



PAY AS YOU EARN ON EMPLOYEE OUTSOURCING ARRANGEMENTS

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

In an employee outsourcing arrangement, workers who are not part of the ultimate employer's regular work force, may be employed through an outsourcing firm or labour broker. In this regard, the employees will be legal employees of the outsourcing firm or labour broker but economically employed by the ultimate employer. The employees remain on the payroll of the outsourcing firm. The ultimate employer pays the outsourcing firm a fee for procuring the staff on its behalf, while the outsourcing firm pays the staff salaries. The employees perform services under the primary direction and control of the ultimate employer; and may work on a part time to full time basis for the ultimate employer.

Legal Basis

Under Section 81 and 82 of PITA, employees have an income tax obligation to be deducted from their emoluments; and employers are required to file a return with the relevant tax authorities. An employer is required to make the income tax deductions from emoluments paid to employees, and is subject to penalties for failure to deduct, or improper accounting for deductions. There is no definition of employer in the PITA, but LIRS adopted/official position is that the employer referred to in the PITA is the economic employer (i.e. the ultimate employer), under whom the employees perform services and receive primary direction and control.

Under paragraph 2(3) of the Operation of Pay As You Earn Regulations where a person other than the employer manages the staff e.g. administers the legal documentation and payroll of the staff, that company or enterprise would be required to provide information of the staff to the tax authorities and also deduct the applicable PAYE.

Compliance Requirements

1. **Deduction of PAYE:** The administrative obligation for the deduction of PAYE, and filing of the return for employee emolument lies with the outsourcing firm, i.e. the company who retains the employees on their payroll. Therefore, the outsourcing firm shall deduct PAYE (and not withholding taxes) with respect to the employees. As long as the individuals are deemed to be employees in providing services to the ultimate employer, they would be liable to PAYE and not withholding tax.
2. **Exposure:** The LIRS does not limit the exposure for improper deductions or failure to deduct to the outsourcing company. The service recipient also maintains an obligation, by the substance of its arrangement, to ensure that PAYE is deducted from employee emoluments. In line with the PITA, the ultimate employer shall also be considered liable for the PAYE of the staff as the PAYE Regulation does not extinguish this obligation. However, if full PAYE can be substantiated for the various staff, both parties shall be absolved from further obligations.

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



PERSONAL INCOME TAX, PAY AS YOU EARN AND WITHHOLDING TAX CONSEQUENCES OF EMPLOYEE OUTSOURCING ARRANGEMENTS

Types

Type 1: Where a firm provides people on a very temporary basis (usually not more than 1 month) to provide short-term service. In such scenarios, the individuals that are contracted to provide the services are neither employees of the outsourcing firm or the firm that requires the service. The individuals are free-lance contractors. Examples of this which should provide guidance for other similar scenarios include:

- Supply of ushers for an event
- Supply of labourers to a temporary construction site
- Supply of software developers for an application development

Tax treatment of type 1: The outsourcing firm is expected to deduct WHT at 5% when paying the individuals as they are deemed to be independent contractors. The firm that receives the service is expected to deduct WHT on the service portion of the invoice issued by the outsourcing firm and treat the payment to the individuals as a reimbursement i.e. exempt from WHT. However, if the outsourcing firm does not separate the payment to the individuals (with 3rd party documentation bank payments or invoices) from its service fee, then WHT should be applied on all the invoice.

The individuals are expected to account for the PIT on the income through direct assessment, using the WHT deducted from their payments as a credit against their final tax.

Type 2: In this scenario, the firm provides people on a more permanent basis to provide services to another firm. The individuals that are contracted to provide the services may perform their functions in the offices of the firm that requires the services but the services being provided are non-core. This category of individuals are “workers” as defined in the Labour Act which include manual labour or clerical work but excludes persons exercising administrative, executive, technical or professional functions. While the employees may receive instructions from the firm that requires the services, the services are non-core that the individuals can be changed without recourse and replaced by another individual. Examples of this which should provide guidance for other similar scenarios include:

- Supply of cleaning services staff
- Supply of servers
- Supply of caterers

Tax treatment of type 2: The outsourcing firm is expected to deduct PAYE when paying the individuals as they are considered to be employees. The firm that receives the service is expected to deduct WHT on the service portion of the invoice issued by the outsourcing firm and treat the payment to the individuals as a reimbursement i.e. exempt from WHT. However, if the outsourcing firm does not separate the payment to the individuals (with 3rd party documentation bank payments or invoices) from its service fee, then WHT should be applied on all the invoice.

