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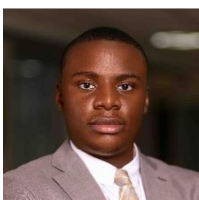
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TEMPLARS ThoughtLab

Double Tax Treaty Provisions or Domestic Digital Tax Laws: what Applies to Non-Resident Digital Companies in Nigeria?

Introduction

The cross-border taxation of digital service providers has been an issue of particular concern for national tax authorities and policy makers around the world in the recent past. As between countries that have bilateral tax treaties, this issue could potentially be addressed under such treaties. In the case of Nigeria, none of the existing double tax treaties ("**DTTs**") to which Nigeria is a party expressly address the taxation of digital earnings.

To plug this ostensible loophole and ensure that non-resident companies ("**NRCs**") account for their digital earnings in the country, Nigeria has made several amendments to existing tax laws in the recent past. These amendments include the digital service tax rules introduced by the Finance Act 2019 (which amended the Nigerian Companies Income Tax Act "**CITA**"), the Companies Income Tax (Significant Economic Presence) Order, 2020 (SEP Order, 2020); and other relevant laws and regulations (the "**digital service tax laws**").

In spite of the above, there is a school of thought that argues that the provisions of the DTTs should govern the taxation of digital earnings of NRCs notwithstanding the absence of express mention of digital income in the treaties. By implication, this view proposes that the provisions of the DTTs should be widely interpreted to cover digital earnings because the parties to the DTTs only intended to tax the income of tax residents of other contracting States where such NRCs are considered to have a permanent establishment under the DTTs.

This argument favours NRCs that would rather pay income tax on their digital earnings at the rate of 7% to 10% under the DTTs, instead of 20% to 30% applicable under the digital service tax laws.

The jurisprudence is not settled on whether the courts would prefer the provisions of the DTTs over the new digital service tax laws that aim to close the gap in our corporate tax jurisprudence, and there are potential grounds for either position to prevail.

Contentious Questions to Address:

The following issues form the basis of our analysis:

1. Is it legal for Nigeria to rely on the new digital service tax laws when there are DTTs that should govern the taxation of such income stream?
2. Despite the international commitments made by Nigeria, does the doctrine of hierarchy of laws in Nigeria allow a domestic law, let alone a subsidiary legislation, trump the provisions of a domesticated treaty?
3. What are the ways out of this legal quagmire?

Overview of Double Tax Treaties

Generally, a DTT is an agreement between two contracting States detailing how the countries will resolve issues arising from double taxation of passive and active incomes of their citizens and/or residents. This is to ensure that a resident of one or both contracting States does not suffer double taxation or unlawfully gain from double non-taxation. Therefore, DTTs ensure that none of the above tax misnomers happens. It goes further to determine the amount tax partner States impose on incomes, capitals, estates and other forms of earnings of taxpayers from the other partner State. DTTs do not extend to consumption taxes, such as Value Added Tax or sales taxes. Presently, Nigeria is a party to fifteen ratified DTTs.[1] Many cross-border transactions are structured to benefit from tax advantages that the DTTs accord taxpayers from a treaty partner State.

The most recent of 15 DTTs Nigeria entered with its trading partners were signed in 2017, 2005 and 2000 respectively.[2] All other DTTs were signed long before 2000. Therefore, relatively new concepts such as digital services tax (DST), or significant economic presence (SEP)[3] are not captured by the existing DTTs. As such, with the enactment of the new digital service tax laws, the Nigerian government has insisted that NRCs providing digital services in the country must be taxed under the new regime.

Taxation of Digital Services Under Nigerian Law

Prior to the enactment of the digital service tax laws, non-resident digital service providers operated in Nigeria without any form of tax liability. The 2019 Finance Act expressly amended the Nigerian CITA to capture virtually all forms of income-generating digital service activities: provided that the significant economic presence threshold is met. Clearly, this settles any debate concerning the tax liability of non-resident digital service companies in Nigeria. But the new debate is *whether, for NRCs from treaty partner States, the digital service tax laws or existing DTTs ratified and domesticated by Nigeria should govern the taxation of digital earnings of NRCs operating in the Nigerian digital space*.

Are Non-Resident Digital Service Companies from Treaty Countries Taxable Under the Applicable DTTs or the Nigerian Digital Service Tax Laws?

