AN ANALYSIS OF THE CHALLENGES IN TAXING DIGITAL AND E-COMMERCE ECONOMY IN NIGERIA

BY
ISAU OLATUNJI AHMED
Lecturer,
College of Law, Kwara State University, Malete, Kwara State
Email: ahmed.isau@yahoo.com
Tel: 07030070078

ABSTRACT
The normative basis for the taxation of foreign companies under the international tax rules is rooted in the traditional requirement of mandating such companies to establish physical and taxable presence in the form of a 'permanent establishment (PE)' in a country upon which their income and profit will be subjected to tax. In line with this, the provision of Section 54 of the Companies and Allied Matters Act (CAMA) requires foreign companies desirous of carrying on business in Nigeria to incorporate a separate entity for that purpose. However, the advent of globalization led to the emergence of digital and e-commerce companies that could extend their business activities to other countries without necessarily having a PE. This altered the basis of taxation under the international tax rules and created a situation whereby such companies can carry out business activities in Nigeria without having physical and taxable presence in the country. The implication of this is that such companies usually avoid tax in the country. This constitute a significant challenge for a developing country such as Nigeria. Yet, there is no clear rules in the country on how the income and profit of such companies will be subjected to tax which had resulted in substantial revenue loss. The objective of this article is to examine the nature and the tax challenges of the digital and e commerce economy. The article will also examine the various recommendations that have been made by the international community led by the Organisation for Economic Cooperation and Development (OECD) for countries to overcome these tax challenges. The article recommended that the Nigeria government should urgently put in place necessary legal framework and administrative procedures to domesticate and implement the various recommendations of the OECD in this regard to prevent loss of revenue.

1.1: INTRODUCTION
Traditionally, the basis for taxing the income and profit of a company in respect of its business activities in another country is to tax such income and profit through the company's permanent establishment (PE) in that country.[1] This means that the income and profit of a company can only be taxed in a foreign country to the extent to which its income and profit are attributable to its permanent establishment in that foreign country. This is to ensure that foreign companies have physical and taxable presence in the form of a PE in a country upon which their income and

[1]OECD, (2010) *Model Tax Convention on Income and Capital.* Available from: http://www.oecd.org/tax/treaties/2014-model-tax-convention-articles.pdf(Accessed on 9 July 2018) and OECD, (2010) *Commentaries on the articles of the Model Tax Convention.* Available from: http://www.oecd.org/berlin/publikationen/43324465.pdf>(Accessed on 9 July 2018)

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profit from their business activities in that country will be subjected to tax. The emphasis here is that foreign companies will be allowed to carry on business activities in another country only through their PEs. A PE means a fixed place of business through which the business a company is wholly or partly carried on in another country.[2] It include a place of management, a branch, an office, a factory and a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, a building site, a construction, assembly or installation project or supervisory activities in connection therewith.[3] This means that a PE is an independent and separate entity in form of a subsidiary.

In line with this, the provision of the Companies and Allied Matters Act (CAMA) makes it mandatory for any foreign company desirous of carrying on business in Nigeria to incorporate a separate entity for that purpose.[4]This means that a foreign company will not be able carry on any business activity in Nigeria unless and until it incorporates a subsidiary operating as a separate and independent legal entity. In this respect, a foreign company is deemed to be resident in Nigeria if it is incorporated in Nigeria[5] and such company will be assessable to tax on any of its income or profits accruing in, derived from, brought into, or received in Nigeria.[6]

What is clear from the above is that the traditional basis of taxing companies is predicated on the physical presence of that company in a country. This theory seems to respect the geographical boundary and territorial limitation between countries which allow tax authority to tax the profit and income of foreign company through the PE within its jurisdiction.[7] The theory appears to be straightforward in practice and it was therefore considered as the best possible means by which the income and profit of a foreign company in respect of its business activities in another country can be subjected to taxation.[8]

However, the advent of globalization significantly altered this normative basis of taxing foreign companies through their PE.[9]The introduction of sophisticated communication systems and advanced high speed information technologies in the new globalized economy led to the emergence of digital and e-commerce economy whereby companies were able to extend their business activities to other countries without necessarily establishing physical and taxable presence in the form of PE as required under the international tax rules.[10] The new digital and e-commerce economy renders the geographical boundaries and territorial limitations between

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[2] Ibid, Article 5

[3]Article 5(2a-i) of the OECD Model Tax Conventionhttp://www.oecd.org/tax/treaties/2014-model-tax-convention-articles.pdf> accessed on 9 July 2018

[4] Section 54 of the Companies and Allied Matters Act CAP. 20 LFN 2004

[5] Ibid

[6] Federal Inland Revenue Service (FIRS), (1993) *The Taxation of Non-Residents in Nigeria.* Information Circular No: 9302. See Section 9 of the Companies Income Tax Act CAP. C21 LFN 2004