Type 3: In this scenario, the firm provides people on a more permanent basis to provide services to another firm. The individuals that are contracted to provide the services may perform their functions in the offices of the firm that requires the services and the services being provided are core. This is the category of employee outsourcing covered under the rest of this section of the explanatory notes.

In such an employee outsourcing arrangement, workers who are not part of the ultimate employer’s regular work force, may be employed through an outsourcing firm or labour broker. In this regard, the employees will be legal employees of the outsourcing firm or labour broker but economically employed by the ultimate employer. The employees remain on the payroll of the outsourcing firm.

The ultimate employer pays the outsourcing firm a fee for procuring the staff on its behalf, while the outsourcing firm pays the staff salaries. The employees perform services under the primary direction and control of the ultimate employer; and may work on a part time to full time basis for the ultimate employer.

Legal Basis for type 3

PAYE

Under Section 81 and 82 of PITA, employees have an income tax obligation to be deducted from their emoluments; and employers are required to file a return with the relevant tax authorities. An employer is required to make the income tax deductions from emoluments paid to employees, and is subject to penalties for failure to deduct, or improper accounting for deductions. There is no definition of employer in the PITA, but LIRS adopted/official position is that the employer referred to in the PITA is the economic employer (i.e. the ultimate employer), under whom the employees perform services and receive primary direction and control.



Under paragraph 2(3) of the Operation of Pay As You Earn Regulations, where a person other than the employer manages the staff e.g. administers the legal documentation and payroll of the staff, that company or enterprise would be required to provide information of the staff to the tax authorities and also deduct the applicable PAYE.

WHT

Under the Companies Income Tax (Rates, etc. of Tax Deducted at Source [Withholding Tax]) Regulations and the Personal income Tax Companies income Tax (Rates, etc. of Tax Deducted at Source [Withholding Tax]) Regulations, a deduction is required to be made from payments made for any activity or a service, and the deductions shall be regarded as tax due on the payment, and not as an additional cost on the contract.

Compliance requirement for PAYE purposes for type 3

1. Deduction of PAYE: The **administrative obligation** for the deduction of PAYE and filing of the return for employee emolument lies with the outsourcing firm, i.e. the company who retains the employees on their payroll. Therefore, the outsourcing firm shall deduct PAYE (and not withholding taxes) with respect to the employees. As long as the individuals are deemed to be employees in providing services to the ultimate employer, they would be liable to PAYE and not withholding tax.
2. Exposure: The LIRS does not limit the exposure for improper deductions or failure to deduct to the outsourcing company. While the outsourcing firm may have an administrative obligation, the service recipient also maintains **a legal obligation**, by the substance of the arrangement, to ensure that PAYE is deducted from employee emoluments. It must therefore include such legal provisions in the contract with the outsourcing firm and ensure that the outsourcing firm fulfils all PAYE obligations. In line with the PITA, the ultimate employer should be considered liable for the PAYE of the staff as the PAYE Regulation does not extinguish this obligation. However, if full PAYE can be substantiated for the various staff, both parties shall be absolved from further obligations. This clarification is not intended to amend or override the provisions of any law in force in Nigeria including but not limited to the Personal income Tax Act (as amended to date).

Compliance requirement for WHT purposes for type 3

1. The amount liable to Withholding Tax (WHT) shall be the margin earned on the service (Le. the difference between the contract sum and the payroll cost to the hiring company) it clearly specified on the face of the invoice with clear documentary evidence of the salary cost incurred.
2. In respect of documentary evidence to benefit from this treatment, the outsourcing firm is required to provide documentation to:
 - Justify the salary of the employees by keeping appropriate records, AND
 - Demonstrate that PAYE has been fully accounted for on all staff.
3. Where there is no evidence that PAYE has been fully accounted for on all staff, the LIRS reserves the right to demand for the full WHT on the full contract sum.
4. This guideline has been issued to encourage economic activity in the state and to reduce the burden on taxpayers. The LIRS will not collect Withholding Tax and PAYE on the same tax base in such arrangements in order to eliminate double taxation.