

WITHHOLDING TAX: INSIGHTS

Income is undoubtedly a key essence of the business world. Whether as oil companies in the upstream sector, ordinary companies, or individual earners, we all have a source(s) of income, right? Accordingly, as a civic responsibility, it is expected that anyone who has a source of income should pay what is known as an 'income tax' as required by whatever law applies. While ideological stances might not agree with this notion of civic responsibility, it however remains the law, and the duty of a citizen is to obey the law by paying taxes as and when due, as much as it is the duty of the relevant tax authorities to ensure the law is complied with.

How then do the relevant tax authorities (RTAs) ensure that taxpayers pay taxes on their taxable income and how does this relate to withholding tax (WHT)?

The answer lies in the simple definition of withholding tax as an advance payment of income tax which can be used to offset a tax liability of a tax payer at the end of the period. Basically, "withholding tax also known as retention tax can be defined as the tax that is required by law to be withheld or deducted by the payer of the income from the income of the recipient and [remitted to the tax agencies of the government](#)". In other words, "[withholding tax is basically an advance and indirect source of taxation deducted at source from the invoices of the tax payer](#)" It is not a separate form of tax, thus there is no such legislation as Withholding Tax Act similar to the likes of Value Added Tax Act, Personal Income Tax Act, Companies Income Tax Act, etc. in Nigeria. It is however more appropriate to refer to it as a method used to collect income tax in order to avoid incidences of tax evasions/fraud by taxpayers.

CLARIFICATION OF TERMS

For ease of comprehension, it is important that you are acquainted with certain terms before delving into the essay properly. These terms are briefly highlighted and explained accordingly.

Relevant Tax Authorities (RTAs/RTA), in the context of this article, refers to the tax administrative authority/body responsible for the collection of withholding tax - In Nigeria, the Federal Inland Revenue Service (FIRS) and other internal revenue services of states e.g. KW- IRS and LIRS for Kwara and Lagos state respectively.

Taxable income refers to those incomes of a taxpayer which are subject to income taxation by the government. This amount is used to calculate how much an individual/company owes in taxes [to the government within a tax year.](#)

Tax liability may refer to the duty of a taxpayer to pay tax as well as the [total amount of tax debt owed by an individual, corporation, or other entity to a taxing authority](#)

WHT credit note is a receipt issued by the RTA to a taxpayer [as proof of deduction of withholding tax from their income](#)

Tax assessment year may refer to the year following a financial year within which income earned in [a financial year is assessed and taxed.](#)

Final income tax liability refers to the final income tax payable by a taxpayer at the end of a financial and after assessment by the RTA.

HOW DOES WITHHOLDING TAX WORK?

The basic rundown of how withholding tax works is that in a transaction to which WHT applies, the party who is to pay another party will pay on behalf of that other party, the percentage of the total contract sum which is subject to withholding tax. That is, the person paying the other party is to “withhold” the percentage of the WHT; for his remittance to the RTA.

Let us look at an example. Where under a contract, Jaiye Enterprises (payor) is to pay the contract sum of One million Naira (N1,000,000) to Halimah Ltd (payee) and the percentage of withholding tax deductible is pay 10% of the contract sum. Here, Jaiye Enterprises will have to deduct the sum of N100,000 (i.e 10% of 1,000,000) as withholding tax from the invoice of N1,000,000 payable as the contract sum and then remit the deducted amount to the RTA as WHT.

Furthermore, upon payment, Jaiye Enterprises is also obligated to obtain evidence of remittance in form of a withholding tax credit note on behalf of the payee, Halimah Ltd. The payee will then use the tax credit note to reduce any income tax payable at the end of a financial year. The question then is: How will Halimah Ltd. use the WHT note to reduce its income taxes?

Simple. Remember that WHT is an advance payment of income tax right? Great. So, if at the end of a financial year Halimah Ltd's tax payable is N500,000, then Halimah Ltd can use its WHT credit note of N100,000 to reduce its tax payable to N400,000. As you can see, the reduction is because Jaiye Enterprises had paid the WHT in advance on behalf of Halimah Ltd while they were transacting and equally obtained the credit note.

APPLICABLE LAWS

Although WHT is to be complied with by companies and individuals who are subject to it, Nevertheless, it is not contained in a single legislation.

Instead, various snippets of tax legislations in Nigeria cater for it. The laws that provide for deduction of tax at source (WHT) are the Company Income Tax Act (CITA) and the Personal Income Tax Act (PITA). These Laws impose income taxes on the taxable incomes of companies and individuals. In addition to these acts, the WHT tax regime in Nigeria is governed by regulations made under sections 73 and 81 of the PITA and CITA respectively.