[7]OECD, (2013) *Review of Comparability and of Profit methods: Revision of Chapters I-III of the Transfer Pricing Guidelines.* Available from: http://www.oecd.org/ctp/transfer-pricing/45763692.pdf (Accessed on 9 July 2018)

[8] Ibid

[9] Vann N., (1998) International Aspects of Income Tax in Thuronyi (Ed.) *Tax Law Design and Drafting* 783

[10] Avi-Yonah R. S., Clausing K. A & Durst M. C, (2009) Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split. *Florida Tax Review.*9, 497-500

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countries recognized under the international tax rule irrelevant as companies were able to conduct their business activities in different geographical jurisdictions without the need the establish physical or taxable presence in those jurisdictions.[11] The new digital and e-commerce economy therefore constitute a significant departure from what was obtainable in the past where companies were required to have a permanent establishment in a country before they could extend their business operations into the country.[12] The borderless nature of digital and e-commerce economy and its elimination of the need for companies to establish a PE before they can operate in a particular country therefore renders the international tax rules obsolete and old-fashioned.[13]

It has been reported that foreign digital and e-commerce companies such as Amazon, Alibaba, Google, Facebook, YouTube, Yahoo, Wikipedia, LinkedIn, Twitter, Instagram, Netflix and other relevant companies in this regard have been conducting enormous cross border transactions and businesses in Nigeria without having any legal, physical and taxable presence or PE in the country.[14] Due to the absence of physical and taxable presence in the country, the Federal Inland Revenue Service (FIRS)[15] is usually unable to tax the income and profit earned by these companies in respect of their business activities in the country. The companies therefore consider this as an opportunity to avoid tax payment in the country without breaking any law. This had resulted in the country been deprived of tax revenue that could have accrued to it to.

In Nigeria, there are no clear rules on how the income and profit of digital and e-commerce companies that have no physical and taxable presence in the country will be subjected to tax. Nigeria, like most develop countries, is still stuck in the traditional old ways of taxing companies through their PE in the country which has become obsolete as a result of globalization. The tax challenges posed by digital and e-commerce economy is therefore one that must be addressed by the Nigerian government to prevent the tax base of the country from being eroded. The international community led by the OECD had proposed various recommendations on how countries can overcome the challenges of digital and e-commerce economy. The article examined the nature and the tax challenges of digital and e-commerce economy as well as the recommendations proposed by the OECD to overcome the challenges. This article will therefore go a long way to assist policy makers in Nigeria to develop the best possible approach to tax the income and profit of companies in the new digital and e-commerce economy.

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[11] Kobetsky M., (2011)*International Taxation of Permanent Establishments: Principles and Policy.* Cambridge, Cambridge University Press 76

[12]OECD, (2015) *Addressing the Tax Challenges of the Digital Economy, Action 1 Final Report.* Available from:http://www.oecd.org/ctp/addressing-the-tax-challenges-of-the-digital-economy-actoion-1-2015-final-report-97892642 (Accessed on 29 October 2017)

[13] Ibid

[14] Li J., (2014) *Protecting the Tax Base in the Digital Economy.* Available from: http://www.un.org/esa/ffd/tax/2014TBP/>(Accessed on 9 July 2018)

[15]Created by the Federal Inland Revenue Service (Establishment) Act No. 13 2007 and saddled with the responsibility of assessing and collection of income tax from companies in Nigeria

1.2: THE NATURE OF DIGITAL AND E-COMMERCE ECONOMY

Digital and e-commerce economy is an internet/mobile technology driven economy whereby economic and social activities are conducted through information and communication technologies (ICT).[16] It is an information-rich environment built on a global instant/real-time information flows.[17] It is also defined as "the global network of economic and social activities that are enabled by platforms such as the Internet, mobile and sensor networks".[18]

The growth of the digital and e-commerce economy is largely attributable to the drop-in ICT (hardware and software) prices caused by advances in technology and the pressure for constant innovation.[19]This allows for the use technology throughout the economy at low cost. Key ICT include personal computing devices (e.g. personal computers, smart phones and tablets), and telecommunications networks that form the Internet and software (such as the World Wide Web). Content production, consumption and indexation appear to drive the digital economy's growth. Collecting, analysing and monetising personal data is key to digital businesses.[20]

The Digital and e-commerce economy involves an interaction between different layers characterized by a mix of hardware and software. The OECD identified the different layers of the Digital and e-commerce economy to include: the infrastructure, software resources, accessibility, interface and the users.[21]The infrastructure consists of the cables, tubes, routers, switches, and data centres that are designed and manufactured by firms specialised in network interconnection, and operated by internet service providers (ISPs), carriers, and network operators. Content providers pay ISPs, carriers, and network operators for hosting servers in their data centres. IP addresses and domain names are managed at this level. Software resources, on the other hand, enable organisations to create applications, which can consist of raw data, digital content, or executable code. Accessibility includes tools providing the fundamental accessibility necessary to allow software resources to be combined on top of the infrastructure to create applications useable by individuals or business end users. The interface layer is the machine-to-human interface. It represents the user experience and is displayed through a physical point of contact that can be either a generic/non-generic device or physical place (such as a store). Generic devices include computers, smart phones or tablets, which support many applications. Non-generic devices include a connected thermostat, connected cars, which run one application. The users interact directly with the interface layer to access applications directly or through the

