RE: Withholding Tax: The A-Z of Grossing Up

(Rejoinder by Dr. Olumide Obayemi)

'Taxspectives' by **Afolabi Elebiju** | Originally published in *ThisDay Lawyer, 30th October 2012, p.12*

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Introductory Note:

My good friend, Dr. Olumide Obayemi, a member of the Nigerian and Californian Bars who currently practices in the USA, sent in an interesting rejoinder to my grossing-up article published in this column on February 16 2010. We take a break from planned review of NTP/PIB to publish the rejoinder. Enjoy.

Harvard trained lawyer, Afolabi Elebiju's piece entitled: *WITHOLDING TAX: The A-Z of Grossing Up*, is highly informative and rich in depth. Yet, it curiously fails to look beyond European models for guidance. One of the Asian Tiger economies, Cambodia, has an instructive guide towards avoiding the injustice and incongruity associated with using the "Grossing-Up" theory in calculating withholding taxes (WHT). That the "stronger" party can coerce the "weaker" party to cough up both the WHT and the grossed up monies does not aid or promote equity. Nigerian tax practice must adopt rules that allow the payer to deduct the invoice or contract amount of the service, rent or other payment. If the payer must bear the cost of WHT under the contract, the "grossed-up" amount may not be deducted as an expense for by the payee. If the recipient/payee bears the cost of the WHT, then the payer may deduct the invoice/contract amount regardless.

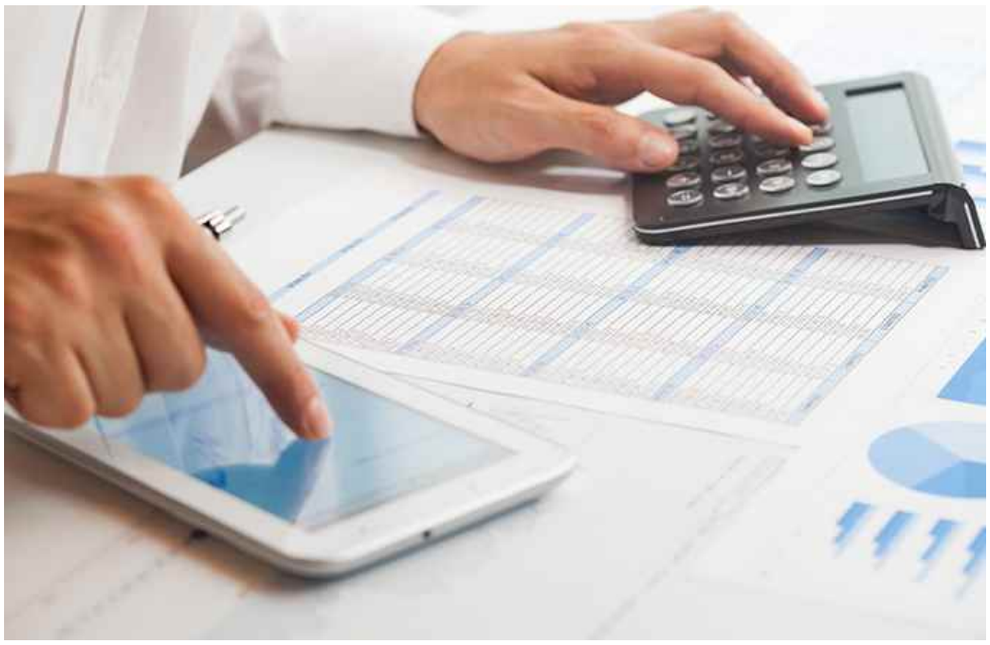
Tax Gross-up entails paying the full amount on a transaction, without any deduction. A gross-up clause in a contract provides that all payments must be made in the full amount, free of any deductions or withholding and without exercising any right of set-off, and that if there is a mandatory withholding or deduction by operation of law tax, then the paying party shall "gross-up" the payment so that the receiving party receives the same net amount.

