Taxation of Employee Share Based Compensation Schemes in Nigeria.

Introduction - *Everyone is an owner*

In light of the serious migration crisis in Nigeria, organizations are devising new ways to attract, hire and retain talent. Hence, apart from monthly salary remuneration and other benefits, organizations are offering Employee Share Based Compensations (ESBC) to their staff in order to, amongst other things, give them a sense of belonging and ownership of the organization. This work would therefore focus on providing a succinct overview of the concept of ESBCs with a view to resolving the question of what tax obligations arise from the with respect to ESBCs.

What are Employee Share Based Compensations?

Employee Share Based Compensations are options granted to an employee of a company offering the options holder the right to buy a certain amount of company shares at; a predetermined price, no price or a price below fair market value (the Exercise Price) after a specified period of time, during the course of employment (grant date). The concept of ESBCs have been referred to as novel practice in the corporate world, presenting a win-win situation for both the employer and the employee with the aim of ensuring that both sides work towards improving the value of the company, as it benefits both parties.

ESBCs may be included in employment contracts stipulating the number of shares offered, exercise price, grant date and waiting period before the stock options become exercisable (Cliff/Vesting Period). By general practice, where an employee resigns during the vesting period, he forfeits his right to exercise the stock options. ESBCs may take the form of Employee Stock Option Plans (ESOPs), Employee Stock Purchase Plan (ESPPs) and Stock Appreciation Rights (SARs).

Taxation Obligations

The question which therefore arises is this: What tax obligations arise from the ownership of ESBCs?

To resolve this question, we would make reference to the provisions of Section 3(1)(b) of the Personal Income Tax Act which provides that tax shall be payable on:

> **"all 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 other than so much of any sums as expenses incurred by him in the performance of his duties, and from which it is not intended that the employee should make any profit or gain"**

A quick review of the above Section shows that where any "other gain or profit from employment…" accrues, personal income tax obligations arise. As such, though expressly stated, there exists a liability to pay personal income tax on ESBCs.

Further to this, the Lagos State Internal Revenue Service (LIRS) issued a public notice in 2017 clarifying the above referenced Section. According to the notice, the LIRS noted that where an employee is issued share options at prices below the market value of the stock, said employee receive a taxable benefit or gain which is taxable in the hands of the employee. Therefore, by virtue of the Notice employers are required to compute tax on the difference between the actual share price and exercise price and remit to the LIRS. The Notice further stipulates that the obligation to deduct tax arises on the exercise date or the effective date of payment for phantom shares.

With respect to non-listed companies, the price per share is the net assets of the company issuing the shares (as reported in its penultimate financial statement) divided by the number of shares. In the case of phantom shares, the taxable benefit is the cash payment made to the employee. In addition, the Notice stipulates that dividends paid to individuals that are shareholders is liable to withholding tax at 10% and mandates every employer to file, alongside their annual returns, a schedule showing the information on its employee share options.

Further to the above, pursuant to the provisions Section 30(2) of the Capital Gains Tax Act, where an investor or any person (including an employee) disposes shares issued by any quoted and/or unquoted Nigerian company at a premium or profit, such disposal is ordinarily chargeable to CGT if it attains the threshold prescribed by the CGT.

CONCLUSION

From the foregoing, it is clear that notwithstanding the vagueness of the PITA as to taxation of ESBCs in Nigeria, an obligation to pay PIT on ESBCs exists. Thankfully, the LIRS's notice expatiates and clarifies the position of the law, with particular reference to Lagos. Similarly, tax obligations arise where such shares are sold and profit is made by the employee.

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