

Finance Act 2020:

Implications for individuals and employers of labour.



Background

The President of Nigeria assented to the Finance Bill 2020 on 31 December 2020. The Act which takes effect from 1 January 2021 introduced amendments to several tax and fiscal laws including the Personal Income Tax Act (PITA) and the Capital Gains Tax Act (CGTA). Broadly, the changes provide clarity to some previously grey areas, address areas of possible non taxation or double taxation and introduced an income exempt category.

We highlight the changes and their implications for individuals and employers in this alert.

Redefinition of Gross Income

Section 33(2) of PITA has been amended as follows;

“For the purposes of this Section, “gross income” means income from all sources less all non-taxable income, income on which no further tax is payable, tax-exempt items listed in paragraph (2) of the sixth schedule and all allowable business expenses and capital allowances.”

Implications: Gross income is the basis for calculating the Consolidated Relief Allowance (CRA); the higher of ₦200,000 or 1% of Gross Income plus 20% of Gross Income. The new definition means tax exempt items should now be deducted from gross emolument before computing the CRA.

This means employees will no longer enjoy the additional 20% relief previously claimable on the portion of their income that relates to National Housing Fund, pension contribution, and other tax exempt items. The reduction in CRA would result in higher effective tax rate and lower disposable income. Employers need to update their payroll templates or applications to ensure compliance.

Tax exemption for minimum wage earners

Section 37 and para 33 of the Third Schedule of PITA have been amended to exempt from personal income tax, any persons earning the national minimum wage or less from any employment. Section 108 defines this as the extant national Minimum Wage pursuant to National Minimum Wage Act.

Implications: Employees who earn not more than the National Minimum Wage (currently ₦30,000) are no longer liable to tax or deduction of monthly PAYE.

Tax exemption threshold for compensation for loss of employment

Section 36(2) of CGTA is amended to state that sums obtained by way of compensation for loss of office, up to a maximum of ₦10m, shall not be chargeable gains subject to tax under this Act. Provided that any sum in excess of ₦10m shall not be so exempt but the excess amount shall be chargeable gains and subject to tax accordingly.

Sections 36(3) &(4) further state that any person who pays compensation for loss of office to individual is required, at the point of payment of such compensation, to deduct and remit tax to the relevant tax authority in line with the Pay As You Earn (PAYE) Regulation.

Implications: Any payment to an employee as compensation for loss of employment up to N10m is exempted from tax. However, any excess above N10m is taxable at the GCT rate of 10%. An employer paying such compensation is required to deduct the CGT and remit to the relevant tax authority within the time specified in the PAYE regulations (being the 10th day of the month following payment). Employers will also be required to report such payments during the annual tax filing.



Significant Economic Presence

Section 6(A) of PITA introduces the Significant Economic Presence (SEP) rules to the taxation of non-resident individuals, executors or trustees carrying on a trade or business comprising Technical, Professional Management or Consultancy (TPMC) services to persons resident in Nigeria. The Minister of Finance may by order define what constitutes SEP for this purpose.

Implications: Foreign persons earning business profits from Nigeria are taxed under Section 6 of PITA once a fixed base/taxable presence is created subject to existing treaties.

Section 6A introduces another basis for taxing such profits that previously escape a fixed base. In such cases, the gains or profit attributable to the activities will now be deemed to be derived from Nigeria and subject to withholding tax (mostly 5% for individuals) as final tax.

This may lead to double taxation on the profits even for treaty beneficiaries. While the constitution provides that tax treaties should be respected in Nigeria, and the Double Tax Agreements (DTAs) generally contain domestic law override provision, the tax authority may seek to apply section 38 of the PITA which provides as a condition, that a treaty only comes to effect if it is **expedient** that the agreement has effect.

The overall implication would be double taxation except a relief is available in the country of residence of the taxpayer.

Life assurance as an allowable deduction

Section 33(3) reinstates the relief by way of deduction for the premium paid by an individual to an insurance company in respect of insurance for his life or that of his spouse or contract of deferred annuity for his own life or that of his spouse in the preceding year of assessment.

Implications: This provision was previously removed by the Finance Act 2019, perhaps in error, but has now been reinstated.

Individuals can now continue to claim tax reliefs on premium payments on their life assurance or that of their spouse.

Pension contributions

Section 20(1g) of PITA has been amended to specifically limit tax relief for pension contributions only to schemes, provident or retirement benefits fund that are recognised under the Pension Reform Act (PRA) 2014.

Implications: Any pension contribution made into a scheme not recognised under the PRA 2014 will not qualify for tax deduction. Individuals who contribute to foreign schemes will not be able to claim a deduction in Nigeria for such contributions. Employers should ensure that only contributions to approved pension schemes under the PRA are treated as an allowable deduction on payroll.

Commencement and cessation rules

Sections 24 & 25 of PITA have revised the basis of taxation for individuals during commencement or cessation of business. The amendment effectively eliminates possible double taxation during commencement or non taxation during cessation. Rather, taxation will be based on the relevant accounting period of such business without any gap or overlap.

Implications: The revision of commencement and cessation rules will prevent possible double taxation which previously applied to a new enterprise on its profits of at least 12 months within the first 3 years of assessment. Also, the possibility of any accounting period escaping taxation during cessation has been eliminated.

Takeaway

The Finance Act 2020 has clarified some grey areas regarding the taxation of individuals, introduced some changes to broaden the tax net, cut back on generous personal reliefs while granting exemption from tax to the most vulnerable employees by exempting minimum wage from tax.

Employers will need to review and update their payroll systems, assess the impact of the new provisions on their employees, payroll compliance and reporting obligations. Any potential impact should be communicated to employees in advance.

Non resident individuals who provide TPMC services should consider if they will create an SEP under the new rules subject to any clarification by the Finance Minister.

For more information, contact members of our team below:



Esiri Agbeyi
M: +234 708 727 3056
E: emuesiri.agbeyi@pwc.com



Oluwafemi Kasali
M: +234 814 268 7562
E: oluwafemi.kasali@pwc.com

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