LAGOS STATE GOVERNMENT
PUBLIC NOTICE

TAXATION OF EMPLOYEES SHARE/STOCK OPTIONS

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

Share/Stock options agreement gives employees the right to a company's shares based on prices agreed on the initiation date (grant date). However, the employees must wait for an agreed period (known as the vesting period) before they can exercise the right.

Legal basis

Based on Section 3 (b) of the Personal Income Tax Act (PITA), any salary, wage, allowance, other gain or profit from employment granted to an employee is a taxable income. More often than not, the employees are issued the share/stock options at prices below the market value of the stock. This arrangement gives rise to a benefit in kind 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 actual share price and exercise price and remit to the relevant authority. The obligation to deduct tax arises on the exercise date or the effective date of payment for phantom shares. The share price for a public limited liability company is the value for which the shares are traded on the stock market at the date of exercise. For non-listed companies, the price per share is the net assets of the company issuing the shares (reported in its penultimate financial statement) divided by the number of shares. The taxable benefit for a phantom share is the cash payment made to the employee.

2. Employers are required to remit the tax deduct on 10th day following the month that the shares were exercised. The LIRS will enforce the provisions of PITA where an employer fails to deduct or remit the taxes due.

3. Reporting Obligation: Every employer is required to file, alongside their annual returns, a schedule showing the information on its employees share options.

4. Other Issues:
    a) Where the employee does not own legal title to the shares (e.g. in the case of phantom shares or unvested shares), whereby a dividend equivalent is payable, the payment will be liable to personal income tax in accordance to PITA because the payments are not actual dividends. The employer is required to deduct PAYE.
    b) Withholding Taxes: Upon exercise, any dividend paid to individuals that are shareholders is liable to WHT at 10%.
    c) Where shares are given for free, i.e. it is not assumed that the employees will acquire it through an exercise or a right to buy, the benefit shall be valued using the principles above and subject to PAYE.

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 SHARE OPTIONS AND OTHER FORMS OF EMPLOYEE SHARE-BASED COMPENSATION

Definitions

Stock Options: A Stock options agreement gives employees the right to a company's shares based on prices agreed on the initiation date (grant date). However, the employees must wait for an agreed period (known as the vesting period) before they can exercise the right. In recent times, employee stock option plan has been a successful tool used to attract and retain top executives.

Phantom Share

A phantom share is a bonus payment calculated with reference to a change in value of some number of notional shares over a period of time. The taxable benefit of phantom shares is the cash paid to an employee (less any payment made by the employee if any).

Grant date is the date an employee receives a stock option.

Vesting period is the time an employee must wait in order to be able to exercise the share options. Vesting period can be performance based or time based 9.9. increase in the market share of the company or the number of years an employee has spent in a company.

Date of exercise is the date an employee purchases the company's shares at the price set on the grant date.

Exercise Price: The consideration given by the recipient of a stock option In exchange for the stock received.

Legal Basis

Section 3 of the Personal income Tax Act (PITA) provided that "every taxable person is liable to tax on income source inside or outside Nigeria, including … any salary, wage, fee, allowance or other gain or prom from employment including compensation, bonuses, premiums, benefits or other perquisites allowed, given or granted by any person to any temporary or permanent employee....'.

More often than not, the employees are issued the stock Options at prices below the market value of the stock. This arrangement gives rise to a benefit in kind which is taxable in the hands of the employees.

There have been issues with regards the treatment of share options for personal income tax purposes; particularly with respect to the recognition and valuations of the taxable benefits to the employees.

Objectives

The objectives of this are to:

a. simplify issues surrounding the taxation of stock options,
b. provide companies with a guide on determining the taxable value and when tax obligation arises, and
c. promote voluntary tax compliance among taxpayers.

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 Requirements

1. Deduction of PAYE:

The employer is required in accordance to the provision of the personal income tax. to compute tax on the difference between the share price & exercise price and remit to the relevant authority.

2. Recognition of taxable benefit with respect to stock option

There is no tax obligation on the grant date. However, tax obligation arises on the date of exercise (after the vesting period).

3. Taxation of stock options when employment duties are partly performed in Nigeria

Stock options granted to employees for services that are partly performed in Nigeria are liable to tax in Nigeria whether or not the stock options vests during the employment duties in Nigeria. However, income tax will be limited to the income attributable to the services performed in Nigeria during the vesting period.

The taxable benefit is the difference between the share price and the exercise price apportioned for services performed in Nigeria by adopting a work day ratio system. That is:

$$\frac{\text{Number of work days in Nigeria}}{\text{Total number of work days from grant to exercise date}} \times \text{Taxable Benefit}$$

4. Taxation of stock options which have been fully subject to tax in a double tax treaty (DTT) country

Where a Nigerian tax resident receives a share option scheme for services that was partly performed in a DTT country and the income has been fully subjected to tax in the DTT country. a tax credit shall be allowable in accordance to section 11(1) of PITA. The tax credit in a particular tax year is restricted to the tax arising from the share option scheme that is taxable in Nigeria.

5. Valuation of taxable benefit with respect to stock options

Listed Companies

The taxable benefit of a share option issued by a listed company is the difference between the market value of the shares of the issuing company and the exercise price multiplied by the number of shares. The market value of the shares is the value for which the share is traded on the stock market at the date of exercise.

For example: if the exercise price is ₦5, market value is ₦ 8 and the number of shares is 10,000 units. The taxable benefit will be:

(₦8 - ₦5) X10,000 = ₦30,000

Note: In the event that the employees are granted shares at nil cost, the taxable benefit will be the market value of the share multiplied by the number of shares. For example: if a company gives its employee 5000 units of shares traded at ₦25 per share at no cost. The taxable benefit is:

Units X share price

5000 x ₦25 = ₦125.000

Non-Listed Companies

The taxable value of shares issued by a non-listed company is the difference between the exercise price and the price per share multiplied by the number of shares. The price per share is the net assets of the company issuing the shares divided by the number of shares.

The net asset to be used is the total assets less liabilities as stated in the company's latest financial statements.

For example: If the company with a net asset of N125milllon and 50mlliion shares issues 15,000 unite of share options to employees at zero exercise price. The taxable benefit will be:

$$\frac{\text{₦125mlllion}}{\text{₦50million}} \times 15.000 = \text{₦37,500}$$

Reporting Obligation

Every employer is required to tile. alongside their annual returns, a schedule showing the information in appendix 1.

Disposal of Shares

The disposal of share is subject to the provisions of the Capital Gains Tax (CGT) which is currently exempt from taxes.

Other Issues:

a) Where shares are given for free, i.e. it is not assumed that the employees will acquire it through an exercise or a right to buy (e.g. phantom shares). the benefit shall be valued using the principles above and subject to PAYE

b) Before exercise, payment of dividend equivalent will be liable to personal income tax in accordance to PITA. The employer is required to deduct PAYE.

c) Withholding Taxes: Upon exercise. any dividend paid to individuals that are shareholders is liable to WHT at 10%.

d) Note that the tax treatments outlined above do not change if the shares that are issued or referenced are that of a foreign company, as long as employment was exercised in Nigeria.

e) If an option or share scheme is liquidated by the issuing company before the exercise or vesting date (either through an acquisition or a redundancy). the compensation paid to the employees for the dissolution of the scheme would be considered as employment income and subjected to PAYE accordingly.

Note that the rules apply even lithe shares or options are granted to another person because of the employees' entitlement to the scheme.

Appendix 1: Income tax reporting requirements

Name	Designation	Number of shares granted	Grant date	Vesting period	Exercise date	Exercise price	Number of shares exercised	Share price	Dividend equivalent earned