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Legal Practitioners, Arbitrators and Notaries Public

Revenue & Taxation

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**A review of Lagos State Internal Revenue
Service Circular on Taxation of Employee Loan¹**

The Lagos State Internal Revenue Service (“LIRS”) by its public notice of 27th September, 2017 issued guidelines towards regulating the treatment and taxation of employee loan in Lagos State.

As contained in the circular, the LIRS provided fresh compliance requirements on employee-loans provided or offered to employees by employers. The major thrust of the public notice is reproduced as follows:

1. Deduction of PAYE: The employer is required to compute tax on the difference between the rate on such employee loan and the adjusted Monetary Policy Rate (MPR) and remit to the relevant tax authority. The adjusted MPR is MPR less 3%; and
2. Reporting Obligation: Every employer is required to file, alongside their annual returns, a schedule showing the information on its employee loan and payment terms.

It was further stated in the LIRS notice that its provisions shall apply to directors, significant shareholders and employees of a company and will continue to apply even after the relationship of the employee with the company has been terminated, as long as the loan remains unpaid. Also, any employee loan with interest above adjusted MPR or at commercial rate shall not be assessed to additional benefits for the employees receiving such a loan.

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Commentary on LIRS Circular on Taxation of Personal Income

The legal basis for taxation of income accruing to individuals in Nigeria (as opposed to incorporated entities), is the Personal Income Tax Act, (PITA).² Section 3 (1) of PITA provides that:

1. *Subject to the provisions of this Act, tax shall be payable for each year of assessment on the aggregate amount each of which is the income of the taxable person, for the year, from a source inside or outside Nigeria, including, without restricting the generality of the foregoing:*
 - (a) *gain or profit from any trade, business, profession or vocation for whatever period of time such trade, business, profession or vocation may have been carried on or exercised;*
 - (b) **Any salary, wage, fee, allowance or other gain from profit or employment including compensation, bonuses, premiums, benefits, or other perquisites allowed, given or granted by any person to an employee ...” (emphasis supplied)**

Based on the above provisions, tax is imposed on gain or profit accruing to the individual from any trade, business, profession, or vocation. With respect to individuals in paid employment, directors and shareholders of incorporated entities, tax is imposed on the salaries, wages, fees, allowances, compensation, bonuses, premiums, benefits as well as other perquisites which may accrue to the individual in the course of his employment. It is worthy of note that the law does not make reference to the tax treatment of interests on employment related loans advanced or offered to employees by employers in the course of their employment.

In our opinion, there is no legal basis for the LIRS Notice, which seeks to apply the Central Bank of Nigeria (“CBN”) adjusted MPR to interest rate on loans advanced to an employee by an employer. MPR is the rate at which the CBN advance loans to commercial banks and it is an instrument deployed towards controlling and regulating the supply of money and ensuring price stability in the economy. The MPR is applicable to banks and other financial institutions who receive loans from the CBN and it constitutes a risk management strategy.

Based on the provisions of the law, the LIRS is empowered to levy tax on the profit or gain accruing to individuals and as such does not have the powers under the PITA to regulate the rates at which companies offer loans to employees or whether such loans are offered at an interest rate lower than the market interest rate or zero percent interest rate. Furthermore,

² Cap P8 Laws of the Federation of Nigeria (LFN) 2004 as amended

the LIRS Notice did not indicate or provide the provisions of PITA which empowers it to adjust rates at which companies offer loans to employees as obtainable in other jurisdictions. In the United Kingdom for example, the revenue authority, Her Majesty's Revenue & Customs ("HMRC") exempts from any form of tax, national insurance deductions and does not impose reporting obligations in respect of loans with a combined outstanding value to an employee of less than 10,000 pounds. Also, the LIRS notice is silent as to whether the MPR interest rate will apply to loans granted to employees in the low income bracket which may be as low as ₦50,000.00 (Fifty Thousand Naira).

It appears that the purpose of the LIRS Notice is to counteract incidences of artificial or fictitious transactions, whereby in a bid to reduce their overall effective tax rates (ETR), companies under-declare interest charged on loans or other similar benefits-in-kind advanced to their employees. In other cases, the LIRS Notice may also be used to achieve the purpose of ensuring that interests realized by the employee from re-investing loans obtained from an employer is taxed.

If this is the case, it is debatable which of the two authorities, i.e., the Federal Inland Revenue Service (FIRS), statutorily charged with the taxation of companies in Nigeria³ and the LIRS is the appropriate authority to enquire if such an arrangement is fictitious or does not conform to the arms' length principle. This is due to the fact that any tax saving which may be gained may either inure to the benefit of the employer or the employee, depending on how the loan arrangement is structured.

In our opinion, the provision of the LIRS notice does not have a basis in law and its legal foundation is weak. It remains to be seen how the provision of the notice will be administered and enforced, in the absence of an appropriate amendment to the prevailing tax legislations in Nigeria.

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³ Section 9 Companies Income Tax Act Laws Cap C21 Laws of the Federation of Nigeria (LFN) 2004