

Taxation of employment

Ade Ipaye

What is employment Income?

According to section 108 of the Personal Income tax Act, 'Employment' includes any appointment or office, whether public or otherwise, for which remuneration is payable. For tax purposes, a person in paid employment should be distinguished from another who is self-employed as an independent contractor. In the case of employment, a contract of service exists between the employer and the employee whereas the independent contractor is said to have a contract for service. In a contract of service, the employer exercises powers of selection and control over the employee and the latter has an obligation to act in obedience. However, under a contract for service an independent contractor is bound to deliver the agreed service but he is not obliged to obey orders or do his work in any particular manner. The distinguishing factors can be summarized as follows:

"Factors pointing to employment are that you need to carry out the work wholly or mainly for one business, you need to carry out the work in person, you have to take orders as to how and when to do it, to work where those providing the work tell you to, and to work set hours at an hourly, weekly or monthly rate, and you get paid for overtime, sickness and holidays. Factors pointing to self-employment are that you risk your own capital and bear any losses, you control whether, how, when, and where you do the work, provide your own equipment, are free to employ others to do the work and are required to bear the cost of correcting anything that goes wrong. None of these factors is conclusive.

As we have seen earlier, the Personal Income tax Act (PITA) makes different regulations for the taxation of such self-employed or independent contractors.

They are treated as individuals carrying on business, trade, profession or vocation.

The statutory definition of employment hinges on the words 'appointment' and 'office'. In *Great Western Railway v Bater*, Rowlatt J. described employment as "something analogous to an office and which is conveniently amenable to the scheme of taxation which is applied to offices as opposed to the earning of man who follows a profession or vocation."

Appointment suggests the subordination of an individual to the employment or direction of another. The former thereby becomes an employee and the latter an employer. An office is a subsisting, permanent, substantive position which exists independent of the person who fills it and which typically goes on and is filled in

succession by successive holders. This definition has been generally accepted, subject to the reservation that permanence and continuity of the office are not so critical anymore. We may conclude by saying that an office is a position or place to which certain duties are attached, especially those of more or less public character.

"Getting appointed' and 'holding an office' are however not mutually exclusive. The holder of an office is usually appointed as such. But not all appointments create an office of a permanent nature. 'Appointment' therefore has wider connotations than the holding of an office. The PITA does not define the term 'office'. In *Great Western Railway v Bater*, Rowlatt J. defines office as a independent, permanent, substantive position which had an existence independent of the person who filled it, which went on and was filled in succession by successive holders". The House of Lords *Macmillan v. Guest* affirmed this definition. In recent times, the significance of permanence and continuity have diminished as factors of the existence of an office.

In *Edwards v. Clinch*, Lord Lowry in describing the nature of an office, stated that:

"A genuine office does not lapse because the holder dies, retires or completes his assignment. To be in a position of authority is not necessarily to hold an office, and when you appoint somebody to do something you do not thereby appoint him to be something (in other words, to hold an office) unless the Act says so".

Sometimes it might be difficult to say whether a person holds an office or not. In *Edwards v. Clinch*, the House of Lords, by a 3-2 majority, held that the taxpayer, a civil engineer who was appointed by the Department of Environment to act as Inspector at public local enquiries from time to time, did not hold an office. At the Court of Appeal, Ackner L.J. gave the majority reasoning behind the decision. "It was a temporary ad hoc appointment confined to the taxpayer. He was not appointed to a position, which had an existence of its own. It had not quality of permanence about it." This implies that an office must exist separate from the office holder. In this regard, company directors, auditors, judges, trustees and personal representatives etc. have been held to be office holders.

The PITA does not also define 'appointment'. An appointment has however been said to be the 'designation of person, by the person or persons having authority therefore, to discharge the duties of some office or trust." Here, the definition of appointment includes 'office' just as Lord Lowry's dictum in *Edwards v. Clinch* includes appointment.

In Nigeria, there has been virtually no controversy on the issue of distinguishing, for tax purposes, an employee from persons who carry on business, profession or vocation as independent contractors. Usually, an independent contractor is paid once and for all or in a few installments, pursuant to a contract having that effect. Even if

he holds an office, it is temporary and his compensation or reward is not regarded as salary or wages. On the other hand an employee has his annual salary determined at the commencement of his employment and is usually paid on a monthly basis.

While the independent contractor is sometimes subject to withholding tax on his income, the employee is taxed under the Pay as You Earn (PAYE) system.

This practical distinction is muddled somewhat by section 3(3) (d) of the PITA which defines employment as including "any service rendered by any person in return for any gains or profits." The definition does cover independent contractors, but in practice they are never taxed as employees. They claim deductible expenses, capital allowances and loss relief, where applicable, before declaring a chargeable profit. In contrast, employees are only entitled to some tax-free personal allowances and reimbursement.

