

Public Notices on tax matters recently issued by Lagos State Internal Revenue Service

Newsletter

The Lagos State Internal Revenue Service (LIRS) has recently issued a series of Public Notices on tax matters. This is with a view to curtailing abuse of tax avoidance schemes and providing clarifications on grey areas in certain provisions of the Personal Income Tax Act (PITA). The following Public Notices are reviewed in this Tax Alert:

- Taxation of employee loan (see [link](#))
- What constitutes “reasonable removal expenses” for the purpose of tax exemption (see [link](#))
- Pay-As-You-Earn (PAYE) on employee outsourcing arrangements (see [link](#))
- Withholding tax (WHT) on employee outsourcing arrangements and other labour brokerage arrangements (see [link](#))

1. Public Notice on tax treatment of employee loans

It is quite common for some employers to provide loans to their employees at interest rates below commercial rates charged by banks or, sometimes, at no interest at all. Prior to the adoption of the International Financial Reporting Standards (IFRS) in Nigeria, the provision of such loans was a non-issue for accounting and tax purposes. However, with the adoption of IFRS, such loan arrangements are required to be “marked to market” for accounting purposes.

In 2013, the Federal Inland Revenue Service (FIRS) clarified in Section 11.9 of its Information Circular on the Tax Implications of IFRS Adoption, how the benefit-in-kind

(BIK) attributable to below-market-interest-rate arrangements would be computed. However, the guidance was presumably intended to apply to employees whose PAYE taxes are payable to the FIRS (e.g., employees resident in the Federal Capital Territory, Abuja, etc.). Likewise, this Public Notice is for guidance of employers and employees resident in Lagos State.

The Public Notice provides that employee loans are “loans given by an employer to an employee for specific reasons with the expectation that such loan will be repaid in full to the employer through a pre-agreed deduction from the employee’s net salary, with or without any interest”. It also applies to similar loans advanced by a company to its directors or significant shareholders.

Based on the Notice, an employer is required to account for PAYE tax on the BIK relating to its employee loans. The BIK is to be calculated as the difference between the interest rate on the loan and the adjusted Monetary Policy Rate (MPR), such being the Central Bank of Nigeria’s MPR minus 3%. At the current MPR of 14%, this translates to an adjusted MPR of 11%.

The PAYE tax on the BIK is to be remitted to the LIRS as the loan is being repaid. Employers are also required to file, alongside their annual returns, a schedule providing information on their employee loan arrangements and the related payment terms. These compliance obligations would continue to apply until the loan is fully repaid, even if this is after the relationship of an employer and its affected employee, director or significant shareholder has ceased.



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However, an employer would have no PAYE tax compliance obligations whatsoever in respect of loans where the interest rates are above the adjusted MPR.

2. Public Notice on reasonable removal expenses

Section 4(3)(c) of PITA exempts from tax, “reasonable removal expenses” incurred by an employer by reason of a change of an employee’s employment which requires the employee to change his place of residence. However, there is no explicit guidance in PITA on the definition of the term, or the criteria for evaluating its reasonability.

The Public Notice attempts to remove the ambiguity surrounding the interpretation and application of

the above provision by specifying instances where such expenses would be tax-exempt, and the documents to be provided by employers to justify the treatment. In the Notice, the LIRS defined "reasonable removal expense" as "any expense which an employee incurs to move to a new employment location and the payment made by the employer towards the expenses which results in no net overall benefit to the employee. It is also any payments made to or on behalf of an employee taking up employment with a new employer such as relocation allowance."

For reasonable removal expenses to qualify for tax exemption, based on the Notice, the employee must, indeed, move from his current residence to a new one. Also, the payment made by the employer must be the exact actual cost incurred by the employee to relocate. Consequently, any amount paid to an employee as relocation allowance or temporary subsistence allowance, which covers expenses already incurred by the employer, would amount to duplication, and be taxed accordingly in the hands of the employee.

The Notice stipulates that employers who need certainty on the tax treatment of their removal expenses, may submit their staff policy and guidelines, including per diem rates, to the LIRS for prior approval.

3. Public Notices on employee outsourcing arrangements

The last two (2) Public Notices focus on the PAYE tax and WHT treatment of employee outsourcing arrangements. These are described by the LIRS as arrangements in which workers, who are not part of the ultimate employer's regular workforce, are employed through an outsourcing firm or labour broker, but economically employed by the ultimate employer. In such

arrangements, the ultimate employer pays the outsourcing firm a fee for procuring the staff on its behalf, while the outsourcing firm pays salaries to the staff through its payroll.

In the Public Notice on PAYE tax, the LIRS stated that the administrative obligation for the deduction and remittance of PAYE tax on the outsourced employees, and filing of the related PAYE tax returns, lies with the outsourcing firm. However, any tax exposure arising from improper deduction of PAYE tax from the employees will be extended to the ultimate employer, based on Paragraph 2(3) of the Operation of PAYE Regulations. Consequently, it behoves the ultimate employer to ensure that the PAYE tax of the outsourced employees is correctly deducted and remitted to the LIRS.

In the Public Notice on WHT, the compliance requirement of the ultimate employer relates to the deduction of WHT from qualifying payments to the outsourcing firm. The amount liable to WHT is the margin earned by the outsourcing company on the service (i.e. the difference between the contract sum and the payroll cost of the outsourced employees). However, this would only be the case if the margin is clearly specified on the face of the invoice with clear documentary evidence of the salary cost incurred, and evidence that PAYE tax has been properly accounted for.

Our Comments

The above Public Notices are in the right direction and should increase tax certainty. However, it is crucial that the LIRS applies the prescribed compliance requirements, especially in relation to employee loan arrangements and reasonable removal expenses, prospectively, in line with best practice by tax administrators in other jurisdictions.

To ensure consistency and uniformity of the tax treatment of employee benefits and arrangements across the country, it is necessary for clarifications such as these, on grey areas of our tax laws, to be provided via ministerial regulations or directives issued by the Joint Tax Board as the umbrella organization of all the tax authorities in Nigeria. Ultimately, though, the expectation is that such issues would be addressed through amendments to existing laws from time to time.

In light of these Public Notices, many employers would need to update their staff policies/hand books in relation to the affected employee arrangements and benefits. Compliance with the Public Notices, especially in relation to employee loans where the interest rate charged is below the adjusted MPR, comes with additional administrative obligations on employers. For greater ease of compliance, the time has come for Nigerian tax authorities to introduce electronic platforms for e-tax filings by employers and individual self-filers. With this and other measures, we can expect Nigeria's low ranking (of 181 out of 189 economies) on the World Bank's Ease of Paying Taxes Index to improve significantly.

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