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TEMPLARS Thought Lab

Enforceability of Net Of Tax and Gross Up clauses in Ghana

Introduction

In commercial transactions where payment is to be made for goods, services or works supplied, there is usually the issue of whether the agreed fee is inclusive or exclusive of taxes. The parties would have to agree on which party will bear the tax burden. The party who ultimately bears the tax burden would typically be the party with the weaker bargaining power.

Although Ghanaian law generally recognises the right of parties to a contract to choose the terms and conditions that will bind them, the Income Tax Act, 2015 (Act 896) (the "ITA") seeks to limit this right.¹ The ITA declares as void, any agreement which prohibits the deduction or withholding of a tax required to be deducted or withheld under the ITA, unless the agreement is ratified by Parliament.²

In this light, this article examines the enforceability of net of tax and tax grossing up clauses in commercial contracts, under Ghanaian law.

Nature of Net Of Tax and Tax Gross-Up Clauses

A net of tax clause is a provision typically found in commercial contracts, under which the party supposed to make a payment under the contract is required to make the payment free and clear of any deduction. On the other hand, a tax gross up clause is a clause that would go a step further by requiring that if a deduction is required on account of the payee's withholding tax liability, the person making the payment must add an additional amount to the payment, such that the recipient of the payment will receive the same amount they would have received, had no deduction been made or tax withheld.³

¹ Young Trading Agencies v. Staveley & CO., LTD. [1977] DLCA 1440.

² Section 117(6) of the Income Tax Act, 2015 (Act 896).

³ Practical Law Glossary, "Gross-up", accessible at [https://uk.practicallaw.thomsonreuters.com/5-5018610?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/5-5018610?transitionType=Default&contextData=(sc.Default)&firstPage=true)

To illustrate, Company A and Company B, two entities resident in Ghana, enter into an agreement for the supply of accounting services by Company A to Company B. Assuming the fee payable for the service is GHS 2,000.00 and the payment for the service is subject to withholding tax at a rate of 7.5% of the gross amount of the fee, the tax to be withheld on the payment would be GHS 150.00. The tax gross up provision of the contract would now require Company B to pay Company A an amount of GHS 2,150.00. However, the additional amount of GHS 150.00 would also be subject to withholding tax which if deducted from the GHs 2,150.00 would result in Company A receiving less than the expected GHS 2,000.00.⁴ This process would have to continue until the sum payable as service fee under the contract, after deducting withholding tax, is GHS 2,000.00. To avoid this tedious process, the suggested formula for determining the amount by which the service fee must be increased is as follows,⁵

$$\text{Grossed up Service Fee} = \frac{\text{Service Fee} \times 100}{100 - \text{rate of tax}} = \frac{\text{GHS } 2000 \times 100}{100 - 7.5} = \text{GHS } 2,162.1622$$

In the context of a net of tax provision, using the illustration above, Company A will agree to pay Company B GHS 2,000.00. If any deduction is required by law for any reason, Company B will bear the cost of the deduction.

General Scope and Enforceability of Illegal Contracts Under Ghana Law

The Supreme Court's decision in **Mensah v. Ahenfie Cloth Sellers Association**⁶ is instructive on the general scope and enforceability of illegal contracts under Ghanaian law. The framework provided by the Supreme Court in **Mensah** is as follows.

First, contracts which involve an act prohibited by statute, or whose performance is prohibited by statute are illegal contracts.

Second, not all illegal contracts are unenforceable. Where the subject matter of the contract is prohibited, the contract is void ab initio and unenforceable. Accordingly, the parties cannot obtain any remedy under the contract.

On the other hand, where the subject matter of the contract is prohibited subject to stipulated sanctions or conditions, the contract is voidable and enforceable within the terms of the statute.

Similarly, in **Olatiboye v. Captan**⁷ the Court distinguished between contracts which are void for illegality and those which are voidable. The Court held that, if the act contemplated by the contract was statutorily prohibited but was subject to a penalty imposed for the benefit of revenue, the contract was voidable and enforceable.