The analysis above indicates that the word 'employment'; as used in the context of Nigeria tax law has less expansive meaning than the ordinary. For example, a person may 'employ' himself in the profession of law but he is not necessarily an employee of his clients for tax purposes. Accountants who act as auditors for several companies practice a profession and cannot be treated as employees of the companies. But an accountant who is appointed to be a company's internal auditor holds an office under it. He is an employee of the company. Thus an employment existing where a person holds an office or receives wages or salaries from an employer for duties performed. As stated earlier, this is often described as a "contract of service."

In case where an employee works for more than one employer, it may not be expedient to charge each of his wages as a separate employment income. Rather, his engagement may be seen as services of contracts performed as part of a profession or vocation. The income from all sources could then be aggregated and taxed as the profits or gains of a business or profession.

Therefore under the PITA, persons who hold office or appointments for remuneration or render services in return for any gains or profits are persons in employment. However, gains or profits from professions are distinguished from employment. "The dividing line between a profession and an employment is a narrow one and not easy to determine".

In *Davies v Braithwaite* an actress carried out engagements of acting in stage plays, performing for films, performing on the wireless for BBC and performing for gramophone record purposes. She was held assessable to income tax in respect of her earning in all four classes of engagements as earning from a profession or

vocation because none of her engagements came within the meaning of the expression employment. Rowlatt J. Stated thus:

"It seems to me quite clear that one can have both an employment and a profession at the same time. Quite clearly, one can have it in different categories. A man might have the steadiest employment in the world by day, and he might do something else in the evening and make some more money by way of a professional vocation".

Usually, whether a person is engaged in a profession or employment is a question of fact and there are no hard and fast rules because of the diverse situations that may arise.

In *Fall (Inspector of Taxes) v. Hitchen* the tax payer, a professional ballet dancer was engaged by Sadler's Wells Trust Ltd. under a standard form contract. He was to work full time during specified hours for a regular salary. The contract provided that he should work exclusively for the company and should not undertake other work without its consent, which was not to be withheld unreasonably. The company provided him with costumes for stage use. The court distinguished *Davies v. Braithwaite* and held that the taxpayer in respect of his engagement with the company was not a person performing services in business on his own account, all the relevant factors pointed to the relation between the taxpayer and the company as being one of contract of service. The taxpayer was therefore held to be in the company's employment.

Determining an employee's taxable income

In the context of Nigerian Law, it is not necessary to distinguish between one type of taxable reward of an employee and another. Under section 3(1)(b) of PITA, chargeable income includes "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 an employee..." Section 3(2)(b) further provides that income includes any amount deemed to be income under the Act. To qualify as taxable allowance, a payment does not even have to be made directly to or kept by the employee. Under the Act, "Allowance" includes any sum paid or payable in respect of expenses and any sum put by an employer at the disposal of an employee and paid away by the employee.

However, it is necessary to distinguish the rewards of employment from a mere gift or present made to an employee on personal ground and not by way of payment for services. Because these are personal gifts and not remuneration; they are not subject to tax. In *Seymour v Reed*, the appellant was not assessable in respect of the benefit he was granted in as much as it was a personal gift and not a profit or perquisite arising from his employment. The test is whether from the standpoint of

the person who receives the payment, it accrues to him by virtue of his office; if it does, it does not matter whether it was voluntary or there it was compulsory on the part of the persons who paid it.

Lord Denning MR in *Laider v Perry* expressed the test in the following words: "The one question ... is this: Was the payment made, or the money's worth given to the employee as a reward or remuneration or in return for his services? If it was, it is taxable in his hands". The House of Lords subsequently affirmed this test.

Tax free re-imbursments

The PITA excludes from the tax net some payments that represent reimbursement to the employee of expenses incurred by him in the performance of his duties. This is on the condition that the employee is not intended to make any profit or gain from such payments.

Within the category of exempted payments are:

- medical or dental expenses incurred by the employee;
- the cost of any passage to or from Nigeria incurred by the employee;
- any sum (not exceeding N2,500 per child) paid in respect of the maintenance or education of a child;
- any compensation for loss of employment;
- so much of any amount of rent the employee is treated as being in receipt of equal to the amount deemed to be incurred by the employer under section 4 of the Act;
- so much of any amount of rent the employee is treated as having received under section 5 of the Act;
- so much of the amount of rent subsidy or rent allowance paid by the employer to or on account for the employee not exceeding N150,000 per annum;
- the amount not exceeding N20,000 per annum paid to an employee as transport allowance;
- meal subsidy or meal allowance, subject to a maximum of N5,000 per annum;
- utility allowance of N10,000 per annum;
- entertainment allowance of N6,000 per annum; and

- leave grant, subject to a maximum of 10 per cent of annual basic salary.