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TEMPLARS ThoughtLab

Tax Management Mechanics in Nigerian Commercial Contracts

Introduction

The incidence of taxation and its consequences are perhaps the most significant consideration by contracting parties in the economic evaluation of most commercial contracts. Consequently, proactive tax management practices and precepts are required to ensure desirable financial outcomes of every informed investor in order to avoid an erosion of the anticipated rate of return on the investment. It is not unusual for a contracting party to seek to manage its potential tax exposures by including explicit terms like "net of taxes" and "tax gross-up" clauses in their agreements. These clauses are intended to avoid a particular tax consequence rather than an evasion of tax.[1]

Tax Indemnities in Commercial Contracts

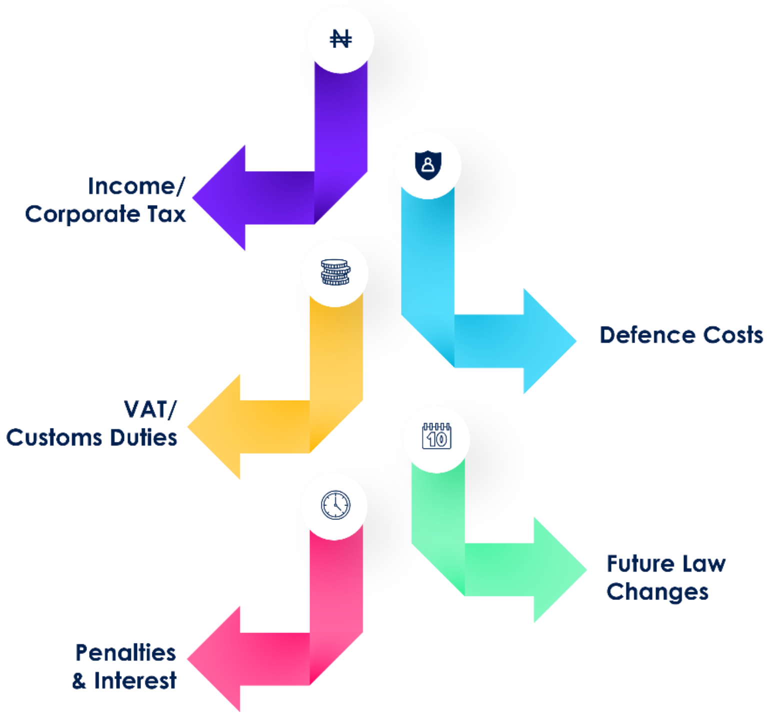
An indemnity is a contractual obligation of one party, the indemnitor, to compensate another party, the indemnitee, for losses or damages incurred by the indemnitee due to a specified event. A tax indemnity is crucial in contracts to protect a party from potential tax liabilities that may arise from the transaction or the actions of the other party by providing financial assurance or cover to the party who would have proposed a tax indemnity clause.

[1] In the case of ***7up Bottling Co. Plc. v. L.S.I.R.B.*** (2000) 3 NWLR (Pt. 650) 565, the court held that whereas tax avoidance is permissible, tax evasion on the other hand, is illegal and gives rise to penalties and in some cases imprisonment.

Indemnity clauses are common in various commercial contracts: Mergers and acquisitions agreements often include extensive tax indemnities for pre-acquisition tax liabilities. Also, leasing agreements may include indemnities for landlords to secure full rental payments notwithstanding attendant withholding tax (WHT) implications. Further examples include some service agreements featuring a service provider indemnifying itself against taxes for service delivery. In addition, loan agreements can incorporate indemnities for taxes on interest or principal repayments. Similarly, construction contracts may include indemnities for unforeseen tax burdens related to material procurements, labour, or specific project levies.

An indemnity clause can cover a wide range of tax-related exposures of the subject matter of the contract, including direct tax liabilities such as income tax, corporate tax, or capital gains tax; indirect tax liabilities like value-added tax, sales tax, or customs duties; penalties and interest; costs of defence; and future tax law changes.

Anatomy of a Tax Indemnity



Effect of Errors & Mistakes and Statute of Limitations

An interesting discussion arises in the likely event of an error or mistake by a party to the contract. This includes situations where an identified tax issue is beyond the statutorily provided period, otherwise known as the statute of limitations, beyond which date revenue officials are more or less statutorily foreclosed from raising additional tax assessments to a taxpayer. In addition, the applicability of an indemnity provision is also nuanced by mistakes of fact, such as when the basis for the indemnity is later found to be factually incorrect or when there is a discovery, after the fact of the execution of the contract, of an error, mistake or omission in the underlying books of account, tax filing and some related records of the indemnitor. It would appear that an indemnity clause would ordinarily not avail the indemnitor from tax consequences of his errors, omissions, or mistakes discovered after the execution of the contract.

Lastly, legal or regulatory changes, post-contract execution, offer a different set of discussions and usually a different set of clauses, otherwise known as "Stabilisation Clauses". The subject of Stabilisation Clauses requires a much more expansive discussion and will be covered in future releases.

A tax gross-up clause can be seen as a specific type of tax indemnity where the indemnitor (the payer) agrees to increase the payment to the indemnitee (the recipient) to cover the tax liability on the related transaction; ensuring the recipient receives a specified amount exclusive of the identified tax taxes imposed on the transaction i.e., net amount. Under Nigerian law, sums recoverable under an indemnity cannot be deducted for the purpose of ascertaining the profits of any company.[2]

Understanding Net of Taxes and Tax Gross-Up Clauses

A net of taxes clause is a contractual term that ensures one party receives a specific amount after all relevant taxes are discountenanced. The major objective of this clause is to shield the receiving party from any reduction in the agreed-upon payment arising from tax payment obligations. Essentially, it transfers the burden of paying taxes to the other party, ensuring that the recipient's income is not impacted by tax obligations.[3] The importance of this provision stems from its capacity to give financial certainty and predictability.

