private equity funds, accelerators and incubators that invest in a labelled startup or in the startup ecosystem to enable them enjoy tax credits on their investments.[33] Investors can enjoy tax credits of up to 30% of their investment in a startup, and such credit must be applied on any gains they have made on the investment which are subject to tax.[34] Where the investor proceeds to dispose of their assets, the gains made from such disposal would be exempt from capital gains tax, provided that the assets disposed of were held in Nigeria for at least 24 months.[35]

Investors are also guaranteed the repatriation of their dividends or profits net of all taxes, and where the startup is sold or liquidated, the investor will be guaranteed the repatriation of all proceeds net of all taxes and other obligations.[36] These will be guaranteed through the CBN's authorised dealer in freely convertible currency. The repatriation will be carried out at the CBN's official foreign exchange rate, provided that the foreign investor can present a Certificate of Capital Importation as proof that the initial investment fund was inflowed through an authorised dealer.[37]

c. *Incentives for Accelerators and Incubators*

Startup accelerators and incubators that have registered with the Secretariat, and are actively involved in providing goods, services, or finance crucial in supporting the operation and growth of startups in Nigeria are entitled to incentives that may be granted by the Federal Government.[38] They are also entitled to grants and aids for research, development, training and expansion projects, and grants provided for under the Nigeria Digital Innovation, Entrepreneurship and Startup Policy and any other policy that may be issued.[39]

Commentary

(i) The Act does not set out a timeframe by which certain key provisions must be implemented. For example, the Act provides for the establishment of the Startup Portal by the Secretariat, which will be largely responsible for conducting registration processes with relevant MDAs, receiving applications for labelling, and also issuing

[29] Section 25(3) of the Act.
[30] Section 25(5) of the Act.
[31] Export (Incentives and Miscellaneous Provisions) Act, No. 65 of 1992, Cap. E19, Laws of the Federation of Nigeria (LFN) 2004. See Section 26 of the Act.
[32] Section 25(4) of the Act.
[33] Section 29(1) of the Act.
[34] Section 29(2) of the Act.
[35] Section 29(3) of the Act.
[36] Section 37(1) of the Act.
[37] Section 37(2) of the Act.
[38] Section 39(2) of the Act.
[39] Section 39(3) of the Act.

permits or licences to labelled startups. Even though this is integral, as it will determine when startups can start applying to be labelled under the Act, it is unclear when these provisions will be implemented. Given that the definition of startup is connected to how long they have been incorporated, immediate implementation is key.

Separately, the absence of a timeline may have a negative impact on the ease of doing business particularly where prospective investors begin to request a label certificate as a condition for investing in a startup.

(ii) The Act appears to overemphasise technology-reliant startups by restricting eligibility to startups whose objects are innovation, development, production, improvement, and commercialisation of a digital technology innovative product or process. This could arguably exclude a lot of innovative startups to the extent that their services are focused on sectors such as agriculture, manufacturing, and service industries.

(iii) Qualification of startups on the basis of the length of their existence may disadvantage some companies in the startup space. Objective parameters to determine a startup's actual growth stage such as revenue, profits, management structure, and number of employees ought to have been adopted. The designated 10-year period may be arbitrary. To illustrate, it is possible for a company to achieve significant growth in 5 years, taking it outside the objective categorisation as a startup.

(iv) The Act establishes the Seed Fund which is to receive a sum not less than ₦10,000,000,000 (Ten Billion Naira) annually, and is to be managed by the NSIA. Notably, access to funding under the Seed Fund is based on the recommendation of the Fund Manager, and subject to the approval of the Council. The Act, however, does not set out the eligibility criteria for startups, which would have helped in promoting statutory clarity and certainty.

(v) There is a proposed bill in circulation, which seeks to repeal the current NITDA Act and provide a regulatory framework for the digital economy in Nigeria (**"NITDA Bill"**). The NITDA Bill empowers the NITDA to regulate and license companies involved in digital services, products, and platforms, including companies that use any digitally enabled system in the provision of service or products, in addition to companies that carry out a business within the information and communications technology space in Nigeria. The NITDA Bill contains some important amendments which are crucial to the advancement of Nigeria's tech ecosystem seems.[40] If the NITDA Bill is passed into law, it is uncertain how it would co-exist with the Act as there could be regulatory overlap.

(vi) Although the Act allows foreign investors own up to 2/3rd of the shares in a labelled startup, and even goes ahead to provide various incentives for them to invest in Nigerian startups, other regulatory directives may foreign discourage investments in Nigerian startups. With the recent issuance of the Revised Handbook on Expatriate Quota Administration 2022, wholly foreign-owned companies will now be required to have a minimum issued share capital of ₦100,000,000 (One Hundred Million Naira) (approximately US$224,215.25)[41] for them to obtain a business permit, as opposed to the previous sum of ₦10,000,000 (Ten Million Naira). This could be counterproductive in encouraging foreign investments into Nigerian startups.

Conclusion

The enactment of the Act is an impressive achievement, as it provides an avenue for qualified businesses to obtain benefits essential to promoting their development, whilst boosting broader economic growth. However, gaps remain, and new fractures may have been created. For example, the requirement for labelled startups to be corporate entities incorporated for 10 years might preclude companies which have been in existence longer, but are, properly considered, still at startup stage from leveraging the law's benefits. Additionally, the requirements for startups to incorporate digital innovation into the production and development process limits the types of startups that may take advantage of the benefits of the Act. The institutions which are mandated with operationalising the law must therefore bear all these in mind and approach the implementation of the Act with purpose and creativity so that the startup ecosystem and the Nigerian economy can properly capture the benefits of this laudable legislation.

[40] Section 16 of the NITDA Bill requires all companies, including foreign digital services registered in Nigeria, with annual turnovers of over ₦100,000,000 (One Hundred Million Naira) ($240,000) to pay an annual levy worth 1% of their profit before tax. Section 15 also authorises NITDA to provide permits and licenses for operators in Nigeria's information and technology sector.
[41] Being the official rate of US$1 to ₦446.00 as at 17 November 2022.

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