In Nigeria, *Section 69(3)(a) PITA* provides: "*in accounting for the tax so deducted to the relevant tax authority, the payer shall state in writing the following particulars which shall accompany the remittance, that is … the gross amount of the rent;…*" Also, *Regulation 3(c), PITA (WHT) Regulations* provides that: "*A person who deducts tax from a payment shall issue a receipt for the tax so deducted and a statement containing the following information, that is … the gross amount paid or payable;…*" Thus, in *TOTAL v. AKINPELU* [2004] 17 NWLR (Pt. 903) 509, *Omage, JCA* held that the lessee (weaker party) was obligated to pay the WHT that it had already contractually agreed to: "*as Decree No. 104 does not contain a provision restricting or forbidding the payment of the WHT payable by [Akinpelu] by [Total], and [Total] has covenanted on the pain of forfeiting the lease, discretion should dictate that [Total] should agree to pay as covenanted with [Total] from his pocket, the 10% withholding tax.*" See *Total v. Akinpelu*, at 524-525, paras H-A.

The above findings, as noted by Bidemi Olowosile, practically demands that different costs would be stated in the books of the tax authorities and the payee's accounts. Where the difference represents a colossal sum that could otherwise have been made available to payee's shareholders as dividends, the payee might be calling for negative shareholder reactions.

The calculation of WHT in Cambodia has changed drastically as from July 2009, when the Ministry of Economy and Finance promulgated *Prakas 599 MEF-PK* on "*Deductible Expenses of the Enterprise Regarding the Withholding Tax*". Its aim was to clarify the Tax on profit ("TOP") deductibility of payments that trigger WHT, in line with the tax calculation method used in the illustrative examples in *Prakas 599*. As a result, the "gross-up" method of calculating both WHT and fringe benefit tax was abandoned in favor of a simpler technique. *Prakas 599* confirmed that the only amount the payer is allowed to deduct for TOP purposes is the amount of the invoice or contract without grossing-up for WHT. Where Company A rents a house from B for N1 million the 10% WHT may not be deducted as an expense by A. This, is so, even if A and B agreed that A will bear the cost for the WHT, A may nevertheless only deduct N1 million as an expense for its TOP calculation in accordance with tax regulations.

Prakas 599 now distinguishes between situations where the payer has to bear the cost of the WHT, and those where



the recipient bears such cost. It is normally the recipient that bears the cost, but the parties are free to contractually agree that such cost will be borne by the payer. In line with current practice, *Prakas* 599 confirms that the payer is allowed to deduct the invoice or contract amount of the service, rent or other payment. If the payer must bear the cost of the WHT under the contract, the "gross-up" amount may not be deducted as an expense for TOP purposes. If the recipient bears the cost of the WHT, the payer may deduct the invoice/contract amount regardless.

Also, in August 2009, the Cambodian General Department of Taxation ("GDT") released letter 973 *GDT/N/ChVS* which confirms that, when calculating both WHT and fringe benefit tax, the gross-up method is indeed no longer to be used, so as to *"simplify the calculation of the taxable base for all kinds of WHT"*. Thus, *"if a taxpayer does not withhold the tax before making payment and pays WHT on behalf of a recipient of income; hence, the tax administration does not allow the WHT to be deducted from the taxable profit of the enterprise and also does not allow to gross-up the taxable value of the WHT."* In essence, *Prakas No.599* does two things at once: it limits the amount of expense deduction for an income that was subject to WHT, and it abolishes the gross-up for that WHT.

Elebiju's position is that *"the tax law should be neutral.... Grossing-up is just another way that counterparties to a deal allocate and mitigate risks: it should be a business decision whether the deal is worth the risk, and that tax law should not strengthen the hands of one party against the other at the negotiating table."* We beg to differ, tax law must make the playing field a level one. Thus, where statutes impose a tax on the payee specifically, i.e., where statutes obligate the payee (and only the payee) to pay a precise dollar amount in tax, if a gross-up were awarded to the payee, it necessarily follows that a portion of the payee's tax burden would be shifted, so that the incidence of such portion would fall upon payer rather than payee. This is the injustice that must be corrected, because if Congress had wanted to impose an extra tax on payer, then Congress would have either explicitly taxed payer directly or made clear its intention to shift part of payee's tax burden. It is inequitable for the payee to ask the payer to bear its tax burden through grossing-up tactics.[1]

Concluding Note [by Afolabi Elebiju]:

Togo, Nigeria's neighbor, criminalises grossing-up vide *Article 1184* of their *Tax Regulation (CGI)*. My view remains that our law does not - despite many opportunities to do so, including as recently as 2007 when the *FIRS Act* was passed. Consequently, parties are free to negotiate whether or not to gross-up.

[1]This was one of two rejoinders to my Taxspectives article, *'Withholding Tax: the A-Z of Grossing Up'*, published in *THISDAY LAWYER, February 16, 2010*.