In contrast, a tax gross-up clause warrants that if one party is obligated to pay taxes on a contract sum, the other party will compensate them for the related tax amount. The party in receipt of the payment obtains a 'grossed-up' payment which comprises both the net amount and the related tax component. The primary objective of this clause is to neutralise the tax impact on the received payment, ensuring that the desired financial outcome is assured in the hands of the receiver.[4] A tax gross-up provision demands that payments to the payee be given in whole, without deductions or withholding, and with no right of set-off for the payer.[5] It guarantees that the receiving party is compensated for any excess tax incurred.[6]

Legal and Regulatory Framework in Nigeria

In Nigeria, the legal and regulatory framework governing commercial contracts is defined by a combination of statutory legislation, judicial precedents, and regulatory provisions. The Federal Inland Revenue Service (FIRS) is the primary regulatory authority for tax administration in Nigeria.[7]

The Companies Income Tax Act (CITA) is the primary legislation regulating corporate taxes in Nigeria, establishing the tax obligations for companies.[8] Prior to recent modifications, CITA did not specifically regulate payments received under a net of tax provision. This sparked a debate that additional sums paid under such terms were not taxes, but rather additional consideration for the supply, and as so, deductible as legitimate and necessary business costs.

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[2] Section 27(b) Companies Income Tax Act. This provision was retained in the Nigeria Tax Act 2025.
[3] Adeoluwa Akintobi, 'The Finance Act and Net of Tax Clauses' (PWC) <https://www.pwc.com/ng/en/assets/pdf/finance-act-net-of-tax-clauses.pdf> accessed 13 June 2025
[4] "Gross-up clause" (Practical Law) <https://uk.practicallaw.thomsonreuters.com/5-501-8610?transitionType=Default&contextData=(sc.Default)> accessed 13 June 2025
[5] Augustine B. Kidisil and Sydney K. Amenyedor, "Enforceability of Net of Tax and Gross Up clauses in Ghana" (TEMPLARS ThoughtLab, April 2024) <https://www.templars-law.com/app/uploads/2024/04/Are-Net-of-Tax-and-Gross-Up-Clauses-Enforceable-.pdf> accessed 13 June 2025.
[6] The formular for calculating tax gross up is: [total sum] x 100 / (100 – [rate]).
[7] Section 2 of the Federal Inland Revenue Service (Establishment) Act 2007. This body has been amended by the Nigeria Revenue Service (Establishment) Act 2025 to become the Nigeria Revenue Service.
[8] "Company Income Tax" (FIRS) <https://www.firs.gov.ng/company-income-tax> accessed 13 June 2025.

The Finance Act 2019 has significantly reformed Nigeria's tax framework, regulating how companies manage tax responsibilities in contractual agreements. The amendment explicitly bans the deduction of "any taxes or penalties borne by a company on behalf of another person".[9] This rule appears to be directly aimed at net of tax provisions, requiring businesses to examine their implications due to significant tax repercussions.

The Deduction of Tax at Source (Withholding) Regulations 2024 posits that WHT deductions are to be considered a tax due on payments, not an additional cost or inclusion in contract pricing, but rather a supplier's advance or final tax.[10]

Similarly, the Petroleum Industry Act provides that when calculating a company's adjusted profit from upstream petroleum operations involving crude oil in an accounting period, no deductions can be made for taxes paid by the company on behalf of a vendor or contractor under a net tax contract or agreement.[11]

Position of Nigerian Courts

Nigerian law generally recognises the right of parties to a contract to choose the terms and conditions that will bind them.[12] In the case of ***Total Nigeria Plc v. Moshood Akinpelu*** is a landmark legal precedent that clarifies the legality of net of tax terms in Nigerian commercial contracts.[13] Total Nigeria Plc became a sublessee under a leasing arrangement that included a net of tax clause. When paying the rental amount, Total Nigeria Plc attempted to withhold the WHT, to which the lessor opposed.

The Court ultimately found that the clause created a binding obligation between the contractual parties. Additionally, the Court concluded that the statute (relating to tax legislation) could not be used to avoid this contractual responsibility, especially as it did not expressly foreclose such arrangements.

Conclusion

Tax clauses and provisions in contracts are essential elements in commercial contracts that enable parties to efficiently manage, minimise or allocate tax responsibilities between the contracting parties. While they may provide financial predictability and certainty, there are significant considerations that require the input of a Tax Professional to better explore the most adequate tax management language in the proposed contract.

If you require any further clarification, do not hesitate to contact us.

[9] Section 27(1)(l) of the Companies Income Tax Act 2004 (as amended by section 11 of the Finance Act 2019).
[10] Regulation 5 of the WHT Regulations.
[11] Section 264(g) of the PIA.
[12] The Supreme Court in the case of ***Kaydee Ventures Ltd. v. Min., F.C.T.*** (2010) 7 NWLR (Pt. 1192) 171 identified that in the event that parties have agreed between themselves upon the conditions for the formation of a contract and these conditions were embodied in a document, then they are bound by the terms and conditions set down in the contract documents.
[13] [2004] 17 NWLR (Pt. 903) 509