

WHEN DOES PENALTY AND INTEREST APPLY TO UNPAID TAX?

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Introduction

The effectiveness of tax laws lies primarily in the coercive powers of tax authorities to enforce compliance and penalties for default, and not an altruistic or patriotic disposition of taxpayers to contribute to the public revenue. To induce compliance with tax obligations, the law imposes pecuniary sanctions in the form of penalties and interest on taxpayers for default. While there is little debate about the justification for these sanctions, the point at which they apply to unpaid tax has been subject to divergent interpretations. This article explores the question of when penalty and interest apply to unpaid tax.

Statutory Provisions on Penalty and Interest

Various provisions of the different tax laws provide for penalties and interest for non-payment of tax. In this article, we will focus attention on the relevant provisions of the Federal Inland Revenue Service (Establishment) Act, 2007 ("FIRS Act"), the Companies Income Tax Act ("CITA") and the Personal Income Tax Act ("PITA").

The FIRS Act

Section 27(2) of the FIRS Act provides that:

Where a tax is not paid, when it falls due under any enactment, by any person from whom it is due, whether or not the payment of that tax has been secured by a bond or otherwise, it shall be paid on demand made by the Service either on that person personally or by delivering the demand in writing to his place of abode or business, and if it is not paid on demand, the person in default shall, in addition to the 100 per cent of tax due and payable, also be liable to a penalty equal to the amount of tax due and payable.

Section 40 of the FIRS Act further provides that:

Any person who being obliged to deduct any tax under this Act or the laws listed in the First Schedule to this Act, but fails to deduct, or having deducted, fails to pay to the Service within 30 days from the date the amount was deducted or the time the duty to deduct arose, commits an offence and shall, upon conviction, be liable to pay the tax withheld or not remitted in addition to a penalty of 10 per cent of the tax withheld or not remitted per annum and interest at the prevailing Central Bank of Nigeria minimum re-discount rate and imprisonment for period of not more than three years.

Section 27(2) of the FIRS Act suggests that liability to pay penalty is triggered by default to comply with a demand by the FIRS for payment of an outstanding tax and not by default to

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pay the tax in the first instance. The implication is that penalty will not apply where the taxpayer complies with a demand for payment.

Section 40, on the other hand, suggests that in the case of withholding tax, interest and penalty accrue from the date of default. The taxpayer will therefore, be liable to pay the tax that ought to have been deducted and remitted plus the interest and penalty upon conviction. A taxpayer may however escape this outcome by promptly paying the tax upon demand.

CITA

Several provisions of the CITA also deal with penalties and interest for non-payment of tax. For instance, section 53 of CITA, which imposes an obligation on taxpayers to self-assess and remit the due tax to the FIRS, provides that where a taxpayer deliberately fails to declare the true and correct amount of the profit or tax payable, the outstanding tax shall become immediately recoverable with penalty and interest. The penalty and interest are payable in accordance with the provisions of the CITA or any other relevant law and accrue from the date the incorrect returns were filed.² In other words, penalty and interest accrue from the date of default and not on the date a demand is made for the outstanding tax.

Similarly, section 82 of CITA provides for a penalty of 10% where a person who is obligated to deduct and remit tax³ fails in his obligation. The accrual of the penalty under this provision does not also seem to be contingent on a demand or assessment but arguably applies from the date of default.

However, section 85(1) of CITA provides that:

... if any tax is not paid within the periods prescribed in section 77 of this Act—

(a) a sum equal to ten per cent per annum of the amount of the tax payable shall be added thereto, and the provisions of this Act relating to the collection and recovery of tax shall apply to the collection and recovery of such sum;

(b) the tax due shall carry interest at bank lending rate from the date when the tax becomes payable until it is paid, and the provisions of this Act relating to collection and recovery of tax shall apply to the collection and recovery of the interest.

The time for payment of tax under section 77(1) of CITA is thirty days from the date of service of a notice of assessment where there is no objection or appeal against the assessment. This means that penalty and interest under section 85 of CITA will only accrue upon failure to pay an assessed tax within thirty days of the assessment where the taxpayer raises no objection or file an appeal against the assessment. In other words, penalty and interest accrue when an assessment has become final and conclusive. This is akin to section 27(2) of the FIRS Act and suggests that where an assessed tax is paid within the prescribed period, penalty and interest will not be applicable, notwithstanding any prior default.

² Section 53(3) of CITA.

³ Under sections 78, 79, 80 or 81 of CITA.

The above provisions of CITA create a bit of confusion on when penalty and interest accrue on unpaid tax. While sections 53 and 82 pin the obligation to pay penalty and interest to the date of default, section 85 makes the application of penalty and interest contingent on a final and conclusive assessment. This ambiguity renders the time of application of penalty and interest for unpaid tax under CITA to varying interpretations.