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[16] Global Trends, (2013) *The Emerging Digital Economy*. Available from:http://www.globaltrends.com/monthly-briefings/60-monthly-briefings/192-gt-briefing-june2013-the-digital-economy(Accessed on 9 July 2018)

[17] Ibid

[18] Collin P. & Colin N., (2013) *Task Force on Taxation of the Digital Economy*. Available from: www.hldataprotection.com/files/2013/06/Taxation_Digital_Economy.pdf (Accessed on 9 July 2018)

[19] OECD, (2014) *Addressing the Tax Challenges of the Digital Economy*. Available from: http://dx.doi.org/10.1787/9789264218789-en(Accessed on 9 July 2018)

[20] Ibid

[21] OECD, (2014) *BEPS Action 1: Address the Tax Challenges of the Digital Economy (Public Discussion Draft)* Available from: http://www.oecd.org/ctp/tax-challenges-digital-economy-discussiondraftmarch-2014.pdf (Accessed on 9 July 2018)

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services of another application acting as a gatekeeper.[22]The spread of ICT across business sectors leads to the growth of the digital and e-commerce economy as virtually all sectors of the economy have adopted ICT to enhance productivity, enlarge market reach, and reduce operational costs".[23]

The digital and e-commerce economy now contribute the Gross Domestic Product (GDP) of most countries. For example, its contribution to the GDP in the UK is now more than that of construction and education. Likewise, it now ranks among the top six industry sectors in China and South Korea.[24]In Africa, Kenya and Nigeria are among the leading countries in adopting digital and e-commerce. The city of Lagos in Nigeria is regarded as an emerging digital and e-commerce sector.[25] Even in the face of inaccessible traffic in the city, digital and e-commerce companies are proliferating, some guaranteeing delivery of products across the city within 24 hours.[26]It is predicted that the growth of digital and e-commerce economy will continue to grow in developing countries particularly the African countries. This is attributed to the fac that Africa's middle class has reportedly tripled over the last 30 years, and the current trajectory suggests that the African middle class will grow to 3.2 billion by 2020 and 4.9 billion by 2030 making it the world's fastest growing continent.[27] This growth, coupled with the forecasted GDP growth of over 6%, is expected to further drive the growth of digital and e-commerce economy as businesses seize upon opportunities arising from the growing number of digitally empowered consumers, who are opting to purchase goods via e-digital and e-commerce channels.[28]

BUSINESS MODELS OF DIGITAL AND E-COMMERCE ECONOMY

The digital and e-commerce economy has given rise to several new business models. Modern advances in ICT made it possible to conduct many types of business at substantially greater scale and over longer distances than was previously possible.[29]The constant innovation in the digital and e-commerce economy allows the rapid development of new business models which can cause existing business models to become obsolete. The business models in this regard include electronic commerce (e-commerce), app stores, online advertising, cloud computing,

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[22] Ibid

[23] Ibid

[24] The Boston Consulting Group, (2012) Report on the Internet Economy in the G-20 (2012). Report number: 6.

[25] Eran R., (2014) *The Rise of Entrepreneurship and E-commerce In Africa*. Available from: http://www.ventures-africa.com/2014/01/the-rise-of-entrepreneurship-and-e-commerce-in-africa/(Accessed on 9 July 2018)

[26]Mashable News, (2014) *The African Version of Amazon Will Emerge from Nigeria*. Available from:http://mashable.com/2014/03/18/nigeria-ecommerce-drones/(Accessed on 9 July 2018)

[27]Grail Research, (2013) *The Rising Middle Class of Africa*. Available from: http://grailresearch.com/pdf/ContenPodsPdf/Grail-Research-The-Rising-Middle-Class-Africa.pdf(Accessed on 9 July 2018)

[28] Ibid

[29] OECD, (2014) B*EPS Action 1: Address the Tax Challenges of the Digital Economy (Public Discussion Draft).* Available from:http://www.oecd.org/ctp/tax-challenges-digital-economy-discussiondraftmarch-2014.pdf(Accessed on 9 July 2018)

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participative networked platforms, high speed trading, and online payment services.[30] This article will only focus on e-commerce business model.

