LAGOS STATE GOVERNMENT

PUBLIC NOTICE

TAXATION OF EMPLOYEE LOAN

The Lagos State Internal Revenue Service (LIRS) is issuing this Public Notice to all employers, company owners or their representatives, employees, high net worth individuals and other members of the public.

Definition

Employee loans are loans given by an employer to an employee for specific reasons with the expectation that such loan will be repaid in full to the employer through a pre-agreed deduction from the employee's net salary, with or without any interest.

Legal basis

Section 3 (1)(b) of the PITA imposes tax on any salary, wage, fee, allowance or other gain or profit from employment including compensations, bonuses, premiums, benefits or other perquisites allowed, given or granted by any person to any temporary or permanent employee. More often than not, an employer may offer loans to its employees at an interest rate lower than the market interest rate or zero percent interest rate. This arrangement gives rise to a benefit which is taxable in the hands of the employees.

Compliance Requirements

1. Deduction of PAYE: The employer is required to compute tax on the difference between the rate on such employee loan and the adjusted Monetary Policy Rate (MPR) and remit to the relevant authority. The adjusted MPR is MPR minus 3%. The obligation to deduct tax on the difference depends on payment terms:

    - Where the payment is on a monthly basis, the tax (the difference between the rate on the loan and the adjusted MFR) should be assessed by the employer on a monthly basis;
    - Where the payment is on an annual basis, the benefit should be assessed by the employer on an annual basis.

2. Reporting Obligation: Every employer is required to file, alongside their annual returns, a schedule showing the information on its employee loan and the payment terms.

3. Other Issues:

    a) Applicability: This provision will apply to directors and employees of a company and will continue to apply to even after the relationship with the company has been terminated as long as the loan remains unpaid. The principle will also be applied to significant shareholders.

    b) Any employee loan with interest above the adjusted MPR or at commercial rates will not be assessed to any additional benefits for the employees receiving such a loan.

For further enquiries, please call **0700-CALL LIRS (0700 2255 5477)** or visit **www.lirs.gov.ng**

Thank You

Signed
Ayodele Subair
Executive Chairman
Lagos Internal Revenue Service

1. *TAXATION OF EMPLOYEE LOAN*

Definition

An employer may offer a less than market interest rate or interest-free loan to an employee to meet certain expenses e.g. daily up-keep, purchase of a car, purchase or building of a property etc. A loan given by an employer to an employee is usually with the expectation that such loan will be repaid in full to the employer through a preagreed deduction from the employee's net salary. The interest which would have been charged on this loan, had it been obtained from a commercial bank, is considered a benefit to the employee. if the employee was a 3rd party, they would have been required to pay interest (if interest-free loan) or pay at a higher rate (if interest is at a rate lower than market interest rate).

The same rules apply where a loan is forgiven to an employee or the employee pays back with an item, other than cash that is less than the value of the loan. Such forfeited amounts constitute a taxable benefit. The same rule applies to salary advances.

The lack of clarity of how this benefit would be valued has led to the benefit not being declared by employers in the PAYE filings for staff.

Legal Basis

Section 3 (1)(b) of the Personal income Tax Act (PITA) imposes tax on any salary, wage, fee, allowance or other gain or profit from employment including compensations, bonuses, premiums, benefits or other perquisites allowed, given or granted by any person to any temporary or permanent employee. . .

Objective

This explanatory note seeks to help simplify issues surrounding the taxation of employee loans and provide companies with a guide on determining the value of the benefit derived by recipients of such loans.

Other issues

Compliance Requirements

1. Deduction of PAYE: The employer is required to compute tax on the difference between the rate on such employee loans and the adjusted Monetary Policy Rate (MPR) and remit to the relevant authority. The adjusted MPR is MPR less 3%. The obligation to deduct tax on the difference depends on payment terms:

    - Where the payment is on a monthly basis, the tax (the difference between the rate on the loan and the adjusted MPR) should be assessed by the employer on a monthly basis;

    - Where the payment is on an annual basis, the benefit should be assessed by the employer on an annual basis.

2. Reporting Obligation: Every employer is required to tile, alongside their annual returns, a schedule showing the information on its employee loans and the payment terms.

3. Other issues

Applicability: This provision will apply to directors and employees of a company and will continue to apply even after the relationship with the company has been terminated as long

a) as the loan remains unpaid. This is on the basis that the loan was granted solely because they had been in employment of the company. The principle will also be applied to significant shareholders. However, depending on their status. the shareholder could be subject to the PAYE if they are also executive directors or direct assessment if they are not employed by the company.

b) Any employee loan with interest equal to and above the adjusted MPR will not trigger any additional benefits for the employees receiving such a loan.

Thresholds: Apart from the exemption for interest above the adjusted monetary policy rates, the LIRS will not impose the rules for loans less than N2million which is usually granted to lower earning staff such as drivers and clerks.