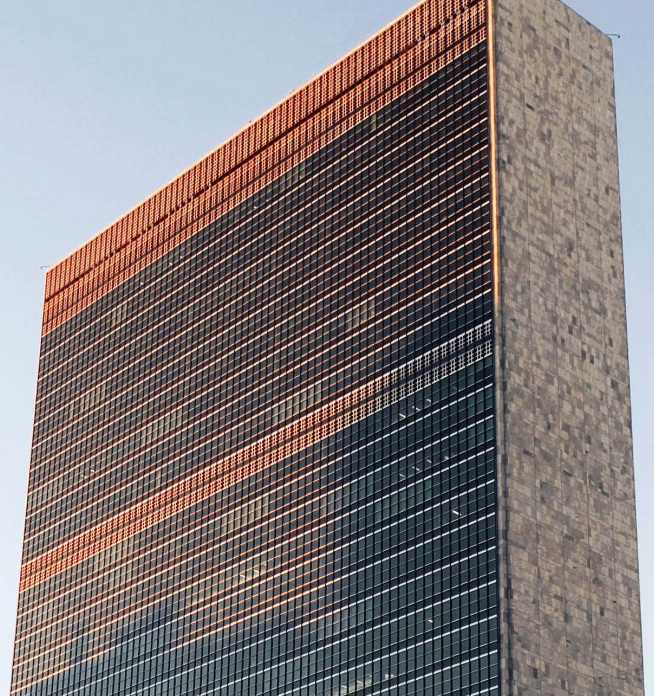


Tax Appeal Tribunal affirms the exemption of gratuities from tax

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The Tax Appeal Tribunal (TAT or “the Tribunal”) sitting in Enugu recently delivered judgement in the case of Nigerian Breweries Plc (“the Appellant”) and Abia State Board of Internal Revenue (“the Respondent”) to the effect that gratuities are wholly tax-exempt under the Personal Income Tax (PIT) Act 2004 (as amended).

Background

Section 3 of PIT Decree 104 of 1993 (now PIT Act, Cap. P8, Laws of the Federation of Nigeria (LFN), 2004), included gratuities as an income chargeable to Pay-As-You-Earn (PAYE) tax. However, Paragraph 18 of its Third Schedule exempts gratuity up to only ₦100,000 from tax, and thereby makes gratuity above ₦100,000 liable to PAYE tax.

Following amendments introduced by the Finance (Miscellaneous Taxation Provisions) (No. 3) Decree 1996 (“the 1996 Decree”), the term “gratuities” was deleted from the list of chargeable incomes under Section 3 of the PIT Decree. This was reflected in the PIT Act LFN 2004 and retained in the PIT Act 2011 (as amended). Nonetheless, the provision of Paragraph 18 of the Third Schedule to the PIT Act remained unchanged.

Facts of the case

The Respondent imposed additional PAYE tax liabilities, inclusive of interest and penalties, on the Appellant following a tax audit conducted for the 2014 and 2015 tax years. The additional PAYE tax liabilities arose because the Respondent subjected gratuities paid by the Appellant to its retired employees to tax. The Appellant objected to the Respondent’s revised assessment, after which the Respondent issued a Notice of Refusal to Amend the alleged liabilities.

Dissatisfied with the Respondent’s action, the Appellant filed an appeal at the TAT arguing that gratuity is no longer taxable under the PIT Act since the 1996 Decree deleted it from the list of chargeable incomes and introduced a new exemption for all compensation for loss of office, thereby, rendering the provisions of Paragraph 18 of the Third Schedule to PIT Act redundant. The Appellant further argued that where there is a conflict between a section of a statute and a schedule thereto, the section will override the schedule.

On its part, the Respondent argued that the 1996 Decree is not part of the LFN 2004 and that only gratuities paid to serving employees through approved schemes, are exempt from tax in accordance with Paragraph 2 of the Sixth Schedule to the PIT Act. The Respondent further contended

that gratuities paid to retired employees are regarded as income on the last day of employment and taxable where it exceeds ₦100,000.

Issues for determination

The issues for determination arising from the submissions of both parties included:

- whether the Appellant is liable to pay penalty and interest in the circumstances of this appeal; and
- whether gratuities are wholly tax exempt under the PIT Act, 2004 (as amended).

TAT’s decision

After considering the arguments of both parties, the TAT entered judgement in favour of the Appellant to the effect that:

- penalty and interest are not applicable as the Appellant objected and appealed against the assessment within the statutory period;
- gratuities are wholly tax-exempt under PIT Act as it has been deleted from Section 3 which is the charging section of the Act, and the provisions of a schedule to a statute cannot override the plain words in a section of the statute.

Consequently, the TAT discharged the Respondent’s revised assessment notice issued to the Appellant.

The TAT’s affirmation that the provisions of schedules in a statute cannot override the plain words in the body of the statute, has effectively eliminated the gap in the law that some tax authorities often capitalize on to impose income tax on gratuities paid by employers

Comments

- i. The failure of the legislative arm of the Government to delete the restriction on tax-exempt gratuities under Paragraph 18 of the Third Schedule to the PIT Act is an obvious omission given that the subject was deleted in the charging section of the PIT Act in 1996.
- ii. Hence, the TAT's decision that gratuities are wholly tax-exempt under the PIT Act is a step in the right direction which should put paid to the controversy on the matter. The judgement conforms with the provisions of Paragraph 2(e) of the Sixth Schedule to the PIT Act 2011 (as amended) which grants unqualified tax exemption to gratuities paid to employees.
- iii. The TAT's affirmation that the provisions of schedules in a statute cannot override the plain words in the body of the statute, has effectively eliminated the gap in

the law that some tax authorities often capitalize on to impose income tax on gratuities paid by employers. For instance, the judgement effectively addresses taxpayers' concerns arising from the Lagos State Internal Revenue Service (LIRS)' Public Notice on "*Exemption of compensation for loss of employment*" wherein the LIRS posited that gratuity payments are only tax- deductible subject to the limitation imposed in Paragraph 18 of the Third Schedule to the PIT Act.

- iv. The judgement further reinforces the position of the Joint Tax Board that any end-of-service benefit paid to employees and described as "gratuity" will qualify for full tax exemption under the PIT Act.

Barring any contrary decision of a higher court, it is expected that concerned tax authorities, who held divergent views on the tax treatment of gratuities before this TAT judgement, would align with the judgement of the Tribunal.

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