FEDERAL INLAND REVENUE SERVICE

INFORMATION CIRCULAR | **NO: 9801**
Date: 1st October,1998

SUBJECT: Explanatory Notes on the Application of Withholding Tax Provisions to Contracts and Agency Arrangements

1. **Introduction.**

It has come to the attention of FIRS that the schedule to the Companies Income Tax [Rate, etc, of Tax Deducted at Sources (Withholding Tax)] Regulations (S.1 10 of 1997) Published as supplement to Official Gazette Extra-Ordinary No.47, Vol.84, of 12th August, 1997-Part B-has generated a lot of controversy, especially regarding:

(i) ***The coverage of the term, all types of contracts and agency arrangement, other than outright sale and purchases of goods and property in the ordinary course of business''.***

(ii) ***The correct interpretation and meaning of the phrase – in the ordinary course of business''.***

It is, therefore, necessary to furnish the clarifications blow for the education and information of members of the public, taxpayers and their agents, as well as tax officials and practitioners.

2. **Coverage of the Term.**

The term covers:
(i) All types of contracts (whether written or not), and:
(ii) All types of agency arrangement.

The only exceptions are those transactions which are, and indeed constitute, **outright** Sale or purchase of goods and property and which take place in the ordinary course of that Particular Kind of business

3. **Contracts.**

It is now explicit that all types of contracts whether oral or written come within the scope of this term. Where, for example, there is a written contractual sale of goods or materials by a trading concern to another, the payment for the transaction will be subject to withholding tax at 5%. Similarly, where there is no written contract but through an arrangement, a company places an order for purchase from another company, such a transaction must also attract withholding tax at 5%. Therefore, on the whole, it must be understood that as long a contract can be read into the actions of two or more persons or companies/enterprises, such transaction must attract withholding tax at 5%.

4. **Agency Arrangements.**

Just as all types of contracts are caught by the withholding tax provision so are all forms of agency arrangements. Before considering the various forms of agency arrangements, it is necessary, first, to differentiate between payments for the services rendered to the enterprises represented and the payments for the sale for, or purchase from, the enterprise. The former, being commission, will attract 10% withholding tax while the latter, being sale on behalf of the enterprise, will attract 5% withholding tax.

At this juncture, it is necessary to consider two types of agents operating ender an arrangement:

(i) Agent of independent status.
(ii) Agent of dependent status.

4.1 Independent Agent.

Ordinarily, an agent of independent status will be regarded as acting in the ordinary course of his business since his actions are not assumed to be controlled by the enterprise being represented. In such a case, he will be liable for the payment of 10% withholding tax on the agency fees or commission only.

However, where the transaction between an agent and another enterprise shows control, the agent loses his independent status as he is no longer seen as acting in the ordinary course of his business. He may still remain independent legally but he is no longer so economically. The control may be shown in the way the agent acts exclusively or almost exclusively for the enterprise(s) begin represented. The sales on behalf of the foreign or local enterprises will attract 5% withholding tax.

4.2 **Dependent Agent.**

This is the agent/Principal relationship and an area of great concern to Nigerian tax authorities because of the control of the agent (usually a local company) by the principal (in most cases a non-resident company). The agent has arrangement with the principal for procurements, deliveries, supplies, sales and various similar activities. It may also have arrangement for the sale of patents, franchise, equipment and property. Because of the control, the agent performs these activities which economically belong to the parent company. In this regard, the agent is not acting in the ordinary course of his business. He is a dependent agent economically though legally he may remain a separate entity. The sale is a behalf of the principal will attract 5% withholding tax. This is different form the 10% withholding tax on the commission or fees payable to the agent or the 10% withholding tax on the rent or royalty.

5 The Exception Clause:

..''Other than outright sale or purchase of goods and property in the ordinary course of business''.

It is instructive to note that the contractual and agency transactions not caught by the withholding tax provisions are such transactions that constitute **outright sale or purchase of goods and property in the ordinary course of business.** Therefore, for a contract or an agency arrangement to be exempted from source deduction, it must constitute an outright sale and purchase of goods and property. It must also be in the ordinary course of business.

5.1 Exemption under Agency Arrangements:

What constitutes an action in the ordinary course of business under an agency arrangement has been explained in paragraphs 4.1 and 4.2 above. In other words, where the agent is seen as independent both legally and economically in his transactions on behalf of the person represented, he will be considered as acting in the ordinary course of his business and therefore be liable to the payment of withholding tax only **on the agency fees.** The **gross sale on behalf of the enterprise represented** will be **exempted** from the 5% source deduction in such a case.

Further, it must be explained that it is not sufficient for the transaction to be executed in the ordinary course of business only. It is also necessary that **it must be a once-and-for-all transaction.** Once it becomes habitual or repetitive, the sale or purchase becomes liable to source deduction.

5.2 Exemption under Contracts:

The Regulation exempts from source deduction transactions that satisfy two conditions:

i. ‘‘those that constitute outright sale and purchase of goods and property’’, and

ii. ‘‘where such sales and purchase are in the ordinary course of business’’

5.2.1 Outright Sale and Purchase:

Where a sale or purchase transaction becomes repetitive or habitual, it will not qualify for exemption. The sale of goods on a once-for-all basis will qualify for the exemption in so far as it meets the second condition.

5.2.2 Sale in the ordinary course of business:

A sale takes place in the ordinary course of business when it takes place in the course of that particular business. Where, for instance, a trader sells goods directly to third parties, he will be seen as acting in the ordinary course of his business, that is, trading. However, where the trader enters into contract for the sale of the goods, he is no longer acting within his ordinary course of business that is, trading, but has made an adventure into another business, that is, contracts. Further, a manufacturer who makes contractual sale or purchase is on longer acting within his ordinary course of business that is manufacturing, but has gone into another business, that is, contract. Although the manufacturer, may us the items purchased or sold in his manufacturing business, the contractual arrangement for the sale or purchase will be subject to 5% withholding tax.

6 Fundamental Issue about Withholding Tax

Withholding tax system is basically to give relief to the taxpayers by allowing him to accumulate the taxes paid in the course of his business transactions and utilize them as set-off against the relevant assessment when he finally makes his annual tax returns. As the name suggests, it is a tax withheld at source, but kept as against future tax liability. Again, the system is designed to prevent tax evasion as taxpayers will be urged to come forward to claim credit for the tax suffered at source during the transaction period. With the above explanation, any controversy surrounding the issue, therefore, is either that of ignorance or a deliberate attempt to perpetuate tax evasion.

7 Enquiries.

Any enquiries on the implementation of this circular or any area requiring further clarification should be referred to

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