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AN APPRAISAL OF PAY-AS-YOU EARN SYSTEM OF TAXATION IN NIGERIA

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ABSTRACT

The objective of this study is to appraise the administration of PAYE system of tax in Nigeria. The paper is a conceptual paper that focused on the procedures, templates and the assessment of income tax in Nigeria. The challenges affecting the assessment of PAYE system in Nigeria are not different from the general issues plaguing the administration of tax which include among other things: poor data base containing taxable persons and chargeable income; lack of competent manpower and the determination of residence. Other challenge is the time required to apply for refund of excess deduction. The approaches in the assessment and collection of tax liability are: simple approach, exact withholding and comprehensive withholding system. The current rate of determining tax liabilities of employees ranges between 7% and 24%. It is recommended that the Federal Inland Revenue Service should employ only chartered accountants, lawyers, graduates of Accountancy, statistics and related discipline in the administration of tax in Nigeria. Above all, the Head of Federal Inland Revenue Service and State Board of Internal Revenue should be persons with cognate experience and knowledge in taxation and Accountancy profession.

Key words: relief, income, relevant, tax, returns, assessment, persons etc.

INTRODUCTION

BACKGROUND TO THE STUDY

Personal Income Tax is a charges made on the wages or income of individuals, communities, families, partnership and trustees through Pay-As-You-Earn System. PAYE is a tax chargeable on the income of taxable adult or trustees at source. The tax is withheld at source either as at when the income is earned or the year end. The PAYE system varies from country to country depending on the extant laws, culture and the approaches of assessment, collection and remitting of returns. It has been adjudged by many scholars that the PAYE system in the United Kingdom is very potent relative to other countries in Europe and even the United State of America. This is in view of the mode of assessment, collection and remitting of returns mechanism of the country (Taxpayers Advocate: 2018)). The approaches or mode of administration may be at the end of the year, as soon as the income is earned or the reconciliation of both methods at the end of the year. The issue of over deductions and under deduction of tax liabilities is a common feature in tax administration. Therefore, it is expedient to choose a more convenient and fair method of tax administration. However, the income chargeable to personal income tax include: the income of it iternerant workers, staff of Nigerian Army, the Nigerian Navy, the Nigerian Airforce, the Nigerian Police Force, officers of the Nigerian Foreign Service, Resident of Federal Capital Territory, Abuja and persons residing outside Nigeria who derives income from Nigeria. Also, chargeable to tax is income of an individual resident in a state by the State Board of Internal Revenue.

The income of a family may be subjected to tax by the territory in which the income of the family is derived if it can be ascertained with certainty. In the case of a trustee, the income arising from settlements, estates or executorship is subjected to tax by the relevant tax authority of such territory.

The income chargeable to tax includes all the gains or profit arising from any trade, business, profession, or vocation. It also includes salaries, wages, fees, allowances, premium even bonus and executive compensation arising from employment, property or occupation. Others include dividend, interest, annuity etc.

Similarly, the gain or profit from partnership is subjected to tax. Such income may include remuneration, interest on capital wholly or partly undertaken in the day to day running of the business. However, not all income is chargeable to tax in Nigeria. Some income are exempted from taxation such as: the National Housing Fund Contribution, National minimum Wage, National Health Insurance Scheme, Life Assurance Premium, National Pension Scheme and Gratuities. The aforementioned are an addition to the income exempt specifically mentioned in the Third Schedule of the Personal Income Tax Act (Section 37). Also, a Consolidated Relief Allowance of ₦200,000 subject to 1% of gross income whichever is higher plus 20% of the gross income is granted at a flat rate The rate of tax in Nigeria is between the range of 7% and 24% on taxable income.

Thus, not all income generated is subjected to tax, the expenses incurred wholly, reasonably, necessarily and exclusively after the income are legitimate deduction in arriving at taxable income. (PWC: 2022).

The allowable deductions may include but not limited to: interest on loan borrowed in generating the income, interest on loan in developing owner's residence, rent and premium for the period, expenses on the repair of premises, plant & machinery and fixtures incurred in generating the income (Section 20, PITA). Deductions not allowed are: private expenses, capital withdrawal from trade or business, loss recoverable from insurance; rent or repair outside the business premises and foreign income brought into Nigeria through convertible currency.

