Recent developments on voluntary pension contribution scheme

Newsletter

August 2017

The Joint Tax Board (JTB) and Lagos State Internal Revenue Service (LIRS) recently issued separate Public Notices, on their position on the adverse effect of voluntary contributions (VC) on tax revenue.

Section 4(3) of the Pension Reform Act (PRA or "the Act") 2014 provides that any employee to whom the Act applies may, in addition to the statutory contributions, make voluntary contributions to his retirement savings account. Section 10(1) of the PRA provides for the tax-deductibility of pension contributions – including VC. Section 10(4) of the Act, however, provides that **any income** earned on VC made and withdrawn within 5 years would be subject to tax at the point of withdrawal. This is in contrast to Section 7(2) of PRA 2004 which taxed VC withdrawn less than 5 years after the date of contribution, and not merely the income earned from it.

The Notices appear to have been triggered by the common tax avoidance practice of employees making uncapped VC from their monthly salaries, claiming reliefs on the contributions made, and subsequently withdrawing the VC from their Retirement Savings Account (RSA).

The position of the JTB is that such practice is inconsistent with Section 16 of PRA 2014; and would be treated by tax authorities as an artificial transaction based on the provisions of Section 17 of the Personal Income Tax Act, as amended (PITA).

The LIRS reflected the same view in its Notice, but also stated that only withdrawals from Retirement Savings Accounts that fall within the ambit of Section 16 of PRA 2014 would be treated as tax-deductible. The section covers pension withdrawals by employees above 50 years old and those below 50 years old with specified health or employment challenges.

> Section 10(1) of the PRA provides for the tax-deductibility of pension contributions – including VC.

Our Comments

The position of the tax authorities raises several issues. One obvious issue is how the Tax Appeal Tribunal (TAT) and/or the courts will evaluate the alleged artificial or fictitious nature of a VC scheme. For instance:

a. What documentary evidence would be considered as sufficient for a tax authority to discharge its onus of proof that a VC scheme is artificial and without substance?

b. What percentage of VC relative to total employment income would the TAT and/or the courts regard as artificial, in the absence of a legislative threshold in PRA 2014?

c. What bearing does Section 16 of PRA 2014 have on the validity of VC withdrawal or the tax treatment of VC withdrawn, given the overriding provision in Section 10 of the PRA 2014?

d. What frequency of withdrawal of VC from RSA would qualify a VC scheme as an artificial transaction since the PRA 2014 is silent on this? Would the periodic and consistent withdrawal of VC, for example, be viewed as being in alignment with the thrust of the PRA, which is primarily for the payment of retirement benefits?

One other issue is whether, in light of the provisions of Sections 10(1) and (4) of PRA 2014, VC qualifies for tax-deductibility because contributions are in fact made, or are not withdrawn within 5 years. This is crucial considering that employers determine their employees' Pay-As-You-Earn (PAYE) tax based on VC made, and would have no knowledge whether (or when) such contributions are subsequently withdrawn by their employees. Taxes due at the point of withdrawing VC have historically been accounted for by Pension Fund Administrators. Consequently, holding employers responsible for "under-deduction of PAYE tax" because their employees subsequently withdraw VC may seem curious from both legal and administrative perspectives.

Furthermore, the LIRS referenced Paragraph 8 of the Fourth Schedule to the PITA as a basis for recovering from employers the PAYE tax due on VC withdrawn by employees. The paragraph provides that "Where in respect of any pension or provident fund any benefit is paid to an employee before the cessation of his employment with an employer, such benefit shall be deemed to be income derived by him from his employment on the date on which the benefit is paid." However, it should be noted that Paragraph 14(1) of the Third Schedule to PITA was amended in 2011 to exempt "pension granted to any person pursuant to any enactment or law for the time being in force" from tax. A harmonious interpretation of both provisions may, therefore, suggest that VC withdrawn by an employee whilst in employment would still not be liable to PAYE tax, as it would constitute employment income but not chargeable income.

In the final analysis, the critical issue appears to be whether the courts would focus on what the law simply says rather than what it was intended to say (no matter the undesirable outcome arising from its application) if and when the case of alleged abuse of VC comes up for hearing.

In the face of all these contentious issues, the best way forward may be for tax authorities to engage with all stakeholders to seek an amendment to the PRA to reflect the underlying intention of the law. It is debatable whether the issuance of workable guidelines on VC by the National Pension Commission (PenCom) will suffice. This may, perhaps, explain the seeming reluctance by PenCom to issue the relevant Guidelines on this matter. Meanwhile, employers may need to put structures around their employees' VC to prevent unwholesome practices.

In the final analysis, the critical issue appears to be whether the courts would focus on what the law simply says rather than what it was intended to say (no matter the undesirable outcome arising from its application) if and when the case of alleged abuse of VC comes up for hearing.

Click to download the Public Notices issued by the **JTB** and **LIRS**.

For further enquiries, please contact:

Wole Obayomi
NG-FMTAXEnquiries@ng.kpmg.com

www.kpmg.com/ng

kpmg.com/socialmedia