Taxation Of the Nigerian Digital Economy and Its Limitations

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Abstract- This study aims to define the concept of digital economy in international taxation. It also elucidates the likely general challenges to be encountered with its introduction more specifically within Nigeria.

I. INTRODUCTION

There are general speculations that the international tax system needs reform to address the digitalization of the global economy at large and various contemporary tax issues in a business-changing environment. Digital economy or "*web economy*", or *"internet economy*", as it is popularly recognized is one of the major sources of steady revenue for every developed and emerging economy. Nigeria is however not an exception, as the need to reform and or re-enact existing tax laws to catch up with this new economy has been one of the major focuses of the Nigerian government, since the last administration.

The digital economy is the new normal economy. Before the outbreak of the global Coronavirus pandemic, research shows that Nigeria's E-commerce business is one of the major areas of investor confidence. To prove this further, Euro Monitor, an independent online consumer products research platform concluded that, *e-commerce advancements have been most notable in Nigeria because of the surge in telecom investments and smartphone purchases which have fueled growth in internet usage from 20% in 2009 to 41% in 2014.* According to Vanguard Nigeria, in one of its publications on the impacts of the digital economy in Nigeria, it was reported that before the end of the year 2021, investment in the digital economy will generate $ 88 billion and create 3 million jobs for Nigerians.

Similarly, worldwide, it is evident that the effect of the current pandemic has moved the vast majority of consumers to online shopping while businesses strive to carve out a niche for themselves and new businesses continue to spring up daily through the internet medium. The digital economy has found its way into major sectors of the economy such as Healthcare, Banking, Entertainment, Education, Financial markets, and many more.

With this obvious and huge potential that the digital economy has brought to the world economy and Nigeria in particular, many believe that this emerging economy should be left to blossom before the government will have its shares, while others are of the view that the government has the prerogative power to determine its sources of revenue knowing fully well that the boundary of digital economy cuts across e-business, e-business infrastructure, and e-commerce.

Therefore, the big question of the impact of this new economy on revenue generation by various governments has raised serious policies and new laws to capture the activities of the digital business into the tax net.

II. BRIDGING THE GAP

The challenge of how to tax the digital economy is one out of a myriad of tax issues that we have in Nigeria. The problem of taxation of the digital economy is not only peculiar to Nigeria, other countries of the world have also resolved to find their local solutions to the problem while some adopted the stand and guidelines proposed by the Organisation for Economic Cooperation and Development (OECD) and other relevant international and supranational organisations. Recently, Nigeria signed its 2020 Finance Act into law with dedicated areas addressing the problem of taxing digital businesses under the Non-resident Companies taxation (NRC). The excerpt from the finance bill is narrated below:

The Finance Act introduces provisions to tax any foreign company that:
"*..…transmits, emits or receives signals, sounds, messages, images or data of any kind from 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"*

Although the Finance Act does not define what constitutes "s*ignificant economic presence*", instead it authorizes the Minister of Finance to define the term. The expectation is that ministerial guidance will be provided.

III. PROBLEM ASSOCIATED WITH DIGITAL TAXATION IN NIGERIA

Before the introduction of the Significant Economic Presence model under the new Finance Act implementation of the Finance Act, a Non-Resident Company (NRC) is taxed if and only if it has a fixed base (a permanent place of establishment) and the income taxable is the income attributable to the operations of that fixed based in Nigeria.

However, after the introduction of the significant economic presence (SEP), the biggest challenge in its application, is that it is silent on the formula for determining the expenses incurred by a Non-resident company (NRC) to produce the profits made in Nigeria. In any event, the Nigerian tax authority is empowered by section 30 of Nigeria's Companies Income Tax Act to assess any company on a fair and reasonable amount of turnover where such company reports zero assessable profits or an amount which the tax authority considers to be less than might be expected from the trade or business carried on. Nigeria's implementation of SEP would thus depend on which key factors are 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.

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 access to the financial statements of an NRC 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 the successful adoption of any of these factors.

The above challenges associated with defining and adopting a 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 stop-gap 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 imposes a flat rate on businesses depending on their revenue and business activities.

Another major challenge with taxing the digital economy or businesses in Nigeria is the lack of digital presence of the taxing authorities to be able to understand the models and structures of digital business. The Nigerian tax system is such that believes in a permanent place of establishment as a basis for taxing non-resident businesses. The new economy requires various tax authorities to be digitally apt and present. The problem of lack of technical experts in tax offices is also a source of concern. To be able to effectively tax digital businesses, relevant tax authorities need sound information technology know-how to understand the layouts and operations of digital businesses and formulate templates and workable patterns for taxing the various degrees and levels of digital businesses.

In summary, to bring digital businesses to tax, a new law or an extension to the existing tax law needs to be made on the subject matter. This and many more were the reasons for implementing the Finance Act, which shows clear-cut grounds by which digital businesses can be taxed beyond physical presence given the various guidelines recommended by OECD. The ambiguity posed by the use of Significant Economic Presence is one of many ways to give veto power to the Ministry of Finance in deciding the jurisdiction and extent to which a digital business is significant. A robust framework that explains the threshold and extent to which a digital business is significant needs to be made common to all concerned.

IV. THE WAY FORWARD

With that being said, the Federal government of Nigeria and the Ministry of Finance have done well in providing a step forward on what is presumed a global challenge. The expansion of the concept of significant economic presence which is currently ongoing is the right step in clarifying any areas of ambiguity on digital economy taxation.

To block the revenue leakages posed by the digital economy on the Nigerian tax system, the government should look for a more creative approach through innovative tax legislation on this matter. It will be better to make a different law that will address these issues rather than extending the interpretation of the concept of Fixed base under section 13 of the Company Income Tax Act. By introducing a digital-based (a yardstick for taxing digital businesses), there will be more to the Nigeria tax base than extending the scope of the Fixed basis to say Significant Economic Presence for Non-Resident Companies. Therefore, the ambiguity around the Significant Economic Presence needs to be addressed through more innovative tax legislation.

More so, sound automation of tax administration such as ITAS has been adopted by the Federal Inland Revenue Service. This will go a long way to measure up with the issues of tax deduction, remittance, and filing. The Nigerian Government should do more to streamline tax processes to fit into the digital world.

Additionally, the Nigerian government should consider a more robust approach in line with what other countries of the world have done. By considering the recommendations of the OECD on this matter, the Nigerian government should seek a suitable approach that will increase the use of the digital economy by businesses and boost investors' confidence. The increase in e-commerce experienced in recent times in Nigeria is a good testament to the enormous potential benefits that the government can derive to better the staggering economy.

To conclude, with over 180 million Nigerians, and the vast majority already established in the digital economy, it's a sector that poses a huge revenue potential for the Nigerian government and it must be exploited fully to reap such benefits extensively. Therefore, the need for them to find better ways to address the issues surrounding taxation in the digital economy should be of utmost concern and be addressed with immediate effect.

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