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Taxation of Interest Benefit on Employee Loans

The Lagos State Internal Revenue Service recently issued a public notice to employers, employees, business owners and the public in general....

Introduction

On 14 September 2017, Lagos Internal Revenue Service (LIRS) released a public notice on the treatment of interest benefits on employee loans. In the notice, LIRS defined employee loans as 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 pre-agreed deduction from the employee’s net salary, with or without any interest”¹. Interest benefit is the difference between the open-market interest rate (Monetary Policy Rate “MPR”) and the lower interest rate charged by employers on loans given to employees. This benefit is enjoyed because employees

pay zero or lower-than-market interest rates on loans collected.

LIRS relying on section 3 of the Personal Income Tax Act now seeks to tax interest benefits.

Tax Treatment on Interest Benefit to Employees

Before this public notice was issued interest benefits on loans granted to employees were largely unrecognized and the tax treatment was unclear.

LIRS will now treat all employee loans using an adjusted MPR of 3% less than the standard MPR as the minimum interest rate allowable on employee loans. When the adjusted MPR is higher than the

interest rate given on the employee loan, the difference will be recognized as an additional benefit (income) to the employee and will be taxed. But if the interest rate is higher than the adjusted MPR it means that no

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benefit has accrued to the employee.

Since the MPR is currently 14% and LIRS will allow a 3% adjustment, this means that 11% will be the minimum interest rate recognized by LIRS on loans to employees. For any loan given to an employee at less than 11% interest rate, the difference in the rate

¹ Public Notice on “Taxation of Employee Loan” issued by Lagos

will be treated as a benefit to the employee and will be taxed.

This interest benefit remains taxable as long as the loan subsists even when the employment relationship has ended.

Persons Affected by this Notice

Employees: Employees will now be expected to pay tax on benefit enjoyed on loans given by employers for loans with lower-than-11% interest rates.

Directors and Significant

shareholders: Though captioned “*Taxation of Employee Loan*”, this tax treatment also applies to loans given to directors and significant shareholders.

Employers: Employers have the burden of deducting tax on the

interest benefit given to the employee and remitting to the LIRS either monthly or yearly depending on the repayment terms agreed between the parties. The annual returns file by employers in January must now include a schedule of employee loans and repayment terms.

Possible Effects of this Treatment of Employee Loans

LIRS’s treatment of employee loans may result in any of these outcomes:

1. Some employers may no longer give loans to their staff.
2. Some employers may increase their interest rates to 11%. This way, no benefit will accrue to the employee and

companies get the additional income to run their businesses. This interest will eventually be taxed as companies’ income tax.

3. Some employers may retain low interest rates while deducting tax on the interest benefits to their employee.

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