ELECTRONIC COMMERCE BUSINESS MODEL

Electronic commerce, or e-commerce or Internet-commerce is perhaps the best-known business model in the digital and e-commerce economy. The OECD Working Party on Indicators for the Information Society defines this term as "the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders. The goods and services are ordered by those methods, but the payment and the ultimate delivery of the good service do not necessarily have to be conducted online. An e-commerce transaction can be between enterprises, households, individuals, governments, and other public or private organisations".[31] E-commerce can be used either to facilitate the ordering of goods or services that are then delivered through traditional channels (offline e-commerce) or to order and deliver goods or services completely online (online e-commerce).[32]

Depending on the parties, e-commerce transactions can either be business-to-business model (B2B), business-to-consumer model (B2C), consumer-to-consumer model (C2C), and business-to-government model (B2G).[33]The B2B e-commerce models can include online versions of traditional transactions in which a wholesaler purchases consignments of goods online, which it then sells to consumers from retail outlets. It can also include the provision of goods or services to support other businesses, including, among others: (i) logistics services such as transportation, warehousing, and distribution; (ii) application service providers offering deployment, hosting, and management of packaged software from a central facility, (iii) outsourcing of support functions for e-commerce, such as web hosting, security, and customer care solutions; (iv) auction solutions services for the operation and maintenance of real-time auctions via the Internet; (v) content management services, for the facilitation of website content management and delivery; and (vi) Web-based commerce enablers that provide automated online purchasing capabilities.[34]It is estimated that more than 90% of e-commerce transaction are B2B.[35]This is confirmed by a research conducted by the US-based International Data Corporation (IDC) which estimated that global B2B e-commerce, especially among wholesalers and distributors, amounted to US$ 12.4 trillion at the end of 2012.[36]

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[30] Ibid

[31] Ibid

[32] Ibid

[33] Ibid

[34] Ibid

[35] WTO E-commerce Report, (2015) *The vast majority of e-commerce consists of B2B transactions*. Available from: www.wto.org/english/res_e/booksp_e/ecom_brochure_e.pdf(Accessed on 9 July 2018)

[36] Li J. (2014)*Protecting the Tax Base in the Digital Economy.* Available from: http://www.un.org/esa/ffd/tax/2014TBP/(Accessed on 9 July 2018)

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B2C models were among the earliest models of e-commerce transactions.[37] It involve the selling of goods or services to individual consumers through online platforms with no physical stores or offline presence. In 2012, the estimated value of global B2C e-commerce exceeded US$ 1 trillion.[38] Examples of B2C include:

i. Etailers: Online version of traditional retailer, including variations such as virtual merchants, bricks-and-clicks, catalog merchants. E.g. Amazon and Alibaba;
ii. Service Provider: Online services providers, such as Google: Google Maps, Google Docs, and so on;
iii. Content providers: providing digital content on the Web, such as news, music, video such as Netflix;
iv. Transaction Brokers: process online transactions for consumers, e.g., financial services, travel services, and job placement services;
v. Market Creators: create digital environment where buyers and sellers can meet and transact, such as Price line and eBay
vi. Community Provider: provides online environment (social network) where people with similar interests can transact, share content, and communicate such as Facebook, Twitter, Linked In).[39]

C2C e-commerce model, on the other hand, allows companies to play the role of intermediaries, helping individual consumers to sell or rent their assets (such as residential property, cars, motorcycles, etc.) by publishing their information on the website and facilitating transactions. These businesses may or may not charge the consumer for these services, depending on their revenue model. This type of e-commerce comes in several forms, including, but not limited to: (i) auctions facilitated at a portal that allows online bidding on the items being sold; (ii) peer-to-peer systems allowing sharing of files between users, and (iii) classified ads portals providing an interactive, online marketplace allowing negotiation between buyers and sellers.[40]

Other e-commerce models include App stores, online advertising, cloud computing, payment services. A newer kind of e-commerce is the so-called 'social e-commerce' or F-commerce or M-commerce.[41] It refers to commerce conducted via social networks, such as Facebook, Twitter, Linked In, Instagram, Google, You Tube, Yahoousing mobile devices. It has been growing as a result of the growing popularity of social media. This trend is particularly notable in developing countries where people increasingly use smart phones, tablets and other mobile devices to gain access to social networks.[42]

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[37] OECD, 'BEPS Action 1: Address the Tax Challenges of the Digital Economy (Public Discussion Draft)'Available from:http://www.oecd.org/ctp/tax-challenges-digital-economy-discussiondraftmarch-2014.pdf(Accessed on 9 July 2018)

[38] Ibid

[39] Ibid

[40] Ibid

[41] Li J. (2014) *Protecting the Tax Base in the Digital Economy.* Available from: http://www.un.org/esa/ffd/tax/2014TBP/(Accessed on 9 July 2018)

[42] Ibid

1.3: REVENUE GENERATION IN DIGITAL AND E-COMMERCE ECONOMY

There is a variety of revenue models in the digital and e-commerce economy. The OECD Discussion Draft describes these models to include: advertising-based revenue, subscription-based revenue, selling of goods and services, licensing content and technology, selling of user data and customized market research.[43] A company may charge a fee for enabling or executing a transaction. Examples are eBay.com and E-Trade.com. The main revenue models can be summarized as follows:

- Under the advertising revenue model, the company offers content, services and/or products and also provides a forum for advertisements and receives fees from advertisers. An example is Facebook, Twitter and Yahoo.
- Under the subscription revenue model, the Website offers users content or services charges a subscription fee for access to some or all of its offerings. Example include Netflix.
- Under the sales revenue model, a company derives revenue by selling goods, information, or services to customers. Examples are Amazon.com and Alibaba.
- The selling of user data and customized market research models are used by ISPs, data brokers, data analytics firms, telemetrics and data gained from non-personal sources.[44]

1.4: KEY FEATURES OF DIGITAL AND E-COMMERCE ECONOMY

The digital and e-commerce economy and its business models present some key features which are potentially relevant from a tax perspective. The OECD describes the key features of the digital and e-commerce economy to include mobility, reliance on data, multi-sided business models, tendency toward monopoly or oligopoly and volatility.[45] It captures the changing dynamics and impacts of the digital and e-commerce economy on value creation and globalization. However, as suggested by the BEPS Monitoring Group,[46] these features may be better explained in terms of: (1) dematerialization of what is being traded; (2) mobility and connectivity and its impact on where income-earning activities or functions are located; (3) role of customers in value creation or paradigm shift in how value is created. These features are briefly considered below.

i. Dematerialisation

The dematerialization of a product literally means less, or no material is used to deliver the same level of functionality to the user.[47] In the context of digital and e-commerce economy, dematerialization refers to the transformation of any material object into something of virtual or digital. Digitization has been keen to the development of digital and e-commerce economy. The goods sold in digital and e-commerce economy can be tangible (books) or intangible (e-books

[43] OECD, 'BEPS Action 1: Address the Tax Challenges of the Digital Economy (Public Discussion Draft)' Available from: http://www.oecd.org/ctp/tax-challenges-digital-economy-discussiondraftmarch-2014.pdf (Accessed on 9 July 2018)

[44] Ibid

[45] Ibid

[46] Ibid

[47] Wernick W., (1996) *Dematerialization: Measures and Trends*. Journal of the American Academy of Arts and Sciences 171-198

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received by consumers in an electronic format). Through digitization of information, an increasing number of goods and services can be delivered digitally. Advances in the ICT have brought about the transformation of tangible goods into intangibles. An example is an e-book. Even when a product remains tangible in form, such as a car or phone, its function and value is driven by its artificial intelligence. Smartphones have rendered conventional phones obsolete. Cars are "computers on wheels". Goods can also be transformed into services deliverable online. Dematerialisation in the digital economy does not mean that everything is digital or virtual. People remain important as producers and consumers. Physical delivery of physical goods remains a significant part of e-commerce.

ii. Connectivity (mobility)

The Internet virtually connects everybody who has access to it using a computer or mobile device. Such connectivity diminishes the relevance of distance or physical barriers. Digitized information (voice, text, image or video) can be communicated and delivered instantly from anywhere to everywhere. Digital technology increases the speed at which information can be processed, analysed and utilized. Connectivity enhances the ability of companies to carry out activities remotely and to expand the number of potential customers that can be targeted and reached.[48]It enables companies to generate revenue from customers located in foreign jurisdictions without having any old-fashioned business presence in those jurisdictions.

The OECD Discussion Drafts notes that such connectivity also increases the flexibility of businesses to choose where substantial business activities take place and as a result, it is increasingly possible for a business' personnel, IT infrastructure (e.g., servers), and customers each to be spread among multiple jurisdictions, away from the market jurisdictions.[49] In short, it enhances the mobility of a firm's business functions, customers, and intangible assets.[50] The more "virtual" of a business model, such as cloud computing and "Pureplay", the more mobility. Digital businesses are, thus, intrinsically global. The "where" issue is neither here nor there.[51]

iii. Consumers' Role in Value Creation

In a digital and e-commerce economy, consumers are empowered. Compared to traditional shopping, they have more choices, more convenience, more bargains, and more say in how they want to be "served". Internet users who shop online tend to be middle class, more educated, younger, and more autonomous. The rise of social media has offered an instant global platform to share ideas, manage natural disasters, or build momentum for revolution (e.g. in the case of the Arab Spring).

There has been a recent shift in the balance of power "from developed markets to the developing world and from institutions such as governments to individuals, who exercise their new power as

[48]OECD, 'BEPS Action 1: Address the Tax Challenges of the Digital Economy (Public Discussion Draft)'Available from:http://www.oecd.org/ctp/tax-challenges-digital-economy-discussiondraftmarch-2014.pdf(Accessed on 9 July 2018)

[49] Ibid 179

[50] Ibid 179, paras.92-102.