On the surface, the legislation on digital taxation seems straightforward. Thus, it appears from the clear wordings of the extant digital service tax laws (specifically, the CITA and the clarifications under the SEP Order) that if a non-resident company meets the SEP threshold, it is taxable in Nigeria. The implication is that the CITA will be used to assess the tax liability of such company, and the SEP Order prescribes the particular modalities triggering digital service taxation.

The above notwithstanding, Paragraph 1(3) of the SEP Order, 2020 provides that despite the provisions of Paragraph 1(1) of the SEP Order, a treaty – either multilateral or bilateral – provision that specifically applies to digital taxation of NRCs in Nigeria will trump any provision of the SEP Order. This appears to comply with the hierarchy of laws in Nigeria

where domesticated treaty ranks higher than a local legislation – save the provisions of the Constitution.

A contrary view to the above is that if an NRC from a treaty partner State with Nigeria earns digital income that meets the SEP threshold, the tax treatment of the earnings should be based on the relevant provisions of the DTT and not the SEP regime.

The question is – *when analysing the language of Nigeria's existing DTTs – are non-resident digital services companies' incomes taxable under these treaties – especially when there is no express provision in them to tax that stream of income? Alternatively, should the local digital service tax laws apply in the absence of express provisions in the DTTs taxing digital incomes?*

Hierarchy of Laws and The Determination of Which Law to Apply to Digital Earnings of NRCs in Nigeria

The relationship between tax treaties and local legislation is complex in many countries. However, the general principle is that in the event of a conflict between the provisions of domestic laws and a tax treaty, the treaty provisions should prevail.[4]

In Nigeria, the hierarchy of laws has long been settled in favour of international conventions and treaties ratified and domesticated in Nigeria, over domestic legislation.[5] It would thus appear that the SEP Order will be interpreted along this trite principle of Nigerian law.

However, this may not completely the case as there are two propositions on this, namely:

1. **Proposition 1:** The language of Nigeria's existing DTTs do not expressly provide for the taxation of digital goods and services. Therefore, a literal interpretation of the provisions of the DTTs will be that digital incomes of NRCs from treaty countries cannot be taxed under the DTTs in Nigeria but under the Nigerian CITA, the SEP Order and other relevant local legislations.
2. **Proposition 2:** The provisions on taxable income under the DTTs can be given a wider and expansive interpretation to accommodate digital incomes. Therefore, digital earnings of NRCs from treaty countries are taxable under the DTTs.

Proposition 1 And Arguments Around It – Nigerian Digital Service Tax Laws/Sep Regime Shall Apply

The core of the argument in support of this proposition is anchored on literal interpretation of the relevant laws. The literal rule provides that where the wordings of a piece of legislation are clear and unambiguous, the courts should, without more, give the words their literal meanings. In ***Unipetrol Nigerial PLC. Vs. Edo State Board of Internal Revenue,***[6] where the right of the Edo State Board of Internal Revenue to institute criminal proceedings against a taxpayer for non-remittance of Pay-As-You-Earn (PAYE) taxes was challenged, the Supreme Court of Nigeria held that the power of the Board to "sue and be sued" must be given its literal construction to mean that the board can institute civil and criminal proceedings and defend itself when sued.

The implication of this decision is that since the existing DTTs do not expressly include digital earnings/income, the DTTs will be literally interpreted to exclude the application of DTTs on digital earnings of NRCs; instead, the local SEP regime is preferred in that instance.

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[1] With Belgium, Canada, China, Czech Republic, France, the Netherlands, Pakistan, Philippines, Romania, Singapore, Slovakia, South Africa, Spain, Sweden, and the United Kingdom (altogether referred to as the "**treaty countries**").
[2] These are the Nigeria/Singapore, Nigeria/China and the Nigeria/South Africa DTTs.
[3] These are developments that arose in international tax law over the past few years to effectively bring digital earnings from the sale of digital goods and services into the tax net of some countries via domestic digital service tax laws.
[4] ***General Sani Abacha & Ors. vs. Chief Gani Fawehinmi*** SC 45/1997 (2000) 6 NWLR 228
[5] Ibid.
[6] (2006) 4 S.C. (Pt. 1) 41

Proponents of Proposition 1 would also argue that while the SEP Order specifically provides for the taxation of the Nigerian digital economy, the extant DTTs do not cover digital taxation and should not be overstretched to cover a subject it is not meant, ab initio, to address. Therefore, a DTT would only trump the local digital service tax laws if it expressly provides for the taxation of digital earnings of NRCs operating in Nigeria's digital space.