The Pay-As-You Earn system of Personal Income Tax Act mandates all employees to file an annual return to the relevant tax authority on or before the 31st of March every year of all emolument received (Sect 81 PITA). And failure to oblige is liable to penalty.

Statement of the Problem

The PAYE System is bedeviled with plethora of challenges but not limited to:

Lack of reliable data base (statistics). The relevant tax authorities at all level do not have an accurate statistical data bank for taxable income or employees. The mode of assessing and collecting tax on the income of employees need much to be desired because non reliable data base. This has often resulted in multiple taxation on the same stream of income by relevant tax authority in the same jurisdiction.

The issue of poor tax administration cannot be ruled out. The issue of competent manpower to assess, collect, and remit returns is a herculean task to most tax agencies. Some tax administrators do not even possess, the requisite skill or knowledge in taxation and related discipline that can enhance the effectiveness and efficiency of revenue collection. There is no doubt that no one can give what he does not have. Some tax agents are not even aware of the exclusion of National Minimum Wage as taxable income.

Another issue is the determination of residence. This relates to the relationship between principal place of residence and many sources of income.

The general objective of this study is to examine the effect of poor tax administration and lack of reliable data base on the assessment of PAYE system of taxation in Nigeria.

Review of Relevant Literature

The PAYE system of taxation is a form of tax charged on the income, gain or profit of employees, families, communities, partnership, estates arising from trade, profession, employment or vocation (Olakanmi 2008). The income involves salaries, wages, fees, allowances, bonus and compensation arising from employment.

Taxable persons includes employees of the Nigerian Government both in Nigeria and outside Nigeria. It excludes those in foreign employment outside Nigeria.

If an employer owns an asset in the course of the business or trade, he shall be deemed to have incurred an expenses during the period and historical cost and he is entitled to 5% of the value of the asset or market value of the assets if the historical cost cannot be reasonably ascertained. The relevant tax authority shall deem it an allowable expenses if such assets is used wholly or necessarily in the course of the business.

Section 4, PITA noted that the employer that also pays rent or hire relating to such assets, the relevant tax authority shall consider it as an allowable expenses for the period. Such provision shall be equal to the annual amount of the rent.

However, such benefit shall not be applicable for the provision of meals at cantain or restaurant, uniform, coverall and clothing to employees by employers.

Sect 5 of the PITA noted that such benefit also applies to living accommodation. It noted that where an accommodation is made available to a wife as a result of the public office held by the husband or wife and the occupier pays no rent or pays rent less than the actual value or prevailing market value, such employee shall be considered as being in possession of such property and reduced by the annual value of the rent payable.

If a business or trade is partially carried out in Nigeria, the gain or profit chargeable to tax shall be the extent of such profit arising from the trade in Nigeria.

Similarly, if a business, trade or profession produces an assessable income that is considered less than the actual profit or income, the relevant tax authority will charge the turnover of the business accordingly (Sect7). In the case of employment, the gain or income is subjected to tax in Nigeria provided such duties, trade or profession is performed in Nigeria either wholly or partly. But if such duty is performed on behalf of an employer in another country and its emolument is not prepared by a fixed base in Nigeria such income is liable to tax in Nigeria (Section 10. PITA). The chargeable income shall not be chargeable to tax if the employee is not in Nigeria for a period of 183 days or above as a result of leave or temporary absence. Also, if the remuneration of the employee is subject to tax in another country under the provision of tax avoidance double taxation treaty with the country.

In the same vein, income from employment shall be liable to tax if the employer is in Nigeria and has a foxed base in Nigeria. The gain or profit from an employment performed in Nigeria shall be considered as income derived in Nigeria or elsewhere. The gain or profit arising from a duty performed in Nigeria during the leave or temporary absence of the employer from Nigeria (Sect 4, PITA).

In spite of the above provision, if a resident who earns income outside Nigeria brings such income into Nigeria through approved government channel such employee shall be entitled to a tax credit not beyond the proportion of the tax liability payable within the year of assessment.