[51]Li J. (2014) *Protecting the Tax Base in the Digital Economy*. Available from: http://www.un.org/esa/ffd/tax/2014TBP/(Accessed on 9 July 2018)

consumers to gain information to their advantage."[52] Consumers are more empowered than ever before in the digital and e-commerce economy.[53] Unbeknown to them, consumers of the digital economy are also contributors to the value creation process. They seem to create value in at least two ways: First, as part of an "ecosystem enabling a continuous, symbiotic and reciprocal relationship of value exchange" and second, "as a source of big data".[54]

1.5: TAX CHALLENGES FOR DIGITAL AND E-COMMERCE ECONOMY

The digital and e-commerce economy poses some tax challenges due to dematerialization and connectivity features of the digital and e-commerce economy. This challenge affect both developed and developing countries. However, as market countries, developing countries tend to be "net losers" in tax revenue.[55] These challenges are considered below.

RISK OF BASE EROSION AND PROFIT SHIFTING (BEPS)

In the digital and e-commerce economy, companies have opportunities to "artificially" segregate income from the activities that generate it. In fact, because of the heavy reliance on intangibles, data, enhanced mobility and globally integrated business models, the digital and e-commerce economy "exacerbate" risks of BEPS in some circumstances which can also extend to indirect taxes such as VAT.[56]

In the context of income taxes, the OECD identifies a number of coordinated strategies associated with BEPS in the context of direct taxation, which can be broken down into four elements:(1) eliminating or reducing tax in the market country through: avoiding a taxable presence, minimizing functions, assets and risks in market jurisdictions or maximizing deductions in market jurisdictions; (2) avoiding withholding tax; (3) eliminating or reducing tax in the intermediate country; and (4) eliminating or reducing tax in the country of residence of the ultimate parent.[57] These elements are briefly discussed hereunder:

i. Avoiding a taxable presence

In a digital and e-commerce economy, a non-resident company may interact with customers in a country remotely through a website or other digital means (e.g., an application on a mobile device) without maintaining a physical presence in the country. The domestic laws of most countries require some degree of physical presence before business profits are subject to taxation. In addition, under Articles 5 and 7 of the OECD Model Tax Convention, a company is subject to tax on its business profits in a country only if it has a permanent establishment (PE) in that country.

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[52] Gregory C., (2013) *Power shift: The rise of the consumer- focused enterprise in the Digital Age.* Available from: www.kellogg.northwestern.edu/.../Rise-of-the-Consumer-Focused-Enterp (Accessed on 9 July 2018)

[53] Insider Whitepaper, (2012) *Rise of the Empowered Consumer: How to reach audiences in 2012.* Available from:www.mediacom.com/.../mediacom%20the%20insider_the%20empowere (Accessed on 9 July 2018)

[54] OECD, 'BEPS Action 1: Address the Tax Challenges of the Digital Economy (Public Discussion Draft)'Available from:http://www.oecd.org/ctp/tax-challenges-digital-economy-discussiondraftmarch-2014.pdf(Accessed on 9 July 2018)

[55] Ibid

[56] Ibid

[57] Ibid paras.119-135.

Companies in digital and e-commerce economy adopt measures to artificially avoid having taxable presence or permanent establishment so as to avoid paying tax on their business activities in the country.[58] This involves using facilities that are not deemed as permanent establishments under Article 5(3) of the OECD Model Tax Convention.[59] This includes using facilities solely for storage, display or delivery of goods, maintenance of a stock of goods for the purpose of storage, display or delivery of goods and maintenance of a fixed place of business solely for the purpose of purchasing goods or of collecting information.[60] The elimination of the need to create PE in the new digital and e-commerce economy therefore presents a practical challenge for taxing a foreign company in respect of its business activities in another country.

ii. Avoiding withholding tax

A company may be subject to withholding tax in a country in which it is not a resident if it receives certain payments, including interest or royalties, from payers in that country. If allowed under a treaty between the jurisdictions of the payer and recipient, however, a company in the digital economy may be entitled to reduced withholding or exemption from withholding on payments of profits to a lower-tax jurisdiction in the form of royalties or interest. Structures that involve treaty shopping by interposing shell companies located in countries with favourable treaty networks that contain insufficient protections against treaty abuse raise BEPS concerns.

iii. Eliminating or reducing tax in the intermediate country

Eliminating or reducing tax in an intermediate country can be accomplished through the application of preferential domestic tax regimes, the use of hybrid mismatch arrangements, or through excessive deductible payments made to related entities in low-or no-tax jurisdictions. Like companies in other industries, companies in the digital economy may locate functions, assets, or risks in low-tax jurisdictions or countries with preferential regimes, and thereby allocate income to those locations. While functions are often located in a particular jurisdiction for non-tax reasons such as access to skilled labour or necessary resources, as business functions grow increasingly mobile, taxpayers may increasingly be able to locate functions in a way that takes advantage of favourable tax regimes. Companies may also reduce tax in an intermediate country by generating excessive deductible payments to related entities that are themselves located in low- or no-tax jurisdictions or otherwise entitled to a low rate of taxation on the income from those payments. For example, an operating company located in an intermediate jurisdiction may use intangibles held by another affiliate in a low-tax jurisdiction. The royalties for the use of these intangibles may be used to effectively eliminate taxable profits in the intermediate jurisdiction.

iv. Eliminating or reducing tax in the country of residence of the ultimate parent

The same techniques that are used to reduce taxation in the market country are often utilized also to reduce taxation in the country of the ultimate parent company of the group or where the headquarters are located. This involve contractually allocating risk and legal ownership of mobile assets like intangibles to group entities in low tax jurisdictions, while group members in the jurisdiction of the headquarters are undercompensated for the important functions relating to these risks and intangibles that continue to be performed in the jurisdiction of the headquarters.

