Digitalization of Nigerian Businesses: Tax Challenges Post COVID-19

By:

Olumide K. Obayemi

July 28, 2020

1. **Introduction**

In Nigeria, the outbreak of Corona Virus (COVID-19) pandemic has made it very impracticable for Multi-National Corporations (MNCs) engaged in digital, online and internet platform transactions to comply with periodic tax filing obligations under the Companies Income Tax Act (CITA), Petroleum Profits Tax Act (PPTA), and Value Added Tax Act (VAT Act). Further, COVID-19 poses a significant negative impact on digital businesses generally, as contractual terms have had to be renegotiated because social distancing and self-isolation gravely affect taxpayers' meeting tax compliance deadlines in Nigeria where tax filling system is not fully digitalized (Olaniyi & Akhator, 2020; PwC, 2020). Also, on January 20, 2020, the Finance Act 2019 (FA) came into force in Nigeria, with the introduction of statutory measures subjecting digital MNCs to tax.[i] Thus,

Sections 9(2) and 13(2) of the CITA were amended via Sections 2 and 4 of the FA by which MNCs with "Significant Economic Presence" (SEP) in Nigeria—even if without physical Permanent Establishment(PE)—would be subject to Companies Income Tax (CIT).[ii] Therefore, this Paper critiques and reviews the challenges arising from attempts to tax digital economies in Nigeria within the context of COVID-19 challenges.

2. From Permanent Establishment to Significant Economic Presence

Hitherto, taxation of MNCs in Nigeria was principally predicated on Permanent Establishment (PE)/Fixed Base in Nigeria under Section 13(2)(a) of CITA[iii] and the Model Double Tax Treaties,[iv] and Nigeria is only entitled to tax the income attributable to that PE.[v] In ***Addax Petroleum vs FIRS***,[vi] the court defined PE as:

> "*To establish a fixed base [Permanent Establishment] within the meaning of the statutory provisions, any significant territorial connection to Nigeria will suffice if the Nigerian location is a place of regular resort for the foreign company, for business purposes*."[vii]

In ***Offshore International SA vs FBIR***,[viii] a wholly-owned Nigerian subsidiary carried out drilling operations for a Panamanian principal, identified physical presence therein, thus:

> "*If the plaintiffs enter into agreement to take up oil drilling contracts in respect of oil wells to be drilled in Nigeria, and they undertake to do it by or through a person who is their son as it were, and they guarantee to supply the wherewithal required by that person for the execution of the said oil drilling operations in Nigeria, and the said operations are in fact being executed, it will be vain for them (the plaintiffs) to say that they have no trade or business in Nigeria*."[ix]

Also, in ***Zapata North Sea Inc. vs FBIR***,[x] it was held that an American company was using its Nigerian agent—OSS as an "active" cover for its drilling operations in Nigeria. Further, ***F.L. Smith Co. Ltd vs FBIR***,[xi] involved the scope of Article 3 (1) of the Nigeria/UK Colonial Double Taxation Agreement as it applied to the company. It provided:

> "*The industrial or commercial profits of a UK enterprise shall not be subject to a Colonial tax unless the enterprise is engaged in trade or business in the country through a permanent establishment therein. If it so engaged, tax may be imposed on those profits by the Colony but only so much of them as is attributed to that permanent establishment*."

In ***Shell International Petroleum Maatchappij B.V. vs. FBIR***,[xii] the appeal court held that Shell Maatchappij had a fixed base in Nigeria:

> "*The situation depicted by the facts and circumstances given above by Mr. Kroven conform to my notion of what having a fixed base connotes within the contexts of the CITA and whereas here the appellant has used the said facilities since 1958 when the relationship with SPDC started. It would be hard to suggest that the appellant does not have a fixed base at SDPC. It is a finding of facts and this court will not interfere .*"

