

## **Abuse Of Additional Voluntary Contributions To Pension As A Tax Relief**

### **Tax Authorities Threaten Stiff Penalties**

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#### **Introduction**

The Joint Tax Board (“JTB”) and the Lagos State Internal Revenue Service (“LIRS”) this week published separate Public Notices on the abuse of the Additional Voluntary Contribution (AVC) to pension accounts as a tax relief by employers and employees.

The publications noted that several employees have, with the collusion of pension fund administrators (PFAs), continually abused the provision in section 4 (3) of Pension Reform Act 2014 (“PRA”) which allows for employees to contribute additional sums from their emoluments to their retirement savings accounts (RSA) maintained with PFA. The PRA explicitly exempts all contributions to RSA from taxation in the hand of employer and employee. Withdrawals from AVC by an employee prior to 5 years of making such contributions makes the interest earned on the contributions liable to income tax. Since the enactment of the PRA in 2014 however, most PFAs appear to have been promoting the use of the AVC as a tax-saving plan for employees, by encouraging employees to channel larger portions of their earnings to the RSA as AVC with assurances of easy withdrawal within a short time.

Unsuspecting employers have fallen for this practice by employees with the excuse that the choice by an employee to contribute more of his earnings to pension is a personal one and that the tax relief resulting therefrom could not be denied, given that same is a function of statute. This practice has in recent months become widespread, leading to significant loss of tax revenues to state tax authorities and the backlash threatened in the public notices.

#### **Import of the JTB and LIRS Public Notices**

Both the JTB and LIRS’s publications tend to agree that the practice of AVC abuse is being marketed/encouraged by PFAs but the publication by LIRS curiously threatens to hold the employer responsible for the collection of the tax underpayment resulting from the practice!

Furthermore, the tax bodies insist that withdrawal from the AVC, as is being practiced by the PFAs, does not meet the requirements outlined in Section 16 of PRA 2014, which restricts withdrawals to the latter of retirement and attainment of 50 years, or upon permanent disability or death of an employee. The section also allows an employee whose employment is terminated and is unable to secure a new employment after 4 months to access his RSA balance.

The JTB publication also refers to the provision of Section 5 (8) of the Labour Act, which limits an employer from allowing only a maximum of  $33\frac{1}{3}$ <sup>rd</sup> of a worker’s wages from payroll in a month. Any deductions of AVC which lead to the violation of this provision, according to the JTB, will be deemed to be an artificial transaction as enshrined in Section 17 of the Personal Income Tax Act (PITA). Section 17, in summary, empowers the tax authority to disregard any disposition or arrangement which reduces the tax liability of a taxpayer, if in the opinion of the tax authority such arrangement or disposition was done with the sole intent of reducing obligation to tax.

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We foresee the tax authorities making employers the whipping boy for this practice, rather than focusing on the PFAs who receive and disburse this moneys to the employees.

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It should not be a surprise to see the various tax authorities rollout fresh tax audit exercises targeted at employers in the formal sector, with specially designed audit procedures to “uncover” shortfalls in tax payments due to the grant of AVC tax relief to employees. Such an unfortunate situation will amount to making employers the whipping boy for this practice, rather than focusing on the PFAs who receive and disburse this moneys to the employees.

## Labour Act Provisions Not Applicable to all Employees

A critical review of the Labour Act of 1990, which details the terms governing relationships between employers and workers, would reveal that the law does not apply to the entire spectrum of the Nigerian workforce. Section 91 (interpretation) of the Act expressly excludes “... persons exercising administrative, executive, technical or professional functions as public officers or otherwise...” from the definition of “workers.” This means that while blue collar employees are definitely bound by the provisions of the Labour Act, same cannot be safely claimed for senior level employees who are mainly the beneficiaries of the AVC tax relief.

### Our View

The fact cannot be denied that some employers may have been careless in allowing their employees to engage in the abuse of the AVC tax relief, especially where the proportion of contributions by these employees were obviously unrealistic and the leftover income not practically enough to sustain the employee till the next pay day. However, the fact that the employer is simply an unpaid agent for both tax and pension deductions must also not be lost on anyone. Therefore, how far can an employer be held responsible for the tax avoidance practices of the employee? How just, would an attempt to hold the employer responsible for the loss to one principal resulting from the performance of obligations on behalf of another principal, where both principals are statutory authorities?

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We are of the opinion that AVC tax relief abuse is wrong and should not be encouraged by anybody, including the PFAs and National Pension Commission (PENCOM), who unfortunately practically promoted the practice, or at best looked the other way while it festered. PENCOM’s silence is perhaps even more worrying, considering the fact that an exposure draft of a guideline intended to prevent the abuse was released as far back as November 2015, but still has not been finalized. It is in view of this complicity that we expect that this problem would be better solved via an inter-agency collaboration, between PENCOM and the JTB. Part of the solution should include PENCOM providing clear guidelines to PFAs on the administration of AVC henceforth.

A long term solution should include the amendment of the PRA, to make clearer provision for the withdrawal of voluntary contributions. This is necessary, as the only provisions for withdrawal in the current law is as in section 16, which apparently contemplates general withdrawals at retirement, loss of employment, permanent disability, and death. A further amendment to Labour Act is also desirable, so that it can cater for all types of employments and not just blue collar workers. Furthermore, section 5 (7) of the Labour Act that limits deductions from a workers wages in a month to  $33\frac{1}{3}$ <sup>rd</sup> of those wages requires an amendment to clarify on whether such wages would be determined prior or subsequent to removing taxes and statutory deductions like pensions.

In the meantime, employers must review their payrolls to confirm that AVC deductions are realistic and that employees are made aware of their exposure to further taxes if the tax reliefs earlier granted are withdrawn by the tax authorities.