



THE IMPACT OF THE FINANCE ACT ON DIGITAL TAXATION IN NIGERIA

INTRODUCTION

The enactment of the Finance Act 2020 on 13 January 2020 introduced various changes to principal tax legislations in Nigeria, among which are the commencement of a new regime of exposure to Nigerian companies income tax for non-resident companies (“NRCs”) providing digital services and products to persons in Nigeria, and the imposition of Value Added Tax (“VAT”) on intangible supplies.

The objective of this newsletter is to analyse the key provisions of the Finance Act relevant to digital tax, particularly in view of developing international trends, and the implication of these provisions to international companies offering digital services and products to persons in Nigeria.

BASIS FOR DIGITAL TAXATION UNDER THE FINANCE ACT

- COMPANIES INCOME TAX

Under Nigerian law, all companies are subject to Nigerian Companies Income Tax (“CIT”) where such income accrues in, is derived from, brought into, or is received in Nigeria.¹ Section 13(2) of the CITA provides the basis for assessing the element of derivation for CIT liability on the profits of an NRC in Nigeria. Prior to the enactment of the Finance Act, the profits of an NRC from any trade or business were only deemed to be derived from Nigeria and assessable to CIT:²

- if that company has a fixed base in Nigeria to the extent that the profit is attributable to the fixed base; or
- if it does not have a fixed base in Nigeria but habitually operate a trade or business through a person in Nigeria authorized to conclude contracts on its behalf or on behalf of some other companies controlled by it or which have controlling interest in it or habitually maintains a stock of goods or merchandise in Nigeria from

which deliveries are regularly made by a person on behalf of the company to the extent that the profit is attributable to business or trade or activities carried on through that person; or

- Derives profits from that trade or business or activities which involves a single contract for surveys, deliveries, installations or construction; or
- Where the trade or business or activities is between the company and another person controlled by it or which has a controlling interest in it and conditions are made or imposed between that company and such persons in their commercial or financial relations which in the opinion of the FIRS is deemed to be artificial or fictitious.

The above provisions of the CITA limited the taxation of business profits of NRCs to only occasions where the NRC:

- has a fixed base in Nigeria (which requires some element of physical presence); or
- concludes contracts through a dependent agent in Nigeria; or
- engage in turn-key projects in Nigeria; or

¹ Sections 9 of CITA.

² At the rate of 30%.

- carries on trade or business with persons who have controlling interests in the NRC, and the conditions made or imposed between the NRC and such persons in their commercial or financial relations are deemed to be artificial or fictitious by the FIRS.

This regime did not contemplate the taxation of income derived by NRCs from digital services or products offered to persons resident in Nigeria. Multinational NRCs typically avoid operational or investment structures that result in the creation of a fixed base or permanent establishment (“PE”) in Nigeria when they are providing digital goods or services. Although there is currently no statutory definition of “fixed base” under Nigerian law, decisions handed down by the Tax Appeal Tribunals, courts and the provisions of section 13 (2)(a) CITA all seem to ascribe a notion of a physical location/building and permanence to what would qualify as a fixed base.³ Intangible goods and digital services provided through internet mediums enable multinationals to easily avoid the physical presence that usually is indicative of a fixed base.

NRCs transacting largely through electronic means in Nigeria also do not need to habitually conduct business through a dependent agent in Nigeria or have any representatives or maintain stock or merchandise in Nigeria from which deliveries are made. Neither do they tend to contract for surveys, deliveries, installations or construction, or carry on business with related entities that have controlling interests in the NRC.

Based on the foregoing, insofar as the profits of an NRC did not fall under any of the

³ *Shell Int'l Petroleum B.V v. F.B.I.R* (2004) 3 NWLR (Pt. 859) p. 46 at 63, paras E-H.; FIRS in its circular stated that a “fixed base” implies that the place must be easily identifiable and must possess some degree of permanence. It includes: (i) facilities such as a factory, an office, a branch, a mine, gas or oil well etc; (ii) activities such as building, construction, assembly, or installation; and (iii) furnishing of services in connection with the activities mentioned above; *Addax Petroleum Services Ltd v Federal Inland Revenue Service* (2013) 9 TLRN 126”... any

categories highlighted above, it was difficult to subject NRCs which provide digital goods or services to Nigeria to be liable to CIT payment obligations in Nigeria.

Introduction of “Significant Economic Presence” by the Act

The Finance Act has provided a key amendment to Section 13(2) of CITA in line with the developing international digital taxation principle of “significant economic presence” (“SEP”).

