Understanding Withholding Tax Regulations in Nigeria

In this edition of our monthly newsletter, we wish to educate our customers, vendors and other business partners on the application of withholding tax (WHT) system in Nigeria in order to ensure mutually beneficial business relationship.

Issues surrounding WHT applications in Nigeria include determination of appropriate invoice/contracts values, non deduction and non remittance withholding tax payments to the government, the need for provision of Tax Identification Numbers (TIN) and obliging claims for WHT credit notes.

What Is Withholding Tax?
A withholding tax is the tax required by Law to be withheld by a party from each payment made to another contracting party from the income or services rendered. This tax, when deducted and withheld, is required to be remitted periodically to the Government Inland Revenue Service (WHT on corporate entities are collectible by Federal Government while WHT on individuals are collectible by State Government). The Inland Revenue Service is in turn required to issue a Withholding Tax Credit Note for the benefit of the latter party, part of whose income was withheld.

Withholding tax is not a final tax. As mentioned above, the paying party is required upon withholding and paying this tax to obtain on behalf of the other party a Tax Credit Note. The latter Note automatically becomes a tax credit to the other party from whose income the tax was deducted.

A withholding tax payment, as a tax credit, allows the latter party mentioned above to claim it as part of its tax benefits when filing its year-end tax returns. The applicable Laws on withholding tax in Nigeria are Sections 60, 61, 62 and 63 of the Company Income Tax (CITA) and Sections 69 – 72 of the Personal Income Tax (PITA). Withholding tax is not another type of tax, but a mode of tax payment. It is an advance payment of a taxable entity's normal income tax, since it is available for set-off against the ultimately assessed tax.

WHT and Grossing Up Issue
Olaniwun Ajayi LP, in his paper titled “Legality of Gross-Up Clauses in Nigeria” and compiled in Legal Aspects of Finance in Emerging Markets (2005) posits the Regulation 2 CITA (WHT Regulations) provision which states that “a deduction made from a payment shall not be regarded as an additional cost to the contract price as tax due on the payment”. This clause makes grossing-up illegal to the extent that it shifts the tax burden in breach of the above Regulation.

In adherence to this, Gaslink Nigeria Limited (Gaslink) does not include WHT charge in its monthly billing to its natural gas utility customers. Also in the same vein, its vendors and other service providers would not be expected to gross up their bills with WHT charges.

Withholding Tax Rates in Nigeria
Except for interest, rent, dividends and directors fees, most withholding tax rates on payments on earned income are assessed at the rate of 10% for corporate bodies and 5% for individuals. The actual rates for most items are shown in the table below:

<table>
<thead>
<tr>
<th>Type of Payment</th>
<th>Companies (%)</th>
<th>Individuals (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Management fees</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Bond interest, royalties</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Interest</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Rent</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Royalties</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Consultancy and technical service fees</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Commission</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Construction contracts</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Income from all aspects of building and other civil Works construction</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Income from contracts other than outright sale and Purchase of goods and property in the ordinary course of business</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Directors’ fees</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Taxed Nigerian dividend subsequently redistributed by a company</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>
In Nigeria, Non-resident recipients of income in the form of interest, dividends and royalties, upon deduction of withholding tax, are not liable to further tax payments, under Nigerian law, provided that for the tax year, they remain non-resident. Also in Nigeria, where there is an agency arrangement, it is only the rewarding commission of the Agent that is subject to payment of withholding tax. Non-resident companies are companies that are not registered in Nigeria and with no place of business in Nigeria.

Penalty for Non-Deduction

While Section 64 of CITA provides a penalty of 10 per cent per annum for not paying within twenty-one days from the date the amount was deducted or the time the duty to deduct arose plus interest at the prevailing commercial rate”, Section 73 of PITA allows up to 30 days from the date of deduction or the day the duty to deduct arose before remittance.

Penalty for Late or Non-Remittance of Withholding Tax

All withholding tax liabilities are required to be collected and paid over to the tax authorities within 30 days of their becoming due for payment. Where there is a failure to remit this Tax for whatever reason, the penalty on conviction is a 200% fine of the tax due in addition to commercial rates of interest until the entire amount accessed as withholding tax is fully paid.

Claim of Withholding Tax Credit

This is only possible when the party making the payment actually remits the tax collected with a schedule containing information about the tax payers from whom the deductions were made, in line with laid down guidelines. This is expected to be the source of information for the relevant tax authority to award tax credit.

Gaslink would normally request Tax Identification Numbers (TIN) details of its vendors and other service providers to enable the processing of WHT credit notes. Similarly, it is expected that all our customers use the TIN details on Gaslink’s invoice to process payment and avail us our WHT credit notes for all WHT deductions from our bills.

The non-adherence to this practice by organisations is the major reason why many taxpayers are unable to obtain credit notes for withholding tax taken from their payments. A tax payer from whom tax has been withheld is expected to obtain withholding tax credit notes from the relevant tax authority via the paying organisation. All credit notes obtained are forwarded to the tax authority, which in turn records the credit against the tax payer's account. Assessed tax and related charges are usually entered as debits in the taxpayer’s tax account, while he is expected to pay only the difference between his assessed tax and withholding tax credit.

Unutilised withholding tax credits are however available for transfer to subsequent tax years. This means that withholding tax credits notes received after the tax year to which they relate are not useless, as the taxpayer can apply to the tax authority to transfer his unutilised tax credit balance in one year to offset or reduce the debit balance in another year.

Withholding Tax on Franked-Investment Incomes

Section 62 (3) of CITA accords dividend received, and from which withholding tax has been deducted the status of a franked-investment income. This means that the withholding tax on such dividend shall be the final tax on the income and that the net-dividend received shall not be regarded as a taxable income in the hand of the recipient. Conversely, credit notes obtained for withholding tax suffered on dividend would not be available for set-off against a company's tax liability. However, where dividend received by a company is further re-distributed, the redistributing company is still required to withhold tax from such redistribution but is allowed to set-off the withholding tax suffered on the initial dividend from the tax withheld on the second distribution.

Tax Exempt Bodies and Withholding Tax

The exemption from tax of the profits of certain organisations as contained in Section 23 of CITA limit the exemption to the incomes of the organisation that has direct bearing on its object clause. Therefore, when a religious organisation, for example, extends its income sources to non-religious activities such incomes become taxable to the extent of their profit tendency.

Therefore, except for specific provisions in Section 19, no ordinarily taxable payments shall be exempted from withholding tax. The specific exemptions provided for include:

1. Dividend of a Small Company involved in manufacturing during its first five years of operation
2. Dividend received from investments in wholly export-oriented businesses
3. Interest on the deposit account of a foreign non-resident company, provided that the deposit is in foreign currencies and brought into Nigeria through government approved channels

In view of the above, Gaslink would demand for a copy of certificate of withholding tax exemption (in line with Section 19 (2) of CITA) before it succumbs to a plea not to withhold tax from payments due to a supplier.

Conclusion

To have a mutually profitable business relationship, all parties must oblige and cooperate with one another in the provision of TIN details and recovery of WHT credit notes. It is also recommended that all players in Nigerian business environment increase their knowledge in this area to ensure that in pre-contract negotiations and documentation, the payment of this tax is resolved and that the correct rate is deducted as withholding tax. Evidence of the payment of this tax will be required by the tax authority before you can benefit from the tax credits accruing when the final tax is computed.

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