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[58] Ibid

[59] Ibid

[60] OECD, (2010) *Model Tax Convention on Income and Capital.* Available from: Http://Www.Oecd.Org/Tax/Treaties/2014-Model-Tax-Convention-Articles.Pdf(Accessed on 29 December 2016)

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Apart from the above, digital and e-commerce economy also pose serious challenge to the collection of VAT. Collecting VAT on B2C transactions is virtually impossible if the foreign online vendor has no physical presence and does not register for VAT in the market country.

1.6: ADDRESSING THE TAX CHALLENGES OF DIGITAL AND E-COMMERCE ECONOMY

Due to the challenges presented by the new digital and e-commerce economy, the current international tax system which dates back to the 1920s is now considered to be obsolete. To this end, there is a growing consensus that the concept of permanent establishment should be replaced by origin and destination. Accordingly, addressing the tax challenges posed by the digital and e-commerce economy was part of the 15-Action Plan developed by the OECD/G20 to counteract various Base Erosion and Profit Shifting Schemes.

Base Erosion and Profit Shifting (BEPS) is a term generally use to refer to various tax avoidance schemes/strategies usually employed by taxpayers to artificially shift profits from high tax jurisdiction to low or no-tax locations.[61] BEPS schemes enables taxpayers to move profits to where they are taxed at lower rates and expenses from where they are taxed at higher rates. The result of this is the reduction of revenue accruable to the government.[62] Addressing the issue of BEPS was therefore a key priority of governments around the globe. It was in this respect that in 2012, the OECD countries and the G20 countries,[63] working together embarked on the most significant and ambitious objective of re-writing of the international tax rules in a century.[64] This ambition was to revise the existing international tax rule and align it to developments in the world economy to ensure that profits are taxed where economic activities are carried out and where value is created.[65]

On 12th February 2013, the OECD issued a lengthy report to address BEPS known as the BEPS Report.[66] This was followed up with the publication of a concrete 15-Action Plan on BEPS in 19th July 2013 (Action Plan).[67] The 15-Action Plan otherwise known as the BEPS Package equips the governments with the domestic and international instruments needed to tackle BEPS

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[61] OECD, (2015) *Base Erosion and Profit Shifting*. Available from: http://www.oecd.org/tax/beps/ (Accessed on 15July 2017)

[62] Ibid

[63] The G20 (or G-20 or Group of Twenty) is an international forum for the governments and central bank governors from 20 major economies. Currently, these are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom, United States, and the European Union. Available from: https://www.g20.org/Webs/G20/DE/Home/home_node.html (Accessed on 17 July 2017)

[64] OECD, (2015) *OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports: Information Brief*. Available from: www.oecd.org/ctp/beps-reports-2015-information-brief.pdf (Accessed on 15 July 2017)

[65] Ibid

[66] OECD, (2013) *Addressing Base Erosion and Profit Shifting 2013*. Available from: http://www.oecd.org/ctp/beps.htm> (Accessed on 17 July 201)7

[67] OECD, (2013) *Action Plan on Base Erosion and Profit Shifting*. Available from: http://www.dx.doi.org/10.1787/9789264202719-en(Accessed on 17 July 2017)

and was eventually endorsed by the G20 Finance Ministers during their meeting of 8th October 2015 in Lima while the G20 Leaders followed suit by endorsing the BEPS package during their summit held in Antalya, Turkey between 15 and 16 November 2015.[68] The 15-Action Plan are listed below:(1) Address the tax challenges of the digital economy;(2) Neutralise the effects of hybrid mismatch arrangements;(3) Strengthen Controlled Foreign Company rules;(4) Limit base erosion via interest deductions and other financial payments;(5) Counter harmful tax practices more effectively, taking into account transparency and substance;(6) Prevent treaty abuse;(7) Prevent the artificial avoidance of PE status;(8) Assure that transfer pricing outcomes are in line with value creation- Intangibles;(9) Risk & capital;(10) Other high-risk transactions;(11) Establish methodologies to collect and analyse data on BEPS and the actions to address it;(12) Require taxpayers to disclose their aggressive tax planning arrangements;(13) Re-examine transfer pricing documentation;(14) Make dispute resolution mechanisms more effective;(15) Develop a multilateral instrument.[69]

