

# A Proposal on How to Implement the Significant Economic Presence (SEP) in Nigeria

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***Abstract- This paper aims to bridge the gap between the newly introduced concept of SEP in the Company Income Tax Act of Nigeria's tax law to be applied to its digital economy and the concept of Permanent Establishment (PE) or Fixed Base (FB) in another section of the same Act which solely depends on the physical presence of a non-resident entity before it can be taxed.***

## I. INTRODUCTION

The amended section 13(2c) of CITA introduced the concept of 'Significant Economic Presence' into the Nigerian tax Law to enable the taxation of Digital foreign companies deriving revenue from Nigeria without physical presence.

The traditional Permanent Establishment (PE) or Fixed Base (FB) Concept as Contained in Section 13(2) of CITA or Articles 5 and 7 of our treaties relies on the physical presence of a Non-resident company doing business in Nigeria before it can be taxed. However, the advent of information and communication technology particularly the internet, means that foreign companies can now do business remotely without the need for physical presence. This has made the PE concept insufficient to capture the full profit made by Non-resident companies doing business remotely and deriving income in territories from which a good part of their profit is made and may not have been subjected to tax due to lack of physical presence.

In response to this problem, at the request of the G20, the Organisation for Economic Co-operation and Development (OECD) published an Action Plan on Base Erosion and Profit Shifting project (15 BEPS Action plans-also known as BEPS 1.0) to develop solutions that will address the problems of profit shifting by Multinational Companies (MNEs). Action 1 calls for work to address the tax challenges of the

Digital Economy. The BEPS report which started in 2013 submitted its final reports in 2015 with various recommendations.

Action 1 of BEPS 1.0 which addresses the Challenges of the digital economy did not fully address the challenges related to the digital economy especially as it relates to Nexus, data, and characterization, except for some amendments to the physical PE rules in BEPS action 7 which were subsequently updated in Articles 5(3,4,5,6) of UN and OECD Model conventions. Most countries also complain that this amendment falls short of addressing the problems of the Digital Economy. Given these complaints, the OECD is now working through the Inclusive Framework- also known as Pillar 1 to address the remaining challenges to the digital economy by coming up with a global rule to allocate the residual profit of digital companies to where sales are made using a yet to be agreed formula known as amount A as part of a three tiered profit allocation methodology called amount A, B, and C ( it is important to note that as inadequate as the amendments to the Physical PE rules were, Nigeria is yet to include them in its domestic Law. Most countries have domesticated these changes, now we are discussing digital and remote businesses.)

## II. THE SEP AMENDMENT IN SECTION 13 OF CITA

A new section was added to the section 13(2) of CITA as follows;

*(c) if 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*

*a significant economic presence in Nigeria in Nigeria and profit can be attributable to such activity ;*

The ministerial order was subsequently published where the threshold of N25 million was defined as a Significant Revenue threshold to create SEP PE Nexus.

### III. THE ADMINISTRATION OF THE SEP CONCEPT

The PE/FB concept works in three steps

- i. The determination of Nexus to the Market economy of the non-resident company
- ii. The attribution of profit of the activity to the Market economy
- iii. The filling obligation

- Step I-the determination of the SEP NEXUS

The inclusion of specific digital activities in section 13(2c) of CITA and the revenue threshold has created sufficient nexus to tax such activities in Nigeria

- Step the attribution of profit to the SEP ACTIVITY  
The attribution of profit to the Activity is the process of determining the part of the profit of the foreign company that can be allocated to that activity that occurred through Nigeria activity from which revenue above the threshold was derived.

How profits are attributed to PE in Nigeria

The attribution of Profit to PE in Nigeria was done based on section 30 of CITA -which is based on 6% up until 2013. But in 2014 the FIRS asked the non-resident companies to file actual accounts based on section 55 of CITA. Unfortunately, because the FIRS did not give clear guidance on how the non-resident companies should file their accounts, the foreign companies saw this as an opportunity to allocate huge unverifiable head office costs and assets including huge capital allowances for assets owned legally by the head office) to the PE. This has led to most non-resident companies now filing losses which was not the case before the notice. The present management of the International Tax Department disagreed with this practice both in law and application of the principles and is now working with Tax policy to reverse the problem to stop the huge tax leakage.

The lack of guidance on profit attribution to Physical PE by the FIRS NOW poses a new and bigger problem to SEP profit Attribution -which is a Virtual PE. The following are my recommendations on the application of the attribution rule to SEP.

