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LIRS' Conditions for Voluntary Pension Contribution Income Tax Relief: Matters Arising

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In Brief:

On Monday, August 21, 2017, the Lagos State Internal Revenue Service (LIRS) released a public notice (the LIRS Notice) on the voluntary pension contribution (VPC) tax relief. According to the LIRS, it will henceforth, only allow the VPC tax relief in the circumstance where there has been no withdrawal of such VPC from the respective retirement savings account (RSA), except in the following instances, that is, where the withdrawing employee:

1. is above 50 years old;
2. who is below 50 years old, is either:

a. a retiree or unemployed on medical grounds; or
b. unemployed, and has so been for a minimum period of 4 months.

The LIRS further threatened that, it will:

1. periodically audit withdrawals of VPC with the respective Pension Fund Administrators (PFAs) and rely on the statutory provision on artificial or fictitious transactions in this regard;
2. recover any tax that may be due from unauthorised withdrawals of VPCs, inclusive of penalty and interests, from employers under the PAYE scheme of Personal Income Tax (PIT) administration;
3. use available judicial processes to defend its position with each taxpayer or employer; and
4. require each taxpayer claiming VPC relief to submit alongside his or her income tax return, a copy of his or her RSA statement for the relevant tax year and any other period requested by the LIRS.

This piece briefly discusses the legal basis of the VPC tax relief and the legal issues that the LIRS Notice generates.

The VPC Tax Relief:

The Pension Reform Act, 2014 (PRA or the Act), established the Contributory Pension Scheme (the Scheme) and at Section 4, recognised 3 kinds of contributions to the Scheme. The first is the employer's statutory contribution of a minimum 10% of the monthly emoluments of an employee. The second is the employee's statutory contribution of a minimum 8% of the same base as the employer. The employer is to administer the process of remittance of both its contribution and the employee's, by deducting the employee's contribution at source, and paying both to the employee's RSA. The third kind of contribution to the Scheme is the VPC which Section 4(3) of the Act sanctioned with the following words: "Any employee whom this Act applies may, in addition to the total contributions being made by him and his employer, make voluntary contributions to his retirement savings account". VPC unlike the statutory employer and employee contributions is purely elective at the instance of the employee.

For any taxman, the significance of contributions to the Scheme is the wide tax advantage granted by Section 10(1) of the PRA when it says: "Notwithstanding the provision of any other Law, contributions to the Scheme under this Act shall form part of tax deductible expenses in the computation of tax payable by an employer or employee under the relevant income Tax Law". In simplified terms, all contributions to the Scheme are tax exempt, including VPC. Tax professionals readily attest that the VPC is one of 5 major tax saving opportunities currently available to the average PIT payer under Nigeria's Personal Income Tax Act (PITA). Naturally, most informed taxpayers gravitate towards the tax saving opportunities under the Scheme, especially VPC, to lower their income tax pay-out to the State where they reside in Nigeria.

In recent times, the opportunity of the VPC has also become a marketing tool for PFAs who advertise its tax benefits to RSA holders, often times, with a promise to help facilitate VPC withdrawals which must always be sanctioned by the National Pension Commission (PenCom). A typical informed taxpayer with means will rather suffer the VPC process and its inherent delay, than have more taxable disposable income. In other words and with the opportunity of an eventual VPC withdrawal, such taxpayer will rather that some portion of his or her income be paid as VPC rather than have to pay income tax on the gross emolument less other statutory reliefs. This somewhat complex process has seen the tax bracket of such tax payers drop significantly from the average maximum effective tax rate of an approximate 19.2% to sometimes as low as the minimum tax rate of 1%.

As it appears, a revenue authority like the LIRS is unhappy with the tax advantages that the VPC option has availed some tax payers and has now decided to take it headlong, even with the promise of war at litigation.

