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Tax Appeal Tribunal's judgement on the tax-deductibility of voluntary pension contribution

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The Tax Appeal Tribunal (TAT or "the Tribunal") sitting in Lagos on Tuesday, 18 June 2019, delivered judgement in the case of *Nexen Petroleum Nigeria Limited ("Nexen" or "the Appellant") and Lagos State Internal Revenue Service (LIRS or "the Respondent")* to the effect that:

a. voluntary pension contribution (VPC) is a valid deduction for calculating Pay-As-You-Earn (PAYE) tax on employees' emoluments; and

b. Nexen has no further obligation to account for tax payable on VPC withdrawn by its employees within 5 years of contribution.

Background

The Pension Reform Act, 2014 (PRA) is the regulatory framework for the administration of the pension scheme in Nigeria. Section 4(1) of the PRA mandates every employer and employee to contribute a minimum of 10% and 8%, respectively, of the employee's monthly emoluments to the Contributory Pension Scheme ("the Scheme") established under the PRA. Section 4(3) of the PRA further allows employees to make voluntary contributions to the Scheme, in addition to the mandatory pension contribution. The PRA places obligation on employers to deduct and remit both the statutory contributions and VPCs to the credit of the employee's retirement savings account (RSA) monthly.

Section 10(1) of the PRA provides that contributions to the Scheme shall form part of tax-deductible expenses in the computation of income tax payable by an employer or employee under the relevant income tax law.

In addition, Section 20(1)(g), and Paragraphs 2 and 3 of the Fourth Schedule to the Personal Income Tax Act (PITA) 2011 (as amended) guarantee tax deductions for contributions made by any employee to approved pension scheme, in determining their PAYE tax liabilities. However, Section 10(4) of the PRA subjects the income earned on VPC to tax at the point of withdrawal, if the withdrawal is made within 5 years of the contribution.

Facts of the case

The LIRS imposed additional PAYE liabilities on Nexen following a tax audit exercise conducted on its financial records for 2013 and 2014 years of assessment (YOAs). The liabilities arose partly because the LIRS disallowed deduction of the VPCs made by the Appellant's employees on the ground that they withdrew the VPCs within 5 years of making the contributions.

The Appellant objected to the demand notices for the additional assessments, but the Respondent issued a Notice of Refusal to Amend the alleged liabilities. Dissatisfied with the LIRS' action, the Appellant filed an appeal at the TAT arguing that:

- mandatory and voluntary pension contributions are allowable deductions for PAYE tax purpose, based on a joint reading of Section 10 of the PRA 2014, Section 20(1)(g) of PITA and Paragraphs 2 and 3 of the Fourth Schedule to the PITA;
- the Appellant has no further obligation to the Respondent having fully deducted and remitted PAYE tax on the emoluments paid to its employees for 2013 and 2014 YOAs;
- PAYE tax represents taxes of the employees and not a tax levied on the Appellant in line with Section 81(1) of PITA and Paragraph 2 and 4 of the PAYE Regulations 2002. Rather, it is an administrative duty to be discharged by the Appellant and no more;
- having fully discharged its responsibility as an agent of the Respondent to deduct PAYE tax at source and remit same to the LIRS, the

responsibility to recover any further income tax from the employees automatically reverts to the Respondent.

On its part, the Respondent submitted that:

- tax was applicable on income or any voluntary contribution withdrawn before the end of 5 years from the day the VPC was made;
- it was the employer's obligation to deduct and remit taxes on the VPC so withdrawn since the VPC formed part of the employees' emoluments;
- it has the power to set aside any scheme that it considers artificial or fictitious and apply appropriate taxes.

Issues for determination

The issues for determination arising from the arguments of both parties included:

- whether the Appellant has fulfilled its statutory obligation of deducting and remitting the correct PAYE tax for 2013 and 2014 YOAs, hence exculpating itself from any additional tax obligation arising from the VPCs made by its employees;
- whether an agency relationship exists between the parties, thus making the Appellant merely an agent of the Respondent for the PAYE scheme and not a taxpayer for the purposes of any future actions of its employees on the earned income on their VPC or statutory deductions;
- whether VPCs qualify as tax deductible contributions and remain so in relation to the Appellant as an agent of the Respondent;
- whether for a VPC remitted on behalf of employees to be treated as tax exempt under section 10(4) of the PRA, it must be shown that the VPC was not withdrawn by the employee affected for a period not less than 5 years.

TAT's decision

After considering the arguments of both parties, the TAT entered judgement in favour of the Appellant, that:

- having fully satisfied its statutory obligation of deducting PAYE taxes and remitting same to the Respondent, the Appellant has no further obligation in that regard;
- the Appellant's legal obligation was to deduct and remit PAYE tax of its employees after deducting all the statutory reliefs in compliance with the relevant provisions, which the Appellant has done in this case;
- as a statutory agent of the Respondent, the Appellant has fulfilled all the statutory obligations imposed on it by the relevant laws. Therefore, the responsibility to recover any further tax on the income of the employees that is not in the custody or control of the Appellant automatically reverts to the Respondent;
- the Appellant, having fulfilled these statutory obligations and paid over all the pension contributions (both the compulsory and voluntary), to the Pension Fund Custodian (PFC), specified by the Pension Fund Administrator (PFA), is not under any further obligation to account for subsequent dealings by the employees, with the VPCs;
- VPCs are allowable deductions by the relevant provisions of the PRA and the PITA for the purpose of determining the income tax liability of employees in a given employment.

Consequently, the TAT discharged the Respondent's notices of assessment for 2013 and 2014 YOAs.

This judgement effectively resolves the concerns of employers arising from the LIRS' Public Notice … on "*Tax Relief on Voluntary Pension Contributions*" where, among other things, the LIRS notified the public that it would recover the tax due on withdrawal of VPC by employees from their respective employers.

Matters arising

1. The TAT's judgement that VPC is a valid deduction for calculating PAYE tax and that the Appellant is not under statutory obligation to account for the tax arising from withdrawal of VPC by its employees is a landmark decision which should lay to rest the controversies on the matter. This judgement effectively resolves the concerns of employers arising from the LIRS'

Public Notice of 21 August 2017 on "*Tax Relief on Voluntary Pension Contributions*" where, among other things, the LIRS notified the public that it would recover the tax due on withdrawal of VPC by employees from their respective employers.

2. The TAT's interpretation of Section 10(4) of the PRA is that VPC should not be treated as tax-exempt if withdrawn within 5 years of making the contribution. The implication of this is that while the provision does not necessarily authorise withdrawal of VPC or the income thereon by employees, both the income earned and the principal amount of the VPC withdrawn within 5 years of the contribution will be liable to tax at the point of withdrawal.
3. In October 2018, the National Pension Commission issued *"Guidelines on Voluntary Contribution under the Contributory Pension Scheme"* to curtail the abuse of the provision of Section 10(4) of the PRA by employees who resorted to indiscriminate withdrawal of their VPC. The Guidelines absolves employers of responsibility to account for tax on VPC withdrawal and prescribes a limit of one-third of an employee's monthly salary as the maximum VPC to the employee's RSA. The Guidelines also provides that active or mandatory contributors shall only have access to 50% of VPCs made into their RSA after 2 years of such contributions, and the balance of 50% shall be available for withdrawal upon retirement of the contributors from active employment.

It is uncertain yet if the LIRS will accept the verdict and look towards the employees who withdrew their VPC indiscriminately, or appeal to the High Court to review the judgement. If it accepts the judgement, it may require the affected employees to account for the tax due on the withdrawn VPC on which they had previously enjoyed tax exemption.

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