How the attribution to SEP should be done

To understand the attribution of profit to SEP we first need to explore the origin of the concept. The SEP CONCEPT was part of the options provided under the 2015 BEPS Action plan to tax the digital economy. India is one of the countries that is championing the concept.

Action 1 of BEPS 1.0 provided the following 3 approaches to attribute profit to SEP

- a. Fractional apportionment methodology
- b. Simplified Deemed profit approach
- c. Withholding taxes approach

- a) Fractional\_Apportionment\_Methodology

This methodology would require the application of the following steps:

- 1) The definition of the tax base to be divided. This could be determined by applying the global profit rate of the MNE group to the revenue (sales) generated in a particular jurisdiction.
- 2) The determination of the allocation keys to divide that tax base, which could be several users, sales, assets employees, etc.
- 3) the weighting of these allocation keys.

One of the shortcomings of the fractional Apportionment Methodology is that it could be marred by the unwillingness of the constituent entity or the MNE group itself to provide relevant information needed for the effective performance of those three steps. INDIA has proposed this method in its draft proposal to attribute profit to PE before it was suspended recently in favor of an equalization levy of 2% on turnover on top of the original 6% equalization levy.

- b) Simplified Deemed profit approach

BEPS Action 1 report also proposed a simplified Deemed profit taxation.

Given the Operational challenges around the fractional Apportionment Methodology and the difficulty in verifying the overseas cost of the Virtual PE in the

form of SEP in case of using an actual account basis. The report recommended the use of the deemed profit rule. Nigeria could adopt the simplified Deemed approach as this method does not require the determination nor application of any allocation key and also resolves the difficulty of verifying offshore costs. This approach is also supported by Section 30 of CITA. (See paragraph 7.6.2.3 of the action 1 of the BEPS 2015 report). The use of this method should not however preclude the FIRS from requesting for information where applicable for Audit.

c) Withholding Tax approach

This approach relies heavily on the effectiveness of the Nigerian payment systems, as it contemplates the possible imposition of a withholding tax as a collection mechanism and enforcement tool.

- Step 3-SEP filing obligation

The filing obligation of all companies doing business in Nigeria is governed by section 55 of CITA. The section appears to have a lacuna by not mentioning the permanent establishment filing obligation. Only the PE of the foreign companies will file tax returns on the tax payable on their activities in Nigeria. In any case, the filing obligation will still be triggered based on profits calculated and determined in line with the relevant sections of the law for determining the threshold of the PE and the attribution rule adopted (whether the actual profit of the non-resident as may be apportioned in line with sections 13, 14, 15, and 16 of CITA or deemed basis in line with section 30 of CITA). The global standard on profit attribution to PE especially the UN attribution rule and our tax treaties support this interpretation. The idea of using section 55 as an excuse by MNEs to allocate capital allowance and fictitious cost to the PE is a gross abuse of legal and substance interpretation of the law. To avert this abuse section 55 may be amended to make specific provisions for PE filing obligations. (for emphasis-please note that the profit of the non-resident company attributed to the PE as contained in the relevant PE sections of the law will constitute the Tax Base for taxability and this is the global best practice interpretation).

IV. ADDITIONAL GUIDANCE IS ALSO REQUIRED TO PROVIDE CLARITY ON THE FOLLOWING;

- Mandatory registration requirement for the non-resident taxpayer within an MNE group providing digital services (this will solve the B2C problem)
- Additional guidance on types of businesses and the nature of revenue
- Determination of rate to be used if the deemed approach is adopted or guidance on actual profit if an actual account is adopted
- The definition of Group to ensure that the group accounts used are not for a member of another consolidated group. This is important to eliminate intra-group transfer pricing.
- The determination of the non-resident member nominated to be responsible for registration, calculating the SEP liability, submitting returns, correspondences with FIRS ETC

CONCLUSION

The ministerial order has put a condition on the applicability of SEP to the non-resident companies that will be captured by an agreement under the OECD inclusive framework that aims to come up with global rules for allocating multinational group profit among nations. It is important to note that the SEP is one of the three proposals that have now been unified to come up with a global consensus on the taxation of the digitalized economy. The other two were the marketing intangible and user participation proposals. The OECD gave more weight to the other two proposals because of their Western origin. The unified approach is currently facing setbacks due to US opposition. It is no longer clear whether the 2020 deadline will be met to conclude the work of the unified approach. It is this lack of certainty that has prompted most countries to come up with interim unilateral measures to protect their tax base. Kenya introduced digital taxes of 1.5% of turnover, UK 2% of turnover, India 2% and 6% of turnover among several other countries. Nigeria must also implement on the percentage of turnover basis like others for ease of administration and enhancement of compliance.