As it relates to company income tax, withholding tax is, as earlier described, a mechanism for collecting in advance, company income tax from companies to which Company Income Tax Apply (corporations earning above one hundred million Naira per annum). Thus, where for example, a company is to pay the sum of 10 million Naira as its final tax liability, and it had earlier paid the sum of 3 million Naira as withholding taxes deducted on its invoices on various transactions during the year, that 3 million Naira will be set off against its final income tax liability of 10 million Naira, and the company will thus be required to pay 7 million Naira. This will however only be achievable with the evidence of a WHT credit note.

Similarly, as it relates to Personal Income Tax (PITA), the withholding taxes of an individual, sole corporation, or group of individuals - to whom Personal Income Tax applies will be set off against their final income tax liability. As such, where such individual's /sole corporation's / body of individuals' final tax liability is for example, N500,000 for a financial year, and the total of their

withholding tax credit notes sum up to N200,000; they will only be required to pay the remaining sum of N300,000. A form of collecting withholding taxes on personal income tax by state governments is the Pay-as-you-earn(PAYE) scheme, under which a portion of a tax payer’s salary is deducted as tax (leaving a net salary) and remitted to the state internal revenue service of the tax payer’s state of residence.

Section 13 of the Value Added Tax Act also mandates government agencies, ministries, and/or statutory bodies to withhold, on behalf of the FIRS, VAT on payments made to contractors.

The following laws provide for the transactions subject to WHT under Nigerian income tax laws along with their applicable rates:

Transaction	PITA	CITA
Dividends, rents, interests and director’s fees	10%	10%
Hire of equipment, motor vehicle, plants, machineries and leases	5%	10%
All commissions, consultancy, technical and management fees, legal, listing, and audit fees other than professional fees	5%	10%
Construction	5%	5%
Royalties	5%	10%
All types of contract and agency arrangement other than sale in the ordinary course of business	5%	5%

See generally: 69(2), 70(2), 71(2), 72(2), and 73(2) of the PITA (RATES, ETC., OF TAX DEDUCTED AT SOURCE (WITHHOLDING TAX)) REGULATIONS 1, (Column 1 and 2) in respect of applicable WHT rates under the PITA.

See generally: sections 78(2), 79(2), 80(2), and 81(2) of the CITA & COMPANIES INCOME TAX (RATES, ETC., OF TAX DEDUCTED AT SOURCE (WITHHOLDING TAX) REGULATIONS, Regulation 1 (column 1 and 2) in respect of applicable WHT rates under the CITA. See also: FIRS’ Information Circular (2006/02) for further explanations on the scope of the income-generating activities subject to WHT.

There used to be ambiguity with determining those transactions which are subject to withholding tax under the CITA. The CITA regulation on withholding tax exempts sales in the ordinary course of business from WHT deductions. The FIRS mandates deductions on all payments whether or not they are in respect of “sales in the ordinary course of business”.

Recently, on 30th of November 2020, the Tax Appeal Tribunal sitting in Lagos delivered judgment on the appeal *Tetra Pak West Africa Limited v Federal Inland Revenue Service* with appeal no: TAT/LZ/WHT/007/2019 held that determining sales in the ordinary course of doing business is a question of fact to be determined by the tax authority, albeit it gave guidelines on determining whether a business activity amounted to sales in the ordinary course of doing business thus:

- Whether the activity was contained in the memorandum and articles of association,
- The type of industry the taxpayer operates in,

- The history and antecedents of the taxpayer, and,
- the frequency of carrying out [the activity](#).

RELEVANT TAX AUTHORITIES

WHT is collected by both the state and local governments. The RTA responsible for the collection of WHT depends on the act under which it is deducted. For the CITA, payment shall be made to the Federal Inland Revenue Services (FIRS). For PITA, personal income tax is usually collected by State Internal Revenue Service(s) depending [on nature and location of employment](#), WHT for personal income is thus paid according to these rules.

Conclusively, it is safe to describe withholding tax as a collection mechanism for income tax [rather than being an actual type of tax](#).



ARTICLE WRITTEN BY:

John Olamide Baiyeshea is a third-year student of the Faculty of law, University of Ilorin. He is an avid researcher and writer. His interests are in commercial law and revenue law. He can be contacted through: johnbaiyeshea20@gmail.com or through his [LinkedIn page](#)

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