However, the voluminous development of digital economy in Nigeria has shown that the traditional rules which exclude income of MNCs without Nigerian PE, will not be adequate to deal with large revenue derived from Nigeria via online, internet and other digital means. Most digital/online businesses, such as Facebook, Netflix, Yahoo, Google, Amazon, etc derive several trillions of Naira from Nigeria[xiii] while escaping Nigerian taxes. This has led to the promulgation that a Company has Nigerian "Significant Economic Presence" (SEP) under Section 4 of the FA:

> *If it transmits, emits, receives signals, sounds, messages, images, or data of any kind by cable, radio, electromagnetic system or any other electronic or wireless apparatus in Nigeria in respect of any activity including electronic commerce, application store, high frequency, trading, electronic data, storage, online adverts, participative network platform, online payment, and so on, to the extent that the company has Significant Economic Presence in Nigeria or profits can be attributed to such activity*.[xiv]

***

If the trade or business comprises the furnishing of technical management, consultancy or professional services outside of Nigeria to a person resident in Nigeria to the extent that the company has Significant Economic Presence in Nigeria.[xv]

Further to the proviso to Section 13(4) of CITA, the Nigerian Finance Minister issued the Companies Income Tax (Significant Economic Presence) Order, 2020 (SEP Order)[xvi] on February 10, 2020, which defined SEP to mean where an MNC derives at least N25million, or its equivalent, in yearly revenue from streaming, transmission, provision of intermediation, goods and services, use of Nigerian domain name, etc[xvii] or from furnishing of technical management, consultancy or professional services outside of Nigeria to a person resident in Nigeria.[xviii] Also, Section 52 of the FA amended Section 2 of the Stamp Duty Act[xix] by providing that instruments subject to stamp duty in Nigeria shall include both written and electronic documents.[xx]

3. Global Solution by OECD/G-20

Generally, digitalization is transforming the global economy and reshaping global value chains, and in an attempt to address the challenges that digitalization poses on international tax norms, the Organization for Economic Cooperation and Development (OECD), through Action 1 of its Base Erosion and Profit Shifting (BEPS) Project, and the European Union provide policy suggestions that seek to align the place of taxation with that of 'value creation'. The OECD has also very recently introduced the concept of 'new taxing right' that attempts to allocate more taxing rights on an MNC's profits to the 'market' jurisdictions, defined as the countries where customers or users are located. These policy discussions have revealed a well-known problem: the role of the current international tax principles in the perpetuation of the imbalances in the international allocation of taxing rights among states.

In the digital era, these imbalances are departing from the traditional division of states into residence and source jurisdictions which has been determined by capital flows and investments requiring physical presence either through a permanent establishment or a dependent agent. There is a new imbalance provoked by the digital economy with a focus on developing countries and the need to introduce the concept of inter-nation equity in the current tax policy

discourse. For developing countries, Covid-19 presents a real and serious risk that their views and interests could be marginalized in global negotiations over digital taxation. So far, the global discussions at the OECD have proceeded with a focus on the secretariat's "unified proposal" under Pillar One, and on a global minimum tax solution under Pillar Two, all taking place in the shade of high-profile transatlantic disagreement between Europe and the United States.[xxi]

4. **General Discussion**

Clearly, SEP Rule would not curb profit shifting, revenue loss and tax leakages since there is a low level of technological development in Nigeria with physical filing still operative. The salient question is, how would Nigerian tax administrators resolve the conflict between the SEP rule the Model DTTs, which prescribes PE physical presence? A solution would be that Nigeria commences operating different tax standards regarding digital platforms located in countries that have DTTs with Nigeria and others without DTTs. Since SEP only applies to corporations, an issue is whether the 183 days physical presence rule [xxii] which governs the taxation of natural persons, be extended to all the employees of Non-Resident digital corporations in Nigeria With the huge inflows and outflows of Nigerian digital business, it remains to be seen whether the introduction of SEP results in the expected corresponding increase in tax revenue within Nigerian jurisdiction.

