

# Tax Alert

Issue 9.3 | September 2019



## **Delta State Public Notice on tax treatment of compensation for loss of employment**

The Delta State Board of Internal Revenue (DSBIR) recently issued a Public Notice stipulating compliance requirements for employers who pay “compensation for loss of employment” to employees who reside in Delta State. According to the DSBIR, the Public Notice became necessary in view of perceived ambiguity in the provision of Paragraph 26 of the Third Schedule to the Personal Income Tax (PIT) Act, which exempts any compensation for loss of employment from tax under the PIT Act.

The DSBIR classifies compensation for loss of employment as either “terminal benefit” or “termination benefit”. According to the DSBIR, terminal benefit refers to a retirement or resignation lump sum payment (e.g. pension and gratuity) and is usually based on pre-defined terms and satisfactory performance of employment duties. Termination benefits, on the other hand, is a redundancy lump sum payment accruable on premature termination of an employment or contract.

The DSBIR’s view is that terminal benefit is revenue in nature and taxable under the PIT Act, while termination benefit is capital in nature and taxable under the Capital Gains Tax (CGT) Act. The DSBIR further states that compensation for loss of employment will only qualify for tax exemption under the PIT Act if the amount paid was not pre-agreed, and that any pre-agreed payment would be liable to CGT in line with Section 6(1)(a) of the CGT Act.

The Public Notice further provides that gratuities paid under the Pension Reforms Act or a scheme approved by the National Pension Commission are tax deductible; while those paid outside such schemes are only tax-deductible subject to a maximum of ₦100,000 and other restrictions imposed by Paragraph 18 of the Third Schedule to the PIT Act.

The Public Notice also mandates every employer, who pays a capital sum as compensation of loss of employment, to deduct and remit the CGT due on such payments, to the DSBIR, within 7 days from the date the payment was made.

## **Comments**

1. The taxation of gratuities paid to employees at the end of service was previously contentious. The apparent disparity was the unconditional tax exemption granted by the Finance (Miscellaneous Taxation Provisions) No. 3 Decree, 1996 and the Sixth Schedule to the Personal Income Tax (Amendment) Act, 2011, and the conditional tax exemption provided in Paragraph 18 of the Third Schedule to PITA.

However, this issue was laid to rest by the Tax Appeal Tribunal (TAT) judgement in the case of *Nigerian Breweries Plc and Abia State Board of Internal Revenue* (TAT/SEZ/002/17) where the TAT held that gratuities are wholly tax-exempt under the Personal Income Tax Act 2004 (as

amended). The DSBIR, therefore, needs to review its position on the taxability of gratuities paid by employers to conform with judicial precedent on the matter.

2. Section 36(2) of the CGT Act exempts compensation for loss of office below ₦10,000 from CGT. While the 1996 Budget pronouncement removed the ₦10,000 cap, it was only the PITA that was amended to exempt compensation for loss of employment from tax. Therefore, the suggestion by the DSBIR that any pre-agreed payment in respect of compensation for loss of office will be taxable under the PITA has no basis in law. However, to the extent that the CGT Act remains unchanged since then, any capital sum paid by an employer to an employee as compensation for loss of office in excess of ₦10,000 is taxable under the CGT Act. The tax-free amount of ₦10,000 is long overdue for review as it does not reflect current economic realities.
3. While it will be easier to collect CGT on capital sums paid to employees where the DSBIR appoints employers as collecting agents, there may be practical issues to consider. For instance, CGT is not payable on gross income and should not be deducted as if it were withholding tax; as doing so may amount to overpayment of CGT. The CGT Act imposes CGT on chargeable gains determined after deduction of relevant incidental expenditure specified in the Act from the capital sum received.
4. Moreover, requiring employers to account for CGT deducted within 7 days of deduction has no basis in the CGT Act or any other law.

While the DSBIR seeks to provide guidance on the tax implications of compensation for loss of employment, its practice must align with relevant statutory and legal pronouncements, and guarantee equity and fairness to taxpayers.

Please click [here](#) to access the Public Notice, and the links below to access KPMG's related publications on the subject:

- [TAT affirms the exemption of gratuities from tax](#)
- [LIRS Public Notice on appointment of payers of capital sum](#)

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