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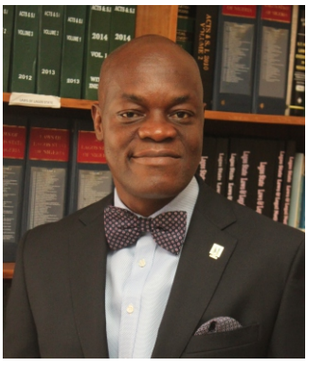
Thought Leadership | *Afolabi Elebiju*

Addendum – 'Withholding Tax: The A-Z of Grossing-Up'

Introduction

In my 2010 *'Taxspectives'* article, ***'Withholding Tax: The A-Z of Grossing Up',***[1] (the Article), I argued that gross-up clauses in commercial transactions were, subject to proper structuring, perfectly legal and could continue to be used, in the absence of any mandatory prohibition in Nigerian tax law. The controversial bent of the Article was exemplified by respective robust rejoinders (the Rejoinders) from two erudite learned friends: Drs. Obayemi and Oyetunde;[2] forcefully contending that my position was wrong. Incidentally, and with the greatest respect, I remain unshaken in my views, even after considering their very persuasive contrary arguments, which - I must concede - clearly enriched discourse on the issue.



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The Article, the Rejoinders and other relevant commentary[3] provide background to the current effort of this writer: to answer the question *whether and to what extent has subsequent developments, particularly tax amendments vide the two* ***Finance Acts 2020*** *(****FA1*** *and* ***2 2020*** *or* ***FAs 2020****) changed the position on gross-up?* Asked in another manner, the pertinent questions are: *given the amendments, can parties still gross-up or otherwise? What new issues should taxpayers be mindful of regarding grossing up in the new dispensation?* We will attempt to answer these questions without repeating discussions in the Article and Rejoinders.

Tax Gross-Up in Nigeria: *Has FA1 and FA2 2020 Moved the Goalpost?*

Despite its topical nature, there does not appear - to the best of this writer's knowledge - to have been any changes - statutory or case law - to the Nigerian gross-up framework since the publication of the Article, until the enactment of ***FA1 2020*** in January 2020.[4] Also, from caselaw viewpoint, the *locus classicus* and 2003 Court of Appeal decision, ***Total v Akinpelu,***[5] is still the binding judicial authority on gross-ups, as it has not yet been reversed.

Section 11 FA1 2020 amended ***section 27(1) Companies Income Tax Act***[6] ***(CITA)*** by inserting a new ***27(1)(1)(l)***, viz: *"any tax or penalty borne*

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[1]Originally published in the *'Taxspectives by Afolabi Elebiju' column, ThisDay Lawyer, 16.02.2010, p.14;* branded version also available online at *LeLaw Though Leadership* page: https://lelawlegal.com/add111pdfs/Witholding-Tax-A-to-Z-of-Grossing-Up1.pdf (accessed 04.04.2021).

[2]***'Re: Withholding Tax: The A-Z of Grossing Up (Rejoinder by Dr. Bode Oyetunde)',*** *ThisDay Lawyer, 16.03.2010, p.vii*; also available at: https://lelawlegal.com/add111pdfs/WHT-Grossing-Up-(Oyetunde-Rejoinder)2.pdf; and ***'Re: Withholding Tax: The A-Z of Grossing Up (Rejoinder by Dr. Olumide Obayemi)',*** *ThisDay Lawyer, 16.03.2010, p.vi*; also available at: https://lelawlegal.com/add111pdfs/WHT-Grossing-Up-(Obayemi-Rejoinder)1.pdf (both accessed on 07.04.2021).