INCOME EXEMPTED

All the income specifically mentioned in the Third schedule to the PITA are exempted from taxation and it includes:

1. The official remuneration of the president and governor and other person performing or functioning in that capacity.
2. The official enrolments of vice president and deputy governor are tax exempt.
3. The remuneration payable from United Kingdom fund to visiting forces in Nigeria or those in the permanent services of the United Kingdom in Nigeria.
4. Consular fee received on behalf of foreign country or those consular officers.
5. Interest accruing to a person who is not resident in Nigeria as relates to interest charged on loan on public fund raised in the United Kingdom, interest on bond raised by the Federal Government relating to International Bank for reconstruction and development under the auspices of the railway loan, interest on money borrowed by the Federal or state government.
6. Interest on loan granted to a person engaged in agricultural trade and the fabrication of local plant and machinery.

7. The income of a national of the United States of America from employment of International Administration.
8. The income of a national of the United States of America from employment with International Development Services or International Development Services or International Co-operation Administration.
9. Income of an individual from employment with the Ohio University of Athens relating to the training schemes or teachers in Nigeria.
10. The income of local government or government institution.
11. The income of ecclesiastical or charitable educational institutions of a public character.
12. Income in respect of person under the provision of immunities and priviledges Act.
13. Pension granted to any person relating to an enactment for the period in force.
14. Wound for the disability pensions granted to members of the armed forces.
15. Income or Trade Union registered under the Trade Union Act.
16. Gratuities payable to a public officer by the federal government or state.
17. Gratuities payable to an employee in the private sector relating to contract service.
18. The income of a registered friendly or statutory society derived from trade or business.
19. The income of a co-operative society registered under the Nigerian Co-operative Society Act.
20. Gratuities payable to former employee of the Nigeria Research Institute Act or the West African Council for Medical Research Act.
21. Gratuities paid to former employee of the Nigeria College of Arts, Science and Technology relating to services rendered under contract services.
22. An amount received as death gratuities or compensation for death or injury.
23. Compensation for loss of employment.
24. Dividend payable with equity participation of the company in foreign currency.
25. The interest accruing to a person on foreign currency domiciliary accounts.
26. Income earned by a professional outside Nigeria by temporary guest, lecturers, nurse, doctor or other professionals brought into Nigeria.
27. Income from dividend, interest, rent, royalties, fee and commission earned from abroad and registration into Nigeria shall be tax exempt.
28. Income earned abroad by author, sportsman, play writer. Musician, artist are brought into Nigeria provided such income is in foreign currencies.
29. Interest armed form issue of bond and short t tem rteasury securities.

Similarly, in addition to the above exemptions, the Minister of Finance of the Federal Republic of Nigeria can include in the Third schedule a Treaty or an agreement with other countries in relation to an international organizations. And also any arrangement subsisting between the federal government and each state.

DEDUCTIONS ALLOWED

The allowable deduction in the payment of income tax are those outflows or expenses incurred reasonably, necessarily, wholly and exclusively in generating the income in the year of assessment. These deductions are:

a. Interest on loan borrowed as part of capital used in generating the income.
b. Interest on loan in developing an owner-occupier houses.
c. Rent on the premises for land or building used in acquiring the income.
d. Other expenses incurred for repair of premises, plant and machinery relating to acquiring the income.
e. Bad debt arising from trade, business, profession or vocation in as much as it relates to the period under review.
f. All sum recovered during the period that was previously written off as bad desk
g. A contribution to an abatement deducted from the pension or salary of a public officer provided it is an approved scheme within the pension Act.
h. A contribution to a pension, provident or other retirements benefit from society or scheme that is approved by the board.
i. In the case of trade, business or profession, trade that is wholly, necessarily and exclusively incurred that relates to the period under review is deductible.

DEDUCTIONS NOT ALLOWED

Section 21,, PITA observed the following as deductions

a. Domestic or private expenses
b. Capital withdrawn from the business
c. Any loss or expenses recoverable from insurances contract or indemmity
d. Rent or repair that are not relating to the production of the income
e. Any payment to pension, provident, savings widows orphans, society as enacted by the Act in the applicable section
f. Any sum reserved out of profit except as permitted by the Act
g. Any expenses incurred outside Nigeria for the purpose of earning management fee in lieu of an agreement.

PERSONAL RELIEF AND DEPENDANT RELATIVES

There are many reliefs granted to tax payers on earned income. The various reliefs range from Consolidated Relief Allowance, children allowance, dependent relative allowance, alimony, rent allowance, transport allowance, premium for life assurance policy to statutory contribution and approved scheme.