Under the Act, an NRC’s profits would now be subject to CIT in Nigeria where it “transmits, emits or receives signals, sounds, messages, images or data of any kind by cable, radio, electromagnetic systems or any other electronic or wireless apparatus to Nigeria in respect of any activity, including electronic commerce, application store, high frequency trading, electronic data storage, online adverts, participative network platform, online payments and so on, to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity”.⁴

However, the vital question would be: what constitutes SEP under Nigerian law for the purposes of tax liability of an NRC? Unfortunately, a definition of SEP is not stated in the Act. Section 3(d) of the Act however provides that the Minister of Finance may by an order determine what constitutes SEP of an NRC in Nigeria.

The non-inclusion of a specific definition of what constitutes a SEP would appear to be a deliberate strategy to provide for flexibility in the characterization of the new concept, in

significant territorial connection to Nigeria will suffice if the Nigerian location is a place of regular resort for the foreign company for business purposes.” “... duration is not a criterion for assessing fixed base although it can (as a matter of evidence) help the court ascertain the existence of a fixed base”.

⁴ Section 4(a)(ii) of the Act.

order to enable alignment of what would constitute SEP with future evolution in business trends. Evidently, the definition and implementation of the SEP principle would significantly define the evolving regime for digital taxation in Nigeria.

**“Significant Economic Presence”-
International Usage and Implementation**

SEP is an emerging principle in international tax law that was formulated by the Organisation for Economic Cooperation and Development (“OECD”) Base Erosion and Profit Shifting (“BEPS”) Action Plan as part of attempts to bring the rapidly multiplying digital businesses of multinationals within the jurisdiction of EU country tax nets.

A definition of SEP and characteristics of the principle were outlined in the OECD Action 1 – 2015 Final Report on Addressing the Tax Challenges of the Digital Economy (the “OECD Report”). SEP was proposed as an option to create a “taxable presence in a country when a non-resident enterprise has a **significant economic presence** in a country on the basis of factors that **evidence a purposeful and sustained interaction** with the economy of that country via technology and other tools. These factors would be combined with a **factor** based on the revenue derived from remote transactions into the country, in order to ensure that only cases of significant economic presence are covered, limit compliance costs of the taxpayers, and provide certainty for cross border activities.”⁵

Nigeria’s implementation of SEP would thus depend on which key factor(s) is chosen as the basis for assessing the minimum requirements for an NRC to have SEP in Nigeria. The OECD Report offers different possible factors, including a revenue-based factor, digital-

based factors, user-based factors, or combinations of the three. To briefly illustrate:

- **Revenue-based factor:** A revenue-based factor for SEP would be predicated on using the revenues generated from customers in Nigeria to establish the nexus for SEP. Revenue on its own is not a sufficient factor but can be used as the basic factor in combination with other factors. The factor, simply illustrated, goes as follows: *If X company generates Y amount of revenue in Nigeria from Nigerian customers in Z year from digital operations, X company is deemed to have SEP in Nigeria.*
- **Digital-based factor:** A digital-based factor for SEP involves using a company’s digital presence as a means of determining SEP. This entails using characteristics such as a local domain name in that country (i.e. www.company.ng), a local digital platform (local websites, websites translated to the language of that country, local terms of service for customers, etc.) and local payment options (i.e. prices calculated in Nigerian Naira with relevant local taxes inclusive), which indicate an NRC having a digital basis for seamless transactions with local consumers.
- **User-based factor:** A user-based factor for SEP entails using an enterprise’s user base and related data as indicators of sustained economic interaction. This could be calculated through using indicators such as monthly active users (calculated on a 30-day basis), regular online contract executions (i.e. customers agreeing to online Terms of Service), amount of data collected, etc.⁶

There are obvious difficulties in implementing the above factors or any combination of them in Nigeria. For instance, revenue-based factors require the tax authority to have specific information on the computation of the NRC’s profits. It may be difficult for the Federal Inland Revenue Service (“FIRS”) to have

⁵ Chapter VII, OECD Action 1, 2015 Final Report on Addressing the Tax Challenges of the Digital Economy, para. 277, p. 107. Available at: [https://www.oecd.org/tax/addressing-the-tax-](https://www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm)

[challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm](https://www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm)

⁶ Ibid., p. 107-111.

access to the financial statements of an NRC in order to ascertain the extent of profits attributable to digital transactions in Nigeria.

Digital or user-based factors offer similar challenges and may depend on the NRC submitting user data or other relevant information to the tax authority. Further, jurisdictional questions may arise (i.e. does SEP apply to digital consumers in Nigeria or Nigerian consumers regardless of location? How would such consumers be traced or tracked by the tax authority?). Information Technology expertise would be needed for successful adoption of any these factors.

The above challenges associated with defining and adopting an SEP principle in tax legislation are also being faced by other jurisdictions. For example, EU member states have continued to debate on revenue-based factors and other characteristics of SEP, and the OECD has proposed a 2020 stopgap deadline for a conclusion to be reached. In the interim, many EU countries have favored short term national solutions like Digital Services Tax (“DST”) which impose a flat rate on businesses depending on their revenue and business activities.