[3]See for example, Olumide Obayemi and Esther Dejo-Ojomo, ***'The Gross Up Clauses in Commercial Leases Within the Context of WHT Regime in Nigeria'*** *Proshare, 21.12.2014:* https://www.proshareng.com/news/Taxation/The-Gross-Up-Clauses-in-Commercial-Leases-Within-the-Context-of-WHT-Regime-in-Nigeria/25451; Olalekan Sowande, ***'The Legality of Gross-Up Provisions in Commercial Agreements Revisited',*** *SPA Ajibade &Co, 15.08.2016:* http://www.spaajibade.com/resources/wp-content/uploads/2016/08/The-Legality-of-Gross-Up-Provisions-in-Commercial-Agreements-Revisited.pdf. See also commentary by Ugadan author, Lubega Balikuddembe, ***'Tax Gross-up Clauses',*** *LinkedIn, 12.04.2017:* https://www.linkedin.com/pulse/tax-gross-up-clauses-lubega-joseph-b-/, where he concluded that *"tax gross-up clauses are merely tax avoidance schemes call it a pricing mechanism."* (All articles herein referred to accessed 06.04. 2021). See also a prior article by Bidemi Olumide, ***'Re-Visiting Total v. Akinpelu - Filling the Gaps to Build the Taxpayer's Haven',*** https://www.scribd.com/document/8901648/Re-Visiting-Total-v-Akinpelu-Filling-the-Gaps-to-Build-the-Taxpayer-s-Haven-by-Bidemi-Olumide-Olowosile (accessed 06.04.2021).

[4]*Cf.* with the hardline stance taken by the legislature in disallowing fines and penalties (as discussed in *footnote 11* below).

[5]***[2004] 17 NWLR (Pt. 903), 509; 5 All NTC 229.***

[6]***Cap. C21, Laws of the Federation of Nigeria (LFN) 2004.***

by a company on behalf of another person", expressly disallowing same.[7] It is noteworthy that unlike some other amendments introduced by ***FA1 2020, FA2 2020*** did not amend this provision in any shape or form.[8]

FA1 2020 *now* ***only*** *further discouraged gross-ups*, because previously as I stated in the Article, *"at best, the 'penalty' against grossing-up in Regulation 2 is that the Revenue may add back the WHT amount to the taxable profits of the payer; but this regulatory response (of disallowed WHT 'expense'), does not make grossing-up illegal."*[9] ***It is now clear how gross-ups will henceforth be treated; they will be added back or disallowed for purposes of computing taxable profits with the clear intent that such will be a disincentive to grossing up.*** At the risk of repeating earlier arguments in the Article, gross-ups have not been made illegal, consequently taxpayers may still go ahead and contract accordingly, once they are willing to bear the financial consequences.[10]

It is hornbook law (almost requiring no authority), that tax is statutory. It therefore bears repetition that if the legislature had intended to proscribe gross-up, they would have done so expressly, whilst enacting the gross-up impacting provisions of ***FA1 2020***. Even more telling is the fact that ***FA2 2020*** (which even further amended some of the erstwhile new provisions introduced by ***FA1 2020***),[11] did not deem it fit to so do, regarding gross-ups.[12] This suggests that the legislature still believes that the practice should be a matter of party autonomy, regardless of arguments that the legislator's presumed preference is against grossing-up. *Nonetheless, what is clear is that on the current state of the law, there is no express prohibition against gross-ups.*

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However, it is conceded that the ***FA1 2020*** provisions will effectively strengthen the argument of a payer that wants to resist gross-up; this could likely tilt the scale where the two counterparties are evenly matched on the negotiating scale. In that regard, ***FA1 2020*** has at least moved the needle, albeit very slightly.

Conclusion

In the meantime payees can continue to argue that *"we will cross the bridge when we get there"*, that is if and when the legislator eventually decides to bite the bullet by proscribing gross-up. Even in that eventuality, payees can still achieve gross-up effects without grossing up; it is by communicating a higher pricing (subject to competitiveness), for goods/services, such that after deduction from the price, the payee is still in a good place.[13]

Since there is no reference whatsoever to grossing-up (even if it happens 'at the backend' (not 'visible' to counterparty and the Revenue, *per* footnote 13 illustration herein), there is nothing to argue about. Ultimately, it will all boil down to applying creativity to validly achieve desired commercial results, without exposure to undue regulatory scrutiny or challenge.

