

## TAX AVOIDANCE THROUGH ADDITIONAL VOLUNTARY CONTRIBUTION TO PENSION - PENCOM FINALLY ACTS



The National Pensions Commission (Pencom) last week issued a circular to all licenced Pension Fund Administrators (PFAs) and Pension Fund Custodians (PFCs) to give directives on acceptable withdrawals from the Voluntary Contributions (VC) by employees before retirement. This circular is coming on the heels of the controversies generated by publications by the Lagos Internal Revenue Service (LIRS) and the Joint Tax Board (JTB) in August 2017, informing the public that AVCs will not be acceptable as non-taxable deduction in arriving at the tax payable by employees, unless evidence is provided to prove that no withdrawals were subsequently made by the employees.

### Details of the Circular

Pencom notes that there has been a rather high trend in the request for withdrawals from voluntary contributions mostly within a very short time from when the contributions were lodged. Pencom is of the view that this practice defeats the purpose of VC, which is to enhance pension at retirement. This has also led to the erosion of the tax payable by the employees who engage in this practice. The circular has therefore instituted the following rules, effective 1<sup>st</sup> December 2017, for approving withdrawals from VC:

- Withdrawals are now limited to once in two years, with subsequent withdrawals limited to the contributions made after the last withdrawal;
- 50% of VCs shall be fixed for pension at retirement, hence only half of the VC is available for withdrawal before retirement
- Foreign and otherwise exempted contributors to VC shall not be limited as in (ii) above, but will be liable to pay tax on both the principal contribution and the return thereon, unlike non-exempt employees who will only be taxed on the return on investment;
- PFAs shall have responsibility of remitting tax due on the withdrawals within 21 days to the relevant tax authorities, with an additional responsibility to file returns of such tax payments to Pencom twice yearly.

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## Our View

This circular justifies the views expressed in our newsletter of August 2017 on this subject, that:

- PENCOM had not done enough to prevent the apparent overuse of the VC as a tax avoidance strategy by employees and PFAs;
- It would be unjust for employers to be held liable for the tax avoidance practices of their employees, especially when those practices did not clearly violate any statutory or regulatory provisions;
- The requirement to remit of taxes due on withdrawal of voluntary contributions within 21 days creates additional burden on the PFAs which is not expressly provided for in the Personal Income Tax Act 2004 (as amended) nor the Pension Reform Act 2014. It may also be difficult for PFAs to know the tax bracket of the employee making withdrawal.

While we do not detract from the fact that Pencom's circular is directed to PFAs and PFCs and cannot constitute a regulation for Personal Income Tax administration, it nonetheless confirms that Pencom has not declared the practice of frequent pre-retirement withdrawals of VC illegal. The argument by tax authorities therefore that withdrawals from the Pension fund are only recognised in the Pension Reform Act 2014 at retirement or loss of employment is therefore not supported by Pencom.

We hope however that Lagos Internal Revenue Service and the Joint Tax Board will align their earlier position with the content of this circular and the effective date of 1<sup>st</sup> December 2017 thereon.

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