Consolidated Relief Allowance (CRF): Section 33 (1) Of PITA granted a consolidated relief allowance of N200, 000.00 subject to minimum of I percent of gross income whichever is higher plus 20% of gross income to tax payer on earned income. The CRA is a replacement for earned income allowance that was in place before 2011. The relief is the higher of N200, 000.00 subject of a minimum of I percent gross income plus 20% of gross income. Therefore, new personal relief allowance is computed thus: N200, 000.00 plus 20% of gross income. This is because the comparison of N200, 000.00 of gross income is usually in favoir of N200, 000.00 except that the gross income is above N20, 000,000.00 (ihendinihu, Alphaeus & Omodero: 2019). Aguolu (2014) also lent credence to this assertion when he noted that section 4 (1) of the Personal Income Tax as amended is a replacement of the principal Act of section 33(1) that computes consolidated relief allowance as N200,000.00 plus 20% of gross emolument and the minimum of 1% of gross income whichever is higher. Aguolu asserted further that a taxpayer whose 1% of gross income is higher than N200, 000.00 plus 20% of gross emolument will receive the 1% of the gross income as the consolidated relief allowance. But in reality, the N200, 000.00 plus 20% of gross emolument is usually granted as the CRA unless the gross income is higher than N20m.

Children allowance: Section 33 (b) of the PTA noted that an allowance of N2500 is granted to an unmarried child provided he/she is below the age of sixteen years and still receiving education, training or instruction in a recognized institution. It is for a maximum of four children.

Alimony: Similarly, a relief of N3000 is granted to a former spouse whose marriage has been dissolved by a court of competent jurisdiction. The clam is valid if it has been paid in the preceding year by the claimant before the year of assessment

Dependent Relative Allowance: Section 33 (4C) of the PTA has granted a relief of not more than N2000 to a taxpayer for maintaining a dependent relative for a maximum of two persons. The relief is claimable provided the expenses is incurred on the year preceding the year of assessment and the relative is infirm or aged.

The dependent relative maybe the widowed mother of the spouse or close relative whose income is not more than N1000 preceding the year of assessment. The aggregate relief claimable in this regard will not exceed N4000 (sect 4c ii).

Premium for Life Assurance: any premium paid by a taxpayer for a life assurance policy for oneself or spouse in the preceding year of the assessment year is granted full relief.

Also, a deduction of N3000 or 20% of the earned income of an incapacitated person is allowed on a taxpayer.

Other reliefs include contribution to. National Health Insurance scheme. National Pension scheme; gratuities; National Housing Fund contribution.

Hence, the current tax rate for determining tax liability chargeable on personal income are:

First N300, 000 @ 7%

Next N300, 000 @ 11%

Next N500, 000 @15%

Next N500, 000 @ 19%

Next N1,600,000@21%

Over N320, 000 @ N24%

APPROACHES TO PAYE ASSESMENT

The Pay-As-You Earn (PAYE) system of taxation is a progressive tax which integrates income, deductions and credit in its administration.

Taxpayers Advocate (2018) observed the following approaches to PAYE collection:

a) Exact withholding approach

b) Comprehensive withholding approach and

c) Simple withholding approach

Exact withholding approach. This is the method used in collecting tax which withholds the actual tax liability of taxpayers at regular interval throughout the year. The collection and filling of tax returns require timeliness, convenience and efficiency in the assessment processes. This is the approach that requires a real time reporting of tax returns. This system advocates for self-assessment by taxpayers by supplying their employers the relevant information to enable the employers remit tax payable to the relevant tax authority. This approach withholds only the actual tax liability payable by taxpayers at regular interval. The merit of this system is the avoidance of over payment, refund and even underpayment. This approach is used mostly in the United Kingdom and it is being adjudged as one of the most effective tax system in the world. Some countries use a variant of exact withholding tax known as commulative exact withholding approach which withhold the accumulated tax liability only in the year end. Countries practicing this approach are Germany and Japan (Taxpayers Advocate: 2018).

