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Lagos State Begins Implementation of Capital Gains Tax Deduction at Source from Compensation for Loss of Employment and Other Capital Payments

Introduction

Lagos State Internal Revenue Service (LIRS) on Thursday, 3rd January 2019 issued a public notice appointing employers and payers of capital sums as collecting agents of payees for the purpose of deducting and remitting Capital Gains Tax (CGT) due on the respective capital sums paid including but not limited to compensation for loss of employment. This public notice purports to give full implementation to the earlier public notice issued in 2017 where LIRS clarified its position on the taxability of compensation for loss of employments.

Highlights of the Public Notice

The notice now makes it mandatory for any organization making a capital payment to any person, (including employees for compensation for loss of office) to make a deduction of CGT from such payment for onward remittance to LIRS. Non-compliance would naturally attract penalties against the organization that fails to make the deduction.

LIRS has based this directive to companies on the powers conferred on it to issue such directive by Section 50 of the Personal Income Tax Act (PITA). This is also in the light of the Section 43 of the CGT Act, which requires assessment and collection of CGT to be in line with the provisions of PITA for same.

Effective date and Reporting Requirements

This notice takes effect from January 2019, meaning that all employers must now ensure deduction of CGT at 10% from payments made to exiting employees, where the payments relate to severance benefit, redundancy or payment in lieu of notice of termination. Even though these payments were not exempted from tax before now, the obligation to account for the tax was personal to the employee to discharge under the CGT Act.

Employers must now also include termination benefits in their annual returns on employee income and tax (Form H1) to LIRS. Employers must also file a nil statement where no such payments were made in the preceding year.

Our Thoughts

The wordings of this public notice indicate that the target for this activity is not benefits resulting from termination of employment alone, but also all transactions with third parties that would ordinarily not attract Withholding tax (WHT) deduction on account of them not being Personal Income Tax related transactions, such as purchase of real estates, copyrights, etc. This intervention of LIRS is probably a subtle attempt to bring CGT into the purview of WHT, but it remains to be seen whether they have the statutory capacity to do so.

LIRS must recognize that unlike employment termination benefits most other capital payments have a deductible cost and that sometimes such transactions may result in a capital loss rather than a gain. It would therefore be unrealistic to expect a payer to make any deductions from such purchases where the gain of the seller cannot be reliably estimated by buyer, without jeopardizing the transaction itself.

Our advice to companies and business therefore is to take steps to implement the deduction of 10% CGT from payment of compensation for loss of office to exiting employees only, given that this benefit is deemed to be at no cost to the employee under the law, pending when further clarity is received from LIRS on the application of this publication to other capital transactions.

Albert Folorunsho
afolorunsho@pedabo.com

Fidelis Chukwu
fchukwu@pedabo.com

Killian Khanoba
kkhanoba@pedabo.com

Adekanmbi Stephen
sadekanmbi@pedabo.com

Lagos Office:
67, Norman Williams Street
South West, Ikoyi
Lagos, Nigeria
Tel: 01-2919041
0808 820 8747
info@pedabo.com
www.pedabo.com

Abuja Office:
4th Floor, Grand Square
Mohammed Buhari Road
Central Business District,
Abuja
Tel: 09-8707692

Morison KSi
Independent member