

# TNP Insights



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The Finance Act which came into force on 13th January 2020, introduced the concept of “significant economic presence” (“SEP”) as a new basis for the taxation of digital and online transactions by non-resident companies. Before the Finance Act, non-resident companies were taxable in Nigeria only if they had a fixed base or permanent establishment in Nigeria. This meant that digital companies providing services and goods without physical presence in Nigeria were not liable to pay income tax in Nigeria. This position has changed with the enactment of the Finance Act.

The impetus to tax digital transactions derives from a growing international consensus that states whose citizens contribute to the profits of digital companies (market jurisdictions) should also enjoy taxing rights over those profits. Taxation of digital transactions is primarily concerned with how these taxing rights are allocated between states.

## Justification for taxation of digital transactions

1. Scale without mass: digital companies are able to operate across various jurisdictions without having a physical presence in those jurisdictions – thereby exempting them from the traditional model of taxation which was based on the existence of a fixed base or permanent establishment. The ability of digital companies to generate income from market jurisdictions without paying “commensurate” taxes due to the limitations of the traditional basis of taxation has led to a realisation that there is need for a new framework to bring digital transactions within the tax net. Furthermore, digital companies rely heavily on intangible assets which can be located in low or no tax jurisdictions thereby providing the digital companies with considerable tax savings.
2. User participation: the business models of some digital companies rely heavily on substantial contributions and information provided by users of the company’s product. This information is monetised by the digital company by using it to provide targeted advertisements or by selling the information to third parties. Proponents of taxation of digital transactions believe that the countries where these users are resident have a right to tax income generated from the activities of these users.

## Taxation of digital transactions in Nigeria

The Finance Act 2019 amended Section 13(2) of the Companies Income Tax Act (“CITA”) by introducing a new paragraph (c) which subjects digital and online transactions of non-resident companies to companies income tax in Nigeria. Specifically, Section 13(2)(c) of CITA provides that a non-Nigerian company will be deemed to have derived profits from Nigeria and so taxable in Nigeria if the company satisfies the following conditions:

1. the company transmits, emits or receives signals, sounds, messages, images or data

## Digital Taxes, Significant Economic Presence and Tax Implications in Nigeria

of any kind by cable, radio, electromagnetic systems, or any other electronic or wireless apparatus to Nigeria in respect of ANY activity including the following:

- a. electronic commerce;
- b. application store;
- c. high frequency trading;
- d. electronic data storage;
- e. online adverts;
- f. participative network platform;
- g. online payments.

2. profit is attributable to such activities; and
3. the company has a significant economic presence in Nigeria.

These three conditions must be present for the non-resident company to be taxable in Nigeria.

### What is Significant Economic Presence (SEP)?

Section 13(4) of CITA vests the Minister of Finance with the power to issue Orders stating what constitutes SEP with respect to digital and online activities. Pursuant to this power, on 3rd February 2020, the Minister of Finance issued the Companies Income Tax (Significant Economic Presence) Order 2020 (the “Ministerial Order”). The Ministerial Order provides that a non-resident company shall have SEP in Nigeria if it satisfies any of these following conditions:

1. the company derives a yearly turnover of ₦25million or its equivalent from the following:
  - a. streaming or downloading of books, music, movies, games or applications;
  - b. transmission of data collected about Nigerian users generated from the users’ activities;
  - c. provision of goods and services through a digital platform to Nigeria;
  - d. provision of intermediation services through a digital platform, website or online application linking suppliers and customers in Nigeria, or
2. uses a Nigerian domain name (.ng) or registers a website in Nigeria; or
3. has a purposeful and sustained interaction with persons in Nigeria by customising its digital page or platform to target persons in Nigeria. This includes pricing its goods and services in Nigerian currency or providing options for payment in Nigerian currency.

It should be noted that for the purpose of determining whether the ₦25million threshold has been met, activities by connected persons shall be aggregated. The Ministerial Order defines “connected persons” as including “associates” as defined under the Companies and Allied Matters Act, or business associates where the same person participates in the management, control and capital of two companies or one company participates in the management, control and capital of another company.

### Implications for non-resident digital and online companies

The SEP concept has several tax implications for companies engaged in digital and online transactions. They include the following:

1. non-resident digital companies with SEP in Nigeria will now be required to file tax returns in Nigeria in compliance with Section

55 of CITA. Failure to fulfil this compliance obligation will render them liable to penalties.

2. banks and authorised agents who receive monies on behalf of companies with SEP may find themselves being appointed as agents of the Federal Inland Revenue Service (FIRS) for the purpose of recovering outstanding tax liabilities imposed under the SEP framework.
3. the basis of taxation of non-resident companies has been expanded such that taxable presence can be created without the existence of a physical address or a dependent agent. In some cases, the non-resident company may not even know whether it is taxable in Nigeria until after its financial accounts have been prepared and its inflows from Nigeria determined.

consensus on this issue means that this will be a thorny point for implementation.

3. Tax jurisdictions where digital companies are mainly resident have largely refused to follow the trend of digital taxation – for obvious reasons. These countries have argued that the existing transfer pricing framework adequately addresses the taxation of digital transactions therefore there is no need to create the SEP concept or any other concept as a separate basis of tax. In order to protect digital companies in their jurisdictions, countries like the United States have threatened to impose retaliatory tariffs against some countries who impose digital taxes on non-resident companies. For instance, France was forced to postpone the adoption of digital taxation after the United States threatened to retaliate with a USD2.4 billion tariff on French champagne, cheese, designer handbags and other products.

4. Using ₦25million as the turnover threshold for determining the existence of a SEP creates two potential problems. First, the amount is low in dollar terms (about USD65,000) relative the benchmark being considered in the European Union which is USD7million. Secondly, denoting the benchmark in Naira terms might create a moving goalpost particularly in view of the instability of the Naira.

### Conclusion

Clearly, the implementation of the SEP concept as a basis of taxation in Nigeria is still a work-in-progress and a potential minefield in view of the lack of international consensus on the topic. The level of information analysis required to establish tax liability under the SEP concept requires expert knowledge which may not be readily available to FIRS at this time.

Also, FIRS may not have the technical capacity to monitor digital transactions involving persons resident in Nigeria. For transactions which can be tracked by FIRS, the problem of enforcement must be overcome because the non-resident companies may have little or no assets within Nigerian jurisdiction. Paragraph 1(3) of the Ministerial Order acknowledges that there will be challenges in the implementation of digital taxes and so provides that any multilateral agreement or consensus arrangement to address these challenges shall also apply in Nigeria – provided Nigeria is party to such agreement or arrangement. This provision does not address the constitutional requirement that treaties must be ratified by the National Assembly before it can take effect in Nigeria.

By incorporating SEP as a basis of taxation into Nigerian law, non-resident companies and the Federal Inland Revenue Service have the obligation to comply with its requirements as from 2020 irrespective of the challenges identified.

It has been argued that the anticipated tax inflow from digital taxes for many advanced countries is insignificant relative to their overall tax profile and therefore not worth the cost of implementation. For Nigeria, the jury is still out on whether digital taxes are worth the hassle.

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### Issues with implementing the SEP concept

1. There is a need to re-negotiate the existing double tax treaties between Nigeria and other countries. These treaties were negotiated with permanent establishment as the basis for taxation. These double tax treaties must be re-negotiated to take care of today’s realities.
2. The SEP framework attempts to tax the income derived from information and value created by users of participative networks. How value will be attributed to such user activity is unclear and there is no agreed framework for the valuation of such user activity. The absence of clarity and