

PwC secures judgment for taxpayer as Tribunal rules that gratuities are wholly exempt from tax



PwC Contacts:

Kenneth Erikume

+234 1 271 1700 Ext 50004
kenneth.y.erikume@pwc.com

Folajimi Olamide Akinla

+234 1 271 1700 Ext 52008
folajimi.akinla@pwc.com

Background

Previously, Section 3 of the Personal Income Tax Act of 1993 (PITA 1993) – i.e. the charging section – imposed tax on gratuities. The 3rd Schedule to PITA 1993 also exempted gratuities up to N100,000 from tax. The implication was that gratuities in excess of N100,000 were subject to tax.

However, section 3 of PITA 1993 was subsequently amended by the Finance (Miscellaneous Tax Provisions) (No.3) Decree (1996 Decree) removing “gratuities” from taxable income. This remains the case under the Personal Income Tax Act 2011 (as amended) (PITA 2011). However, the exemption under the 3rd Schedule was not amended. This created an apparent conflict in that while on one hand section 3 did not specifically mention gratuities as taxable, the 3rd Schedule inferred that gratuities in excess of N100,000 are

taxable. This conflict created an uncertainty as to whether gratuities are subject to tax or not. For this reason different States adopted different practices.

Recently, the Tax Appeal Tribunal (Tribunal) in Nigerian Breweries v. Abia State Board of Internal Revenue held that gratuities are wholly exempt from tax.

Facts and decision of Tribunal

The Abia State Board of Internal Revenue (ASBIR) Revenue subjected Nigerian Breweries (NB) to tax on gratuities paid to the latter’s former employees. ASBIR also computed interest and penalties against NB.

The ASBIR argued that based on Paragraph 18 of the 3rd Schedule to PITA 2011 only gratuities not exceeding N100,000 were exempt.

NB’s position was that the intention of the drafters of the 1996 Decree was to exclude, in its entirety, gratuity from tax because “gratuities” was deleted from the charging section. Also where there was a conflict between a section in a statute and a provision in the Schedule to the statute, the section would prevail.

The Tribunal agreed with NB that gratuities are not subject to tax because:

- the charging section (section 3) expressly excludes “gratuities” from tax;
- where there is a conflict between a section and a schedule, the section prevails;

- the mischief behind the 1996 Decree was to exclude gratuities from tax; and
- by section 68 (1) and (2) of PITA, no interest and penalty should accrue once a taxpayer appeals or objects against an assessment within 2 months of notice which NB did.

The Tribunal also defined “charging section” by stating, amongst other things, that a charging section is the foundation and condition precedent for any tax liability to be imposed. The Tribunal held that a subject cannot be taxed unless the charging section clearly and unambiguously imposes an obligation.

Takeaway

The decision puts to rest the uncertainty created by the inconsistency in PITA, subject to any future decision of a higher court. Before now, different States had taken different positions and often taxpayers were constrained to seek clarification from the Joint Tax Board on whether gratuities were subject to tax or not.

The decision is also consistent with treatment of other post-employment income and a welcome development for businesses and retirees.

In line with the federal initiative to improve ease of doing business and paying taxes, government should now take steps to amend the law so that the intention to fully exempt gratuities from tax is clearly stated without any form of ambiguity.