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[7] ***Section 27 CITA*** is captioned *"Deductions not allowed"*.

[8] *Cf.* with ***section 27(1)(k) CITA*** (as amended by ***section 11 FA1 2020***) disallowing *"any penalty prescribed by any Act of the National Assembly for the violation of any statute"*, further amended by ***section 12 FA2 2020*** to achieve a wider reach. The new ***section 27(1)(k) CITA*** reads: *"penalty or fine imposed pursuant to a legislation enacted by the National Assembly or State House of Assembly."* The ***FA1 2020*** amendment did not catch penalties and fines under ***State Laws***, and might also have arguably been considered doubtful against disallowing penalties by regulatory agencies, even though such were pursuant to ***Acts*** (legislation by the National Assembly). However, the ***FA2 2020*** amendment has closed such gaps, thereby minimising room for ambiguity.

[9] At *p.2* (*LeLaw Thought Leadership* branded version, ***supra***).

[10] *Cf.* with examples whereby businesses that cannot access foreign currency through the *"official market"* (currently, the *Import and Export ("I&E") Window*) can still freely make offshore remittances using funds in their foreign currency domiciliary accounts. This is because they are entitled (by ***section 17 Foreign Exchange (Monitoring & Miscellaneous Provisions) Act, Cap. F34 LFN 2004 (FEMMPA)***), to freely use such for the purposes of their business. Another is where service fees to non-resident providers on registrable, but unregistered, technology agreements with the National Office for Technology Acquisition and Promotion NOTAP are paid from domiciliary accounts or other sources: *such payments would be non-tax deductible by the combined operation of* ***section 7 NOTAP Act, Cap. N62, LFN 2004*** and ***section 27(1)(k) CITA***.

[11] See for example, ***sections 7, 10 and 12 FA2 2020***, which further amended changes to ***sections 13, 23*** and ***27 CITA*** *vide* ***sections 4, 9*** and ***11 FA1 2020,*** respectively.

[12] For a somewhat related discussion, see Afolabi Elebiju and Daniel Odupe, ***'Cessations and Destinations: Issues in Gas Flare Commercialisation in Nigeria'***, *LeLaw Thought Leadership, February 2021, at p.10:* https://lelawlegal. com/add111pdfs/TLR-Cessations_and_Destinations_3.pdf (accessed 04.04.2021).

"Whilst it is now clear from recent cases that the courts were - as a means of discouraging gas flaring - leaning towards disallowing upstream companies' gas flaring penalties, the debate is now moot by virtue of ***section 12 FA2 2020****. That provision inserts a new* ***section 27(k) CITA*** *listing: 'penalty or fine imposed pursuant to a legislation enacted by the National Assembly or State House of Assembly' amongst 'deductions not allowed'. It is trite law that the Courts must give effect to express words of the legislature, where they are clear and unambiguous:* ***NB Plc v Governor of Oyo State (2011) LPELR 4610 CA****. If the penalties are significantly stiff and non-deductible, that would be a double-edged disincentive to continue, or not to, minimise flaring. These two objectives appear to be the contemplation of* ***section 104 PIB [2020]*** *… Cf. the present* ***section 11(2)(b) PPTA*** *which guarantees that eligible companies will pay the lowest gas flare penalty fee charged by the Minister!"*

[13] As opposed to where payee (an individual) says *"pay me ₦100,000 and bear the WHT on my behalf"*; thus creating the standard gross-up scenario by communicating a net sum of ₦100,000. Whereas in this case payee indicates ₦105,263.16 price which is subjected to WHT (at 5%), and still ends up with ₦100,000. The difference here is that whilst the payee still achieved his objective, he did not disclose any net amount that would be grossed up to deliver such net amount – and the anti-gross-up advocates may find this less objectionable.