Our Take:

The LIRS position presents more questions than answers. The summation of our views is that the LIRS seeks to treat administratively an issue which is purely legislative. Quite significant in this regard are the following points:

1. Section 10(4) of the PRA has already spelt out the tax consequence of VPC withdrawals, whether authorised or unauthorised. In fact, the concept of an unauthorised VPC withdrawal is an anathema in the face of Section 10(4). The Section provides that any income earned on VPC shall be subject to tax at the point of withdrawal where the withdrawal is made within 5 years that the VPC was made. In other words, it is the income earned on VPC and not the VPC that is liable to tax if withdrawn within 5 years of making the VPC. In the circumstance that the subsection referenced the earlier subsection (2), such taxable income will include the expressly mentioned: "interests, dividends, profits, investment and other income" earned on the VPC. There is no mention of the taxation of the actual VPC. More so, Section 10(1), earlier reproduced, has already declared VPC a tax-deductible expense.

2. The LIRS Notice speaks too glowingly of Section 16 of the PRA in a manner that suggests that the Section empowers it to subject to income tax any withdrawal not made in accordance with the Section. Section 16 of the PRA does not say so and the LIRS, in the absence of any statutory provision specifically authorising to so do, has no power to subject to tax that which Section 10(1) has said cannot be taxed.

Section 16 of the PRA, speaks generally of withdrawals from the RSA and not specifically on VPC withdrawal as Section 10(4) directly provides. Section 10(4), due to its speciality, would likely displace the generality of Section 16, in accordance with extant Nigerian legal principles for the interpretation of statutes. This is particularly so as no other provision, other than Section 10(4) of the PRA specifically authorises the taxation of any income earned under the Scheme. It is significant that Section 10(1) of the PRA subjects even the Personal Income Tax Act (PITA) to its provision. On the matter of VPC, the PRA trumps PITA.

3. LIRS has threatened to penalise any employer whose employees make unauthorised VPC withdrawals. This for us is a big issue as no Nigerian law can justify this. VPC is purely an affair of employees, even though an employer is duty bound to recognise the VPC as a tax-deductible expense in the computation of the income tax payable by the employee. At worst, that an employee chooses to appropriate his or her VPC post-taxation in a manner unacceptable to the LIRS, is purely a private affair between the employee taxpayer and the taxing authority (for example the LIRS) to which the employee is subject to. It is worrisome that the PAYE Scheme has been taken by many revenue authorities as a gateway into the treasuries of employers and business in Nigeria. This should not be so. The law of the land remains that an employer is not a taxpayer under PITA, it is simply a statutory agent of collection. It is significant that the employer is not just an agent of collection, but a statutory one. Its obligations are cut out for it at law. One of such obligation is to treat VPC, where it is contributed, as a tax-deductible expense in the computation of the income tax payable by an employee. It is simply legally incoherent that the LIRS will seek to burden employers with an issue that is purely not the employer's.

4. LIRS promises to periodically audit VPC withdrawals based on its power under Section 17 of PITA to declare certain transactions artificial or fictitious. With respect, we consider this conclusion arguable. This is considering that we are currently unaware of any precedent where a transaction that is permitted by law and applicable statutory sanction provided for, can judicially be termed artificial or fictitious. There is no hiding the fact that the intention of the taxpayer who takes the VPC option is to save income tax. Such intention and its consequent execution is, in our view, insufficient to qualify the resulting transaction as artificial or fictitious. The centre of the argument being that the transaction is expressly sanctioned by a higher law on the subject matter; the PRA.

We do not think that the flood-gate of litigation that the LIRS is unwittingly unlocking is needful at this time, more so, where the issue ultimately requires the consideration of the National Assembly. Economy remains one of the 9 Smithian cannons of taxation – it should cost relatively less to collect tax. In our view, contesting the issue under discourse may cost the LIRS too much, relatively speaking.Such efforts and resources may be better expended on Nigeria's rather paced legislative process, assuming political will.

For further information on the foregoing, please contact: Ebuka Obidigwe (ebuka.obidigwe@ao2law.com) or Oyeyemi Oke (oyeyemi.oke@ao2law.com) or Bidemi Olumide (bidemi.olumide@ao2law.com) with the subject: ***"LIRS' Conditions for VPC Tax Relief: Matters Arising"***