Country	Rate	Status	Summary
EU	3%	On Hold	Targets businesses with annual worldwide revenue of €750 million and EU revenues of €50 million derived from the selling of advertising space, digital intermediary activities like online marketplaces, and sales of user collected data.
UK	2%	Proposed	Targets businesses that generate at least €500 million global revenue and over £25 million UK revenue from social media platforms, search engines and online marketplaces.
France	3%	Approved	Targets businesses with annual worldwide revenue of €750 million and French revenue of €250 million derived from online marketplaces, digital advertising and transmission of personal data.
Italy	3%	Proposed	Targets businesses with annual worldwide revenue of €750 million and Italian revenue of €5.5 million from online advertising, transmission of user data and provision of a digital interface allowing users to interact.
OECD	TBD	Debating/Consulting	The OECD is still debating a consensual solution to fundamental problems with SEP.

Information in the Table above obtained from Lexology.com⁷

⁷ Bird & Bird LLP. *Digital Services Tax: Overview of the progress of implementation by EU Member States*. 28 October 2019. Accessed at:

<https://www.lexology.com/library/detail.aspx?g=b2f512f2-3244-4a4f-880e-1bae4ff85ed9>

Impact and Risks of SEP for NRCs in Nigeria

Clearly, the implication of the Finance Act amendment is that where an NRC’s profits are derived from digital transmissions, e-commerce, app stores, trading, storage, ads, network platforms, etc. to the extent that such NRC has a SEP in Nigeria and attributes profits to such activities, then the NRC would be liable to pay CIT in Nigeria on the part of its profits attributable to Nigeria.

NRCs, particularly multinationals (such as Google, Amazon or Apple) which offer various digital good and products to persons in Nigeria are likely to have companies income tax obligations in Nigeria under the new regime in respect of profits generated from digital products offered to persons in Nigeria.

- VALUE ADDED TAX

The Finance Act is most prevalently known for increasing the applicable rate of VAT in Nigeria from 5% to 7.5%. The tax authority commenced the enforcement of the increased VAT rate from 1st February 2020. In addition to this increased rate, the scope of application of VAT has also been widened to include intangible goods, which captures digital products. Prior to the enactment of the Finance Act, although VAT was payable on supplies of goods and services by non-resident companies, the scope

did not extend to intangible goods. The Finance Act however expands the scope of VAT to capture supplies of goods and services in the digital economy.⁸ Furthermore, the Finance Act provides that supply of goods anywhere would be subject to VAT in Nigeria, provided that the beneficial owner of the rights in or over the goods is a taxable person in Nigeria and the goods or right thereof is situated, registered or exercisable in Nigeria.⁹

The implication of the above is to the effect that where an NRC supplies digital goods to or for the benefit of persons in Nigeria, such transactions would be subject to VAT.

There have also been amendments to VAT provisions in order to ensure registration by NRCs for VAT in Nigeria, as well as for accounting of VAT on invoices issued by NRCs to Nigerian consumers. Based on the provisions of the Finance Act, NRCs will be required to register for VAT purposes and include the VAT tax payable on its invoices to Nigerian consumers. Where an NRC fails to remit the applicable VAT, the Finance Act requires the recipient of the invoice in Nigeria to self-account for VAT and remit the tax.¹⁰

It is important to note that failure to comply with the new provisions may subject offenders to increased penalties for non-registration¹¹ and non-remittance of VAT.¹²

⁸The Finance Act provides the meaning of “goods” to include all forms of tangible products (excluding money or securities), but also transferrable intangible products, assets or property over which a person has ownership or rights or from which he derives benefits (excluding interests in land)- Section 46 of the Finance Act.

⁹ Section 33 of the Finance Act.

¹⁰ Section 37 of the Finance Act.

¹¹ Failure to register would now be punishable by fine of N50,000 (approx. \$163) for the first month in which the failure occurs and

N25,000 (approx. \$82) for every subsequent month. See Section 35 of the Finance Act.

¹² Failure to remit VAT within the stipulated time would now result in a sum of 10% per annum (plus interest at the commercial rate) of the amount of tax to be remitted being added to the tax. It may also result in enforcement proceedings being instituted against the defaulting taxpayer. See Section 40 of the Finance Act.

CONCLUSION

The Finance Act is a clear indication of Nigeria's intention to bring digital transactions within the ambit of Nigeria's tax laws. Looking further to the future, government officials have recently expressed the intention to amend the Finance Act yearly in accordance with each year's Appropriation Bill. If this approach is adopted, it may be the first step into a new regime of consistent updates to Nigerian taxation to align with the country's ever-changing economic realities and address the emerging challenges to be presented by the digital economy.

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