⁴ Section 116(3) of the Income Tax Act, 2015 (Act 896).

⁵ See the glossary on "Gross-Up" on Practical Law, accessible at [https://uk.practicallaw.thomsonreuters.com/5-5018610?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/5-5018610?transitionType=Default&contextData=(sc.Default)&firstPage=true)

⁶ [2010] SCGLR 680.

⁷ [1968] GLR 146 – 153.

On the other hand, if the intention of the legislature was to prohibit the contract itself, then the contract was void and unenforceable, even if there was a penalty imposed which incidentally benefitted revenue.

These principles were applied by the Court in **Byes and Ways Co. Ltd v. Mes Bre Ltd**.⁸ There, the Court enforced a contract for the supply of poles between resident entities, in which the purchase price was denominated in USD, although Ghanaian law prohibits the pricing and receipt of payment in foreign currency in transactions between resident persons.⁹

The Court in **Byes and Ways** acknowledged the general principle that a court should not lend its aid to persons who found their cause of action on an illegality or immorality, or aid in the frustration of the operation of a statute. The Court, however, cited with approval, the decision of the English courts in **Hall v. Herbert**, where the English court stated that despite this general principle, it is appropriate for a court to identify the policy considerations underlying the prohibition in the statute, and then identify policy considerations which outweigh them, as basis for enforcement.¹⁰

Accordingly, although a contract may be illegal, the Ghanaian courts may still enforce the contract as between the parties. Such enforcement would be “within the terms of the statute”. This, however, does not prevent enforcement of any sanction stipulated in the statute for breach of its provisions.

Legality of Tax Gross-Up and Net Of Tax Clauses

Section 117(6) of the ITA provides as follows.

*Subject to this Act and except where an agreement is ratified by Parliament a provision in **an agreement which prohibits the deduction or withholding of a tax required to be deducted or withheld under this Act or any other enactment** administered by the Commissioner-General **is void**.*

So, the issue to be considered is whether net of tax and tax gross-up provisions prohibit the deduction or withholding of tax. If so, are they enforceable, regardless, under Ghanaian law?

Based on the language of net of tax clauses, as described in section 2 above, net of tax provisions appear to implicitly prohibit the payee from deducting any withholding tax from the payment. Such provisions would therefore be contrary to section 117(6) of the ITA and therefore void.

On the other hand, tax gross-up provisions do not contain such a prohibition. While they may ultimately shift the tax burden to the paying party, the paying party is still permitted

⁸ (2017) JELR 69716 (HC)

⁹ Section 3 of the Foreign Exchange Act, 2006 (Act 723). See also Bank of Ghana Notice No. BG/GOV/SEC/2012/12, where it is stated that “No resident of Ghana, other than those licensed by the Bank of Ghana to do so, shall price, advertise, receive or make payment in any foreign currency for goods and/ or services, such as...sale and rental of real estate...[and] domestic contracts...”

¹⁰ In *Byes and Ways*, the outweighing policy consideration was the need to prevent the unjust enrichment of the other party, if the court were to refuse to enforce the contract. The Court also acknowledged the fact that pricing and receipt of payment in foreign currency in Ghana is notorious, and the Court could order for the payment to be made in the cedi equivalent.

to deduct. The parties would essentially have agreed to a higher fee, taking into account the applicable taxes.

Conclusion

At the time of publishing this article, we had not sighted any reported Ghanaian case law on the enforceability of net of tax or tax gross-up provisions. However, based on the principles laid out in existing case law on illegal contracts, as set out in section 2 of this Article, net of tax provisions may likely be found by the Ghanaian courts to violate section 117(6) of the ITA and therefore illegal. On the other hand, tax gross-up provisions may likely hold up in Ghanaian courts. Ultimately, you may want to seek legal advice on your tax arrangements when navigating such clauses in commercial contracts in Ghana.