



An Article

TAXATION: THE DIGITAL ECONOMY INTRODUCTION



The growth of the digital economy has posed a significant challenge to tax authorities globally. The current global tax system, premised on the Permanent Establishment model ('PE'), only recognizes entities with physical presence in an economy for tax purposes. The digital economy was not considered, and this has caused concerns for countries, as digital entities earn from operations in their economies but do not pay tax in those economies. This has become a global issue, and talks of addressing it are in advanced stages.

The global discussion around taxing Multi-National Enterprises (MNE's) having digital presence in various jurisdictions is dynamic, but two issues take centre stage: defining digital presence in an economy, and determining profit once the presence is established.

The Organisation for Economic Co-operation and Development ('OECD') identified the need for a multi-national approach to redefining PE, and proposed some models under their Base Erosion and Profit Sharing Projects ('BEPS').

Various other nations, including Nigeria, have sought to redefine PE in their economy, in order to establish the significant economic presence ('SEP') of an entity, which forms the basis of their taxation.

The current model aids tax avoidance, and gives foreign digital companies advantage over local competitors being taxed, having physical presence in an economy. It defeats the current PE scope, which is limited to physical presence in determining the minimum degree of presence of a non-resident in a country, necessary for determining their tax obligations.

OECD AND THE GLOBAL DEBATE

OECD's Base Erosion and Profit Sharing Report of 2015 identified the need to create a system to define digital presence in an economy and to determine profits of digital businesses. In 2019, the OECD came up with the following recommendations in arriving at a fair determination of the issues: new criteria for determining Significant Economic Presence and an increased user participation which includes soliciting for information from the MNEs to determine their profit.

In 2018, the European Commission (under the European Union) similarly rolled out a proposed directive for taxing digital businesses. Article 4 of the proposed directive stipulates, that any business which provides digital services is deemed to have a taxable digital presence, with the following activities forming taxable revenue sources:

- Targeted advertising on a digital interface,
- Provision of a multi-sided digital interface for users and;
- The transmission of data collected about users and

generated from users.

The rate is set at 3%, and is only payable by entities whose global yearly revenue exceeds €750,000,000, and whose taxable revenue generated within the European Union exceeds €50,000,000.

This has not been ratified by member states, in the anticipation of a final framework by the OECD, although member states adopted and modified the criteria at national levels in the interim.

France kept the entity's global revenue cap at €750,000,000, while reducing the internal income to €25,000,000. It kept the rate at 3%, and covers digital intermediation and advertising services. Italy also maintains the worldwide revenue at €750,000,000 while reducing the internal revenue to €5,500,000 on advertising on a digital interface, and the provision of online platforms and user data, at the same 3% rate.

NIGERIA

Consequent upon the OECD's interim report and recommendation, the Federal Government of Nigeria developed a policy on Significant Economic Presence (SEP), and issued an Order namely the 'Significant Economic Presence Order, 2020 which became effective on the 3rd of February, 2020.

The Order provides, regarding the digital entities that can be taxed, as follows:

"Any company which derives an income of N25,000,000 or its equivalent in foreign currency in a year, or uses a domain name (.ng) or registers a website address in Nigeria, or has a purposeful and sustained interactions with persons in Nigeria by customizing its digital platform to target persons in Nigeria e.g. by stating the prices of its products or services in Naira".

The scope of the taxable activities includes;

- a. Streaming or downloading of digital contents,
- b. Transmission of data collected about users in Nigeria,
- c. Provision of goods or services directly or through a digital platform, or/and intermediation services that link suppliers and customers in Nigeria.

The Order further provides that entities covered under any multilateral agreement of which Nigeria is a party are protected under the agreement. That is, for example, companies whose host countries have a Double Taxation Treaty ('DTT') with Nigeria, are potentially exempted from this tax obligation.

Platforms like; Uber, Facebook, YouTube, Spotify, Netflix, Twitter, Amazon etc. are captured under this policy, and are taxable under the Order, save if their host countries fall within the 14 countries with which Nigeria have DTT agreements. Although Nigeria does not have a DTT with any country which contemplates 'digital presence', but only for traditional physical presence, which means they may still be taxable.

The SEP Order is commendable, as it seeks to allow Nigeria benefit from the operations of MNEs, by way of taxes. This Order seems to have taken care of the permanent establishment issue, however, the issue of profit determination linger. In order for the FIRS or any other agency to have the necessary information to determine whether a digital entity is taxable, and to determine its profit, the company must file its tax returns or submit this information in any other format, which is hard to enforce, as these companies have no physical presence in Nigeria.

The International Centre for Tax and Development stated that the issue with taxing the digital economy in Nigeria is the absence of a comprehensive profit determination rules for MNEs, and not of permanent establishment. India for example, uses a three-pronged approach by taking into account sales, manpower (employee and wages) and assets, in determining the profit attribution for MNEs.

THE WAY FORWARD

Taxing the digital economy is a global phenomenon, which requires altering the age long permanent establishment principle of international taxation.

The G-7 countries recently met and agreed on a plan to set a 15 percent minimum global tax rate, requiring companies to

pay tax where they operate. The plan approaches the issue from two perspectives; that tax authorities are given the right to tax a share of profits that are earned by the multinational corporation regardless of the location of their headquarters and the adoption of a minimum corporation tax rate to be imposed on the overseas profits of large companies headquartered in another jurisdiction.

For Nigeria, fortunately, the Income Tax (Country by Country Reporting) Regulations of 2018, was released by the FIRS to determine and regulate taxable digital entities. Only MNE's that post a global revenue base of N160,000,000,000 at the end of their accounting year are taxable. The Regulation mandates MNE's to report their profit or loss statement before income tax, income tax paid, stated capital, accumulated earnings, and number of employees, to determine their tax liabilities. There has being little, to no compliance of this however.

Nigeria needs to explore creative ways to ensure compliance with the SEP Order and the Country by Country Regulation of 2018. There is the concern that the Regulation may increase the compliance burden of taxpayers, as it may lead to duplicity of filings across different jurisdictions.

The BEPS framework provides for a government to government automatic sharing of the country by country report. Nigeria must leverage on this and enter agreements with countries for the transfer of the reports. The Government will have to also define and make simple, the method of attributing profits of MNEs, while ensuring it is a seamless and cost-effective process in order to create a system of unending bureaucracy.

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