PITA

PITA also provides for penalty and interest in similar terms as CITA. Section 74(1) of PITA imposes a 10% penalty plus interest at the prevailing monetary policy rate of the Central Bank of Nigeria where a person who is obligated to deduct tax (under sections 69, 70, 71, 72 or 73 of PITA) fails in its obligations to deduct or remit the deducted tax within thirty days from the date the amount was deducted or the duty to deduct arose. There is no requirement for service of notice of assessment or demand for the penalty to accrue.

Further, sections 76(1) and 77 of PITA respectively provide for penalty and interest for failure to pay personal income tax. While section 76(1) of PITA imposes a ten percent penalty where tax charged by an assessment is not paid within the prescribed period under section 68 of PITA, section 77 of PITA provides that “the tax due from a taxable person shall carry interest on annual basis at bank base lending rate from the date when the tax becomes payable until it is paid.” Thus, payment of penalty depends on the failure to pay tax within the time prescribed by section 68 of PITA, while interest applies from the date the tax becomes due. It is however unclear whether the relevant due date for the application of interest under section 77 of PITA is the date the initial obligation arose or the period of payment specified in section 68 of PITA.

In addition, section 82 of PITA imposes ten percent penalty and interest at the prevailing commercial rate for failure to deduct or remit an employee’s tax under the Pay As You Earn (“PAYE”) scheme. The tax plus penalty and interest are recoverable by the tax authority as a debt and there is no requirement for demand or assessment for the penalty and interest to accrue under section 82 of PITA.

By section 68(1) of PITA, any tax charged by an assessment is required to be paid within two months from the date of service of the notice of assessment in the absence of objection or appeal against the assessment. The combined reading of sections 68 and 76(1) of PITA again leads to the conclusion that penalty is not applicable for the initial default to pay tax, but only to the failure to pay within two months after the service of an assessment notice where there is no objection or appeal.

The common thread in the above provisions under the FIRS Act, CITA and PITA is the lack of clarity on the point at which penalty and interest apply to unpaid tax. A combined reading of the above provisions leads to the following mutually exclusive but plausible conclusions:

- a. Penalty and interest only apply upon failure to pay after service of a final and conclusive assessment.
- b. Penalty and interest apply from the date the payment obligation becomes due.

While taxpayers often insist on the first interpretation, tax authorities on the other hand, seem to understandably favour the second interpretation. These divergent positions have been ventilated in a number of cases, but the decisions on the point reflect the lack of clarity in the statutory provisions.

Judicial Decisions on When Penalty and Interest Apply

In *Weatherford v. FIRS*⁴, the Tax Appeal Tribunal (“TAT”) held that interest and penalty only apply where a taxpayer fails to object or appeal an assessment. In this case, the TAT found that the taxpayer objected and appealed the additional assessments within time and that interest and penalty were inapplicable to the unpaid tax.

The above reasoning was reiterated by the TAT in *UBA v. AIRS*⁵. The TAT held in this case that by the provisions of section 68 of PITA, inference can be drawn that:

. . . the Respondent has the legal backing to impose penalty and interest on the Appellant, but only and when the assessment is final and conclusive. By the facts of the appeal before this Tribunal, it’s clear that the assessment made by the Respondent is disputed by the Appellant, hence the duty to impose penalty and interest had not arisen, but in abeyance until the dispute is determined.

The above decisions, however, only represent one side of the debate, as the other side has equally received judicial affirmation. In *CMA CGM Delmasa v. FIRS*⁶, the TAT rejected the taxpayer’s argument that interest, and penalty only apply to unpaid tax where an assessment has become final and conclusive. The TAT held that:

An objection or appeal only suspends collection until the grounds of the objection or the appeal are resolved one way or the other. The interest and penalty will continue to accrue at the background from the time the tax ought to have been paid but will only crystallize if the objection or appeal were determined in favour of a tax authority.⁷

The TAT’s rationale for this interpretation is that:

If an objection or an appeal operates to extinguish liability to penalty and interest for late payment or non-payment of tax, no taxpayer would be compelled to remit taxes as and when due. They would simply wait for the tax authority to issue notices of assessment, timeously object or file an appeal and put the tax fund to other commercial uses knowing that penalty and interest cannot accrue. And where the appeal is eventually determined in favour of the Revenue, the tax fund would have generated enough money from which the tax liability could be paid. That, we say unequivocally is not the intention of the lawmakers.

⁴ 2016 26TLRN 44 at p. 50.

⁵ 2021 60TLRN 29 at pp. 83-84.

⁶ 2021 55TLRN 28.

