



'E Fit Be You Oh!'

-Tax Treatment of Prize Winnings

'Taxspectives' by **Afolabi Elebiju** | Originally published in *ThisDay Lawyer*, 11th January 2011, p.vi



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Introduction

Promotion lotteries and prize winnings have become a recurring decimal in Nigeria, assuming increasing significance as part of marketing/brand visibility strategy of competitive businesses. Winning comes in various shapes and sizes, creative proponents would have us believing that there is **something new under the sun**, hence new promotions emerge by the day with their own unique propositions. Customers will always be attracted by the prospects of 'easy' winnings. Whilst the packaging and marketing of promotions has itself become an industry, this piece addresses the related tax issues, which are often taken for granted.

Are Winnings Liable to Withholding Tax (WHT)?

Recently, a multinational promotions client sought advice whether WHT was applicable to prize winnings, because of divergent views with its partner/client. I opined that there is no WHT requirement on payment to lottery/prize winners, given the specificity of Nigerian WHT system. By the provisions of **sections 69-74 Personal Income Tax Act, Cap. P8 LFN 2004 (PITA)** and WHT Regulations, WHT is only applicable to listed transactions/payments

Although participation in the lottery/promotion consults a 'contract', it is arguable whether the transaction is not *sales in the ordinary course of business even for a manufacturing business* (as opposed to lottery licensee). There is sufficient argument that the FIRS' Interpretative Circular No.2006/02 on WHT Operation does not catch such transactions as lottery pay-outs.

Research shows that applicable lottery laws (i.e. *National Lottery Act, Cap. 23 N145 LFN 2004; Lagos State Lotto Authority Law, Cap. C5 2003*) – constitutionality of Federal v State lottery legislations being another matter entirely – also do not specifically impose a withholding obligation on promoters regarding payments to winners. *The Casino Taxation Act, Cap. C3 LFN 2004* only makes provisions for taxation of licences or casino operation on net gaming revenue.

Accordingly, winners would (currently) be expected to report their winnings as other income when they file their PIT returns, pursuant to section 3(1)(f) PITA which provides that: "... tax shall be payable for each year of assessment on the aggregate amounts each of which is the income of every taxable person,... from a source inside or outside Nigeria... including [on] any profit, gain or other payment not falling within paragraph (a) to (e) inclusive of this subsection." Furthermore, section 36 PITA provides that the total income of an individual for any year of assessment shall be the amount of his total assessable income from all sources from that year. So there is no doubt that prize winnings are ultimately taxable.

It is prudent for payers to deduct WHT if in doubt whether WHT applies to the



(such as interest, dividends, royalties, consultancy, and management/professional service fees). The omnibus classification – requiring WHT deductions on "contracts other than the sales in the ordinary course of business" – does not extend to prize winners.

transaction - to avoid interest and penalties if WHT was indeed applicable. However, erring on the side of caution and thereby erroneously deducting WHT, puts the burden on the prize winner. Because the payer is not bearing the WHT burden, it has little incentive to take the risk or costs of challenging Revenue enforcement of alleged WHT obligation. It is also not improbable that deductions never get remitted, but becomes part of operator/manufacturer's exclusive 'profit' from the "joint venture" with the promotions company. In a typical arrangement, the former contributes its brand and the latter funds the promotions, with sharing of net profits in agreed ratio. For their own part, prize winners may just be too happy to get the net winning, effectively regarding same as "freebies".

Alternatively, promoters may gross up, so winners still go home with the advertised value of prizes, whilst the WHT is regarded as additional cost of the promotion. This approach may be worth more than the reputational risk that paying net prize winnings may engender.

However, tax authorities can only enforce obligations that have statutory basis. Taxing statutes are construed strictly and "*the language of the statute must not be strained in order to tax a transaction which had the legislature thought of it, would have been covered by appropriate words*": **AHMADU V. GOVERNOR KOGI STATE [2002] 3 NWLR (Pt. 755) 502 at 522.**

Lagos State is reportedly planning to amend its lottery law to effect deductions on winnings. It is understood that there is a Lagos State administrative memo on such withholding but same has not yet become operative; in any event, without enabling legislation, its efficacy would be in doubt.

Legislative action to effect advance payment of tax on prizes is necessary (could be done vide PITA amendment) to ensure that the Revenue gets its own share of the **windfall**, same time as the winners. This is the practice in some jurisdictions and, more importantly



should obviate any risk of the winnings ultimately escaping tax. My hypothesis is that WHT is the most optimal way of taxing the pay-out.

Such amendment may stipulate a higher tax rate (say 35%), than current PITA's maximum 25% and clearly obviate potential discrimination between cash and prizes-in-kind, so tax would be payable on the cash value of the latter. Impact analysis of such windfall rate on the economics of promotions is outside the scope of this article.

A school of thought in the Nigerian lotto industry opines that WHT is not applicable because tax has already been paid when the customer paid for the service which qualified him for the promotion. A persuasive example is the UK where lottery/income would have been taxed (and part allocated to charities), before prize amounts are allocated.

Although there is provision in Nigeria for allocation of 20% - 27.5% of lottery proceeds into Trust Funds for socially beneficial projects (sections 24 and 40, Cap. N145), that does not derogate from the point that winnings are liable to tax, only that there is currently no mandatory WHT provision on prize pay-outs. In the USA, lump sum winnings are "subject to ordinary income tax treatment" such that the lottery winnings over \$600 are subject to Federal WHT, in addition to State WHT or other (back) taxes that the winner may be owing his State IRS.

Deductibility of Lottery/ Promotion Expenses

Pursuant to section 24 CITA, lottery/promotions expenses (including prize pay-outs) would be deductible when computing the taxable profits of the licensee or promoter.

Is VAT applicable?

Another issue is the VAT treatment on prizes. For cash payments, the issue does not arise at all because VAT would have been included in the qualifying charges (e.g. SMS/ticket costs) paid by the customer and the promoter will not be required to add VAT to the cash prize. For prize-in-kind, VAT would have been incurred by the promoters in purchasing same, which may then be expensed through the profit and loss account, rather than offset from output tax as the prizes are arguably not "*goods purchased or imported directly for resale and goods which form the stock-in-trade used for the direct production of any new production on which the output tax is charged*", per section 17 VAT Act.

The input VAT on prizes like cars cannot be capitalised with the cost of the assets because they would not be retained in the books of the promoters. Further, section 17(2) VAT Act prohibits input VAT on overhead from being deductible from output VAT; marketing and promotional costs being universally regarded as part of (variable) overhead costs. Accordingly, the only permissible treatment from the input VAT is that it be expensed.

Conclusion

Till date, I have not had the lucky experience of being declared a winner in any promotion. In the event that such becomes a reality for me, I would be claiming my prize in full not only for the potential contribution to 'a merrier Christmas', but also because there is currently no sustainable legal basis for withholding on the pay-out.

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