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2.5% Withholding Tax Rate: Who are the intended beneficiaries?

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Taxes payable on income, transactions or other taxable activities are not due at the same time either because the taxable activities do not occur within the same time frame or the law itself has stipulated different timeframes for the tax to be paid. For planning purposes however, Government must be able to determine upfront the quantum of its tax take as well as manage the time value implications of receipts from tax. Obviously, Government cannot always wait till the end of a fiscal year for all its income from taxes to come in before it commences execution of programs that should have been executed in the preceding year.

This is what makes the operation and administration of withholding tax (WHT) critical to Government's fiscal and economic planning. The basic rule of WHT is that the duty to deduct at the applicable rate arises whenever payment is made or credited, whichever first occurs, by the payer in favour of the beneficiary. After deduction, the payer is required to remit the amount deducted to the relevant tax authorities (RTA) within twenty-one days of the transactions occurring. The amount remitted is available to the beneficiary as a credit which can be set-off against its eventual tax liability for the relevant accounting period or year of assessment.

The operation and administration of WHT is not without its challenges some of which we have reviewed in previous InsideTax publications. One notable specific industry challenge was the applicability of WHT rate at 5% to the construction sector. To address this challenge, the WHT Amendment Regulations were issued and it introduced the WHT rate of 2.5% for the construction sector. This was in January 2015 when the Federal Government issued an official Gazette amending the Companies Income Tax (Rates etc., of Tax Deducted at Source (Withholding tax)) Regulations, 1997 (Regulations).

The amendment replaced Paragraph 1 of the Schedule to the Regulations by reducing the rate of Withholding tax (WHT) on all aspects of building, construction and related activities with the exclusion of surveys, design and deliveries from 5% to 2.5%. The amendment came as a direct response to the plight of construction companies, especially those in the civil construction business, on the impact of 5% WHT deductions on their business margins and cash flow; not to mention that these companies were often in perpetual credit after offsetting available WHT credits against their taxable profits for any given assessment year.

This intervention has however triggered concern on the scope of beneficiaries of the 2.5% WHT rate.

The reduced WHT rate is stated to apply to companies involved in "all aspects of building, construction and related activities…". Does this rate therefore have effect on such activities by companies in both non-oil and oil & gas sectors? For instance, the Federal Inland Revenue Service (FIRS)' Circular No. 2006/2 which defines "building and construction" to include laying of pipelines, maintenance activities and service charges, drilling and related activities. Are oil service companies engaged in construction activities beneficiaries of the reduced rate? What is the intended impact of the exclusion for surveys, designs and deliveries? Are beneficiaries only companies involved in civil construction works (building and construction)? Are the words "building" and "construction" meant to be considered jointly or severally or interchangeably?

The amendment also appears to apply only to Companies Income Tax (CIT) when it is clear that the laws giving effect to WHT include Personal Income Tax Act (as amended) and Petroleum Profits Tax Act. This would then imply that it is limited to companies involved in "all aspects of building, construction and related activities…"

WHT generally operates as an advance payment of income tax payable by companies, partnerships and individuals. A major difference between the application and administration of WHT to different taxpayers is the governing Act, which is Companies Income Tax Act for companies and the Personal Income Tax Act for partnerships and individuals. The relevant provision of both Acts on WHT are similar for the most part, except for the collecting body and in some cases the applicable rate of deduction. The transactions covered in both governing laws are the same and do not differ. In the same vein, the peculiarities of the industry (margins, cashflow etc.) are not limited to companies. Partnerships and sole proprietorships also experience these challenges. Consequently, fairness of the amendment may then be questionable.

There is a very urgent need for intervention to clarify the apparent ambiguity and uncertainty around the application of the WHT (Amendment) Regulations. This is because of the ever present possibility in which taxpayers become exposed to additional liability that crystallises by way of assessment raised by the RTAs following any tax audit or investigation exercises where they determine that the taxpayer had erroneously applied the wrong rate; in this case, the 2.5%.

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