⁷ See p. 72 of the Report.

For this reasoning, the TAT drew insight from the Court of Appeal decision in *FBIR v. Integrated Data Services Limited*,⁸ where the Court held that:

... the purpose of S. 15(1) and S. 31 of VAT Act No. 102 of 1993 as amended is to deter companies or taxable persons from engaging in fraudulent practice, e.g. collecting VAT and keeping or trading with it for some time before remitting same to the Federal Government.

However, the question before the Court of Appeal in the *Integrated Data Services Limited* case was whether the tax authority had powers to impose penalties and interest and not the time of accrual. The question of when penalty and interest accrue on unpaid tax was therefore not decided by the Court of Appeal.

Besides, the Value Added Tax Act, No. 2 of 1993 (“VAT Act”) which was the applicable law to the *Integrated Data Services Limited* case does not suffer any ambiguity as the FIRS Act, CITA and PITA. Section 15 of the VAT Act (now section 19) provides for penalty and interest for failure to remit VAT and empowers the tax authority to assess the taxpayer for the unremitted tax plus penalty and interest at the same time.

There are also no other provisions of the VAT Act which tie liability to pay penalty and interest to a final and conclusive assessment or failure to comply with a demand for payment. This clearly means that penalty and interest accrue from the date of default to remit VAT. The VAT Act therefore does not lend itself to divergent interpretations of the time penalty and interest accrue on unremitted VAT. To that extent, the *Integrated Data Services Limited* case may not be an authoritative guidepost for the interpretation of the relevant provisions of the FIRS Act, CITA and PITA.

Nonetheless, the logic of the Court of Appeal’s reasoning in the *Integrated Data Services Limited* case can arguably be applied to the interpretation of the FIRS Act, CITA and PITA. The purpose of imposing penalties and interest on defaulting taxpayers under the FIRS Act, CITA and PITA is to induce compliance with their tax obligations. This purpose will be defeated if penalty and interest will only apply where an assessment has become final and conclusive. As rightly noted by the TAT in the *Delmasa* case: “if an objection or an appeal operates to extinguish liability to penalty and interest for late payment or non-payment of tax, no taxpayer would be compelled to remit taxes as and when due”. Such an outcome will drain the penalty and interest provisions of their deterrent element, and this may not align with the intent of the legislature.

It is important to note that section 53 which provides for penalty and interest to accrue from the date of default to file correct tax returns was introduced by the Finance Act, 2020. While this appears to be an attempt to remedy the ambiguity on when penalty and interest accrue, the amendment has not achieved this purpose as section 85 of CITA still makes the liability to pay penalty and interest contingent on a final and conclusive assessment. Section 53 may

⁸ (2009) LPELR – 8191 (CA).

however provide an additional impetus for the argument that penalty and interest accrue from the date of default.

Another point to note is that the relevant provisions in the FIRS Act, CITA and PITA suggest that penalty and interest for failure to remit withholding tax or the personal income tax of an employee under the PAYE scheme accrue from the date of default as the obligation to withhold and remit tax is not subject to an assessment. While under section 40 of the FIRS Act, the liability to pay penalty and interest depends on the conviction of the taxpayer, there is no requirement for conviction under section 82 of CITA and sections 74 and 82 of PITA for penalty and interest to accrue.

Section 68 of the FIRS Act provides that in the event of any inconsistency between the provisions of the FIRS Act and the provisions of any other enactments including CITA and PITA, the provisions of the FIRS Act shall prevail.

In view of section 68 of the FIRS Act, it is arguable that the liability to pay penalty and interest under CITA and PITA are equally dependent on conviction of a taxpayer for default to deduct or remit tax.⁹ The requirement for conviction implies that where the default is remedied without trial and conviction, penalty and interest may not apply.

Conclusion

Tax laws are required to be strictly interpreted¹⁰. And a strict and holistic interpretation of the relevant provisions of the FIRS Act, CITA and PITA, in the author's view, will justify the conclusion that penalty and interest are contingent on a final and conclusive assessment, especially for income tax. While the relevant provisions on withholding tax and the PAYE scheme suggest that penalty and interest for default to deduct and remit within the prescribed period apply from the date of default, the question still remains whether penalty and interest will apply where the default is remedied without conviction.

The ambiguity in the relevant provisions of the FIRS Act, CITA and PITA and the conflicting decisions of the TAT regarding the point at which penalty and interest accrue leave taxpayers in a state of uncertainty. Until the issue is finally resolved by legislative intervention, arguments on the issue may continue to result in conflicting outcomes.

⁹ See *UBA v. AIRS* (supra).

¹⁰ *FBIR Vs Integrated Data Services Limited* (supra).