Proposition 2 and Arguments Around It – DTT Tax Regime Shall Apply

Contrary to the position taken in Proposition 1, Proposition 2 holds the view that existing DTTs can apply to NRCs involved in digital earnings in Nigeria. This is achievable through expanding the interpretation of taxable subjects under the DTTs to include incomes accruing from the sale of digital goods and services. However, the challenge would be how to justify such an interpretation.

A cursory look at the DTT between the United Kingdom and Nigeria is illustrative in this instance. Article 7 of the DTT provides that the business profits of enterprises of a Contracting State carrying on business in the other Contracting State through a **permanent establishment** may be taxed in that other State for as much as the profit is attributable to the permanent establishment situated in that other State. The problem here is the definition of the term "permanent establishment" as contained in Article 5 of the DTT. Generally, "permanent establishment" as defined in Article 5 of the Treaty relates to a fixed place of business through which an enterprise, wholly or partly, carries on its business. Since the profit to be taxed must be attributable to a permanent establishment in that other state, the only plausible argument that could be canvassed by the proponents of Proposition 2 is that the court could extend the definition of permanent establishment to include digital presence in the digital space of a contracting state: to show that presence could be both physical and virtual. This argument may be supported by the fact that during the negotiation and execution of the DTTs there was nothing like digital earnings without the physical presence of the income earner in that other State; and the state parties to the agreements would not have allowed any income earner to go untaxed no matter how little a mutually agreed rate may be.

COST IMPLICATIONS OF BOTH PROPOSITIONS

On the cost implications of the two Propositions, it must be noted that Proposition 1 implies that NRCs will pay more income tax than they would under any of the DTTs. Generally, under the Nigerian CITA, income tax rate in Nigeria can graduate up to 30% depending on the annual turnover of the company involved. Many NRCs would meet the annual turnover threshold for large companies – that is N100,000,000 (approx. $84,000) and above – and, therefore, will be charged at the rate of 30% instead of 7.5% or 10% under a DTT arrangement.

Proposition 2 on the other hand favours NRCs. Indeed, it offers a tax-saving path for NRCs that will pay corporate income tax at the rate of 7.5% (or 10% as the case may be) under a Nigerian DTT instead of a rate of about 30% under the Nigerian SEP framework.

Conclusion And Considerations

Both Propositions appear plausible in determining the tax treatments of digital earnings of NRCs operating in Nigeria's virtual space. However, it is left for the Tax Appeal Tribunal ("TAT") and the appellate courts[7] to decide what they think is proper. Judicial precedents will play a significant role in determining which of the options align more with our laws. While an NRC stands a chance of making a good case in favour of Proposition 2, we note that following judicial precedent in Nigeria, there is a real risk that our courts may favour Proposition 1.

In light of the above, it means that digital service NRCs from treaty partner States may need to assess or re-assess their Nigerian operations. Such entities should be mindful of the possibility of being taxed at a rate up to 30% under the Nigerian CITA, rather than assuming that their digital earnings will not be taxed at all or subjected only to a withholding tax rate of 7.5% - 10% under a relevant DTT.

Finally, it is advised that Nigeria should either renegotiate the existing treaties to cover digital services or ensure that its favoured position is adopted in the ongoing multilateral arrangement championed by the OECD/G20 Inclusive Framework. We are aware that on 11 October 2023, the OECD unveiled a brand-new multilateral treaty intended to replace individual country's digital service tax law; it remains to be seen whether Nigeria will ratify it since the initial complaints lodged by the country have not been adequately addressed. Therefore, NRCs are strongly advised to familiarize themselves with Nigeria's digital service tax laws and existing DTTs.

[7] The Federal High Court exercises appellate jurisdiction over matters emanating from the TAT. Therefore, the appellate courts mentioned here are the Federal High Court, Court of Appeal, and the Supreme Court of Nigeria.