Comprehensive Withholding Approach: the comprehensive PAYE is a broader scope of PAYE that integrates many transaction (income) in the collection process. This is a system that requires end of year tax collection. This system integrates wages, interest, pension, dividend which translate into exact withholding. The benefits of comprehensive PAYE system includes; reduced burden of reporting wages annually, reduction of errors and simplicity.

Simple PAYE approach: The simple PAYE is a system that applied a standard rate on income or wages throughout the year without regard to external factors on income. It is applied mostly in the United States of America. The employers withholds the tax liability of taxpayers at standard rate from wages. The approach continues unless the taxpayer recalculate the tax liability at the end of the year. It often results in overpayment in which tax credit is granted and may also result in under deduction.

DETERMINATION OF RESIDENCE

The determination of the residence of a taxpayer is a herculean task to most tax practioners and relevant tax authority.

The determination of place residence has so much bearing with the source of income of taxpayers. The sources of income could be earned income, foreign employment, Nigeria employment, unearned income, Nigeria pension.

Section 8 (1) of the PTA defined earned income as the income derived from trade, business, profession, vocation or employment exercised or carried on by him including pension from previous employment.

Foreign employment: This is an employment in which its activities or function are performed wholly and exclusively outside Nigeria and it is not liable to tax in Nigeria. This is the employment in which the principal office of the employer is outside Nigeria. A Nigerian who holds such employment on the 1st day at January on a relevant day shall be liable to tax in that territory.

Nigerian pension; it is defined by the Act as the pension payable as a result of past service by a government in Nigeria.

Nigerian employment: This refers to the employment in which the transaction or duties are performed in Nigeria either wholly or pathy.

There is no gainsaying that most individuals and corporate bodies hide under the cloak of residence to avoid tax in their operational base. It is on this note that the concept of place of residence and principal place of residence are instructive. A place of residence of an individual refers to the place which the person carries out domestic activities in a relevant day excluding hotel, rest house and any other temporary abode.

Principal place of residence: The principal place of residence of a person who resides in more than one or two places in a territory has the following applicable rules;

a. If the source of income is a pension without an earned income the principal place of residence shall be the place he resides most.
b. For an individual with an earned income other than pension, the place he resides most that is nearest to his office shall be his principal place of residence.
c. For individual with sources or source of earned income, the principal place of residence is the place he resides most.
d. For individual who works in a branch office as operational base of a company or corporate body, the principal place of residence shall be the operational site of the company provided that the operational site is an oil terminals, oil platforms, flow stations, factories, queries, construction site with a minimum, of 50 workers.

The objection by an individual relating to determination of place of residence or territory of person assessed shall be referred to the Joint Tax Board for settlement provided the individual can furnish them with the relevant ground for the objections. If two or more relevant authorities are also in dispute relating to determination of residence or territory of an individual, it shall be referred to the board for settlement.

RETURNS

Section 41 (3) requires taxable persons to file returns with the relevant tax authority within 90 days of the commencement of every year from 1st January to 31st March. The returns shall contain the amount of income from every sources and other information relating to allowances, relief and deduction that are material.

However, return shall not be filed where the income is N30,000.00 or less.

Similarly, a pension who files a return within the time frame for filling without default in the tax payable shall be entitled to the bonus of 1% of the tax payable.

CONCLUSION AND RECOMMENDATION

Many countries in the world are yet to get it right in the administration of PAYE, the research reveals the anomaly inherent in the PAYE system of many developed countries such as the United States of America that is still using the simple PAYE approach that is fraught with refund other irregularities.

The assessment and collection of PAYE is still a work in progress in many countries including Nigeria. It is recommended among other things.

1. The employees of the relevant tax authorities at all levels especially federal and state level should be trained and retrained in tax matters.
2. Only competent individuals and consultants should be engaged in administering tax in Nigeria.

3. The time allowed for an aggrieved person who has suffered unjust deduction to wait for six years has to be reduced to three months or the month in which the anomaly was uncovered.
4. The relevant tax authorities should have appropriate measures in place to tackle all relevant complaints swiftly.
5. Government at all levels should develop good data base to cater for taxable income
6. The citizenry should change their attitudes in complying with tax policy.
7. Revenue should also be used judiciously by does authorities to encourage voluntary compliance by taxable person.
8. Nigeria should understudy the tax system in the United Kingdom to achieve effectiveness and efficiency in the administration of tax in Nigeria.

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