November 2017

National Pension Commission Issues Circular to Curb Abuse of Voluntary Pension Contribution Scheme

The National Pension Commission (PenCom or "the Commission") on Thursday, 16 November 2017, issued a Circular on "Withdrawal from Voluntary Contributions" to all licenced Pension Fund Administrators (PFAs) and Pension Fund Custodians (PFCs) in Nigeria. This is in apparent reaction to representation from tax authorities on the alleged abuse of voluntary contribution (VC) as a tax planning tool by employees, and its negative impact on their revenue from personal income tax.

Implications of the Circular for relevant stakeholders

The implications of the Circular, which is effective from **1 December 2017**, for the relevant stakeholders are as follows:

i. Mandatory Contributors

Mandatory contributors [i.e. contributors obliged to make pension contributions under the Pension Reform Act, 2014 (PRA or "the Act")] who make VC into their Retirement Savings Accounts (RSA) can withdraw their VC once in every two (2) years from the last approved withdrawal date. Subsequent withdrawals will only be on the incremental contributions from the date of last withdrawal.

50% of VC in an RSA will be treated as contingent and can be withdrawn once in two years, while the 50% balance will be fixed as pension and can only be withdrawn on retirement. The income on any VC withdrawn will be taxed if the VC is withdrawn within 5 years from the date of the contribution.

ii. Exempted/Expatriate contributors

Exempted/expatriate contributors who opt to participate in the Nigerian pension scheme (though they are not obliged to make pension contributions) can also only make VC withdrawals from their RSA once in every two years. Subsequent withdrawals will only be on the incremental contributions from the date of last withdrawal. However, these contributors are at liberty to withdraw their entire contributions at once after two years, provided that such withdrawals are subject to tax deduction on both the principal and income earned thereon when withdrawal is less than five (5) years from the date of the contribution.

iii. PFAs and PFCs

PFAs are required to forward requests for VC withdrawal to the Commission using a revised schedule. They are also obliged to remit taxes deducted from contributors to the relevant tax authorities (RTAs) within 21 days after the end of the month of deduction. Returns on remittances made are also to be rendered to the Commission twice a year.

In addition, PFAs and PFCs are required to report any single lodgment of ₦5million and above to the Economic and Financial Crimes Commission.

Commentaries

A circular from PenCom has long been awaited to clarify matters arising from the regulation of VC in Nigeria, which has been a subject of controversy for some time now.

Employers who had been threatened by some tax authorities with the obligation to account for tax on alleged VC abuse through indiscriminate withdrawals by their employees can now heave a sigh of relief

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as the Circular has saddled the PFAs with the responsibility for tax deduction on VC and/or income on VC, as the case may be. Equally, the Circular has the effect of dispensing with the onerous burden that some RTAs had sought to impose on employers to produce their employees' RSA statements during Pay-As-You-Earn tax audit. It must be noted, however, that there is currently no statutory framework obliging PFAs to account to the RTAs on the income earned by voluntary pension contributors in their RSAs. It is necessary to close this gap in tax administration by either a legislation or directive by the Minister of Finance.

> **It is expected that the Circular will motivate RTAs to absolve relevant stakeholders (employers, employees, PFAs and PFCs) of any tax obligations relating to VC withdrawals made before 1 December 2017**

The **1 December 2017** effective date specified by the Circular provides sufficient time for VC contributors to adjust their positions based on the restriction on withdrawals of their VC. It also puts the PFAs and PFCs on notice to immediately implement reporting systems for compliance with their obligations under the Circular.

It is expected that the Circular will motivate RTAs to absolve relevant stakeholders (employers, employees, PFAs and PFCs) of any tax obligations relating to VC withdrawals made before **1 December 2017**, to the extent that such withdrawals were duly approved by PenCom. This is necessary to ensure a smooth transition to the new VC regulatory framework.

Hopefully, the Circular will help to douse the tension between the RTAs and employers on one hand, and unionized employees and their employers who were concerned about unbridled VC, but were generally helpless to stop it, on the other. However, the question is whether the Circular totally complies with the PRA. For instance, what is the basis for the two-year restriction on VC withdrawal, and the 50:50 split between VC eligible to be withdrawn after two years and VC ineligible for withdrawal until retirement? It calls to question the correct interpretation of Sections 7, 10(4) and 16 of the PRA, which provide a common framework for withdrawal of both mandatory pension contributions and VC without any special treatment for VC, and the taxation of income earned on VC in the event of withdrawal of the income within 5 years of the VC. For the sake of emphasis, Section 10(4) of the PRA does not authorize withdrawal of VC by employees before retirement or loss of employment. Rather, it prescribes the tax consequence in the event of withdrawal of income earned on VC within five years.

The Circular did not recognize relocation of exempted/expatriate contributors as a trigger event for VC withdrawal. Thus, in the event of relocation by an expatriate from Nigeria, before the second anniversary of his VC, it appears that he would not be able to withdraw all the funds in his VC at the time of his exit. The same restriction would apply if he were to leave Nigeria less than two years after his last VC withdrawal. This is because while he can withdraw all his VC within five years based on the Circular, the right can only be exercised once in two years. This is an anomaly that should be corrected.

The separate regimes for mandatory pension contributors and exempted/expatriate contributors is noteworthy. While only the income on the VC will be taxed if the VC is withdrawn in less than 5 years from the date of contribution by the former, both the principal and the income thereon are taxable in the event of withdrawal of VC by the latter. This is not contemplated by the PRA.

What PenCom has done is at best a stop-gap. The new rules prescribed by the Circular should be the subject of legislative action.

Click here to download a copy of the PenCom Circular.

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