A solution is whether Nigeria considers the entire recommendations of the OECD/G-20's Task Force on Digital Economy (TFDE) to wit: the introduction of PE thresholds based on SEP, new withholding tax on certain types of digital transactions and introduction of an "equalization levy." Arguably, with endemic corruption and tax evasion in Nigeria, Nigerian tax authorities may extend SEP rule and so apply Nigerian taxes to the income of Financial Institutions located in tax havens such as Belize, Cayman Islands etc such use digital platforms to receive illicit Nigeria-sourced funds. Of importance is the Nigeria-UAE DTT, where UAE has passed internal guidelines that suggest that a Nigerian company would have a Service PE if it furnishes services, including consultancy services, through employees or other personnel who are offshore without being physically present in UAE—the Source State, leading to double taxation.

5. Conclusion

The effect of COVID-19 on the developing countries and the imposition of tax on the digital economy within the context of the OECD/G-20's Negotiations on enacting appropriate global standards would include new dynamics of participation, new revenue needs, and new policy dilemmas—involving developing countries.[xxiii] There is the need to fully digitalize the tax filling system in Nigeria and completely jettison the mundane practice of manual tax fillings at the office of the tax authority.[xxiv] Hopefully, the interplay between COVID-19 and SEP will be revealed by the close of 2020. The absence of a universally accepted standard for taxing digital platforms means that the challenges posed by COVID-19 and the disparate treatment against developing countries (usually constituting the Source States)—including Nigeria—would continue to linger.

---

[i]. Azeez Alatoye, “Digital Economy Taxation in Nigeria: Toward Specific Legislation Provisions,” CITN Newsletter Lockdown Series 3 (May 2020), at 1-2. (Alatoye).

[ii]. *Ibid.* at 1.

[iii]. See also, Paragraph 4.1 Federal Inland Revenue Service Circular (2014).

[iv]. Article 5 of the Double Tax Relief (Between Federal Republic of Nigeria and the Government of the Kingdom of Belgium) Order [S.I. 15 of 1992] (Nigerian/Belgium DTT);

[v]. Joseph Ajibola Arogundade, *Nigerian Income Tax & Its International Dimension: An In-Depth Analysis of Incomes From Local and Cross-Border Transactions in Nigeria*, (Spectrum Books Limited, Ibadan 2005), at p. 32. (“Arogundade”).

[vi]. (2013) 1 NRLR 33.

[vii]. *Ibid*. at 36.

[viii]. FRC/L/36/75; (1976) 1 NTC 385, quoted in and culled from Arogundade (n 11). at 51-52

[ix]. *Ibid.*

[x]. (1975) APP/COMM/220 in Arogundade, *Ibid.*, at 52

[xi]. (1976) APP/COMM/228 in Arogundade, *Ibid.* at 52-54

[xii]. (2004) 3 NWLR (Pt 859) 46, at 63 paras F-H.

[xiii]. Alatoye (n 7) at 1-2.

[xiv]. CITA (n2) Section 13(2)(c).

[xv]. *Ibd.* CITA, Section 13(2)(e).

[xvi]. No. 21, Government Notice No. 21, Vol. 10m 10th February, 2020, Lagos, Nigeria.

[xvii]. *Ibid.* Para. 1.

[xviii]. *Ibid.* Para. 2.

[xix]. Stamp Duties Act, Cap S8 LFN 2004.

[xx]. See also, Section 84(1) of the Evidence Act, 2011 providing the platform for admissibility of a statement contained in a document, which has been produced by a Computer or other electronic format.

[xxi]. Rasmus Corlin Christensen, “The impact of Covid-19 on global digital tax negotiations, “ 1 April 2020. Available at: https://www.ictd.ac/blog/impact-coronavirus-global-digital-tax-negotiations-oecd/. (Christensen).

[xxii]. Section 10 of the Personal Income Tax Act, Cap P8 LFN 2004.

[xxiii]. Christensen (n 27).

[xxiv]. Andersen (n 5).

View online: Digitalization of Nigerian Businesses: Tax Challenges Post COVID-19

Provided by Afronomicslaw