The combination of both Action 1(Address the tax challenges of the digital economy) and Action 7 (Prevent the artificial avoidance of PE status) of the BEPS Package are specific proposal to address the ability of companies in digital and e-commerce economy to conduct business activities in another country without having physical and taxable presence. The proposal, which is a long-term solution, is to amend the definition of PE to cover situations where a company has a significant digital presence (SDP) in the economy of the country without having physical and taxable presence. The essence of this amendment is to expand the scope of the meaning of PE from the traditional physical presence as presently applicable under Article 5(2) of the OECD Model Tax Convention to cover digital and e-commerce companies that have no physical and taxable presence in the country.[70] Digital and e-commerce services in this regard means services which are delivered over the internet or through an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention. The expansion of the definition of a PE in this regard will ensure that digital and e-commerce companies have taxable presence in a country even though they do not have a PE. It is expected that countries around the world will put in place necessary legal framework to bring this proposition into fruition.

In addition to the above, Action 1 of the BEPS Package also contain a proposal to protect the VAT base. This involve requiring digital and e-commerce companies that have passed a certain threshold to register, collect and submit VAT on sales to customers located in the market country. The OECD has also proposed the introduction of an Equalisation Levy which is a form of withholding tax to be levied on transactions done on digital and e-commerce platforms.[71] Some countries have already introduced this kind of levy. For example, India introduced the levy in 2016 by charging 6% on the fees paid by customers on transactions done on digital and e-commerce platforms such as advertisement placed on search engines such as Google and social media networks such as Facebook.[72]

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[68] Ibid

[69] Ibid

[70] Ibid

[71] Ibid

[72] The Economic Times, (2 March 2016) *Equalisation levy of 6 % on digital ad: Government finds a way to tax companies like Google, Facebook' Economic Times.* Available online from:

Developed countries such as the UK and France have also introduced 'Diverted Tax Profit' and 'Bandwidth Tax' respectively to properly tax transactions on digital and e-commerce platforms.[73] Due to the different options available and to ensure that any option eventually settled for is internationally accepted, the OECD intends to seek an internationally consensus based solution in 2020 in response to the challenge posed by digital and e-commerce economy.[74]

1.7: CONCLUSION

It is clear from this article that the new digital and e-commerce economy pose unique tax challenges to a developing country such as Nigeria. The country does not have clear legal framework to capture and tax the income and profit of foreign digital and e-commerce companies operating in the country. Addressing these challenges therefore require simplementing various measures recommended by the OECD in this regard. The country will also need to develop its own measures to overcome the tax challenges of digital and e-commerce economy.

This article recommend as follows:

1. The provision of section 54 of the Companies and Allied Matters Act (CAMA) should be amended to compel foreign multinational digital companies with 'significant digital presence' in the country to incorporate a subsidiary (permanent establishment) in the country.
2. The interpretation section of CAMA in section 567 should be amended to contain the various criteria to be considered in determining whether a foreign digital company has a 'significant digital presence' in the country. Such criteria can include any foreign digital company whose revenue from digital services rendered in country exceeds a particular revenue which can be determined by the FIRS. Another criterion can be a foreign digital company that has more than 100,000 active subscribers in a taxable year. This can also include a foreign company that has conducted more than 3000 business contracts (such as digital advert placements, digital supply of goods and services) with its subscribers in a taxable year. This recommendation is in line with the proposal released by the European Commission on 21st March 2018 wherein various modes of subjecting digital companies with no physical presence in Europe to tax were proposed. These proposals are to be implemented before the end of 2018 within the European Union.
3. The definition of the word 'company' in section 105 of CITA should be amended to read as follows: 'any company or corporation (other than a corporation sole) established by or under any law in force in Nigeria or elsewhere or digital companies with 'significant

http://economictimes.indiatimes.com/articleshow/51216310cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cpps>(Accessed on 29 October 2017)

[73] European Parliament of Directorate General for Internal Policies, (2016) *Tax Challenges in the Digital Economy*. Available online from:http://www.europarl.europa.eu/studies(Accessed on 29 October 2017)

[74] OECD, (2015) *Addressing the Tax Challenges of the Digital Economy, Action 1 Final Report*. Available online from:<http://www.oecd.org/ctp/addressing-the-tax-challenges-of-the-digital-economy-actoion-1-2015-final-report-97892642>(Accessed on 29 October 2017)

digital presence' in the country'. This is to streamline this provision with the provision of section 54 of CAMA.

4. The provision of Article 5(2) of the Double Tax Treaties which are subsidiary legislation under the Companies Income Tax Act (CITA) be renegotiated with treaty partners to include the phrase 'companies with significant digital presence in the country' as part of the definition of permanent establishment. This is to expand the meaning of permanent establishment from the traditional physical presence as presently applicable in Article 5 to cover entities conducting business in the country but with no permanent establishment.
5. Nigeria should ensure that all future tax treaties should include the phrase 'companies with significance digital presence' as part of the definition of permanent establishment.
6. The Nigerian government should consider amending the Companies and Income Tax Act (CITA) in order to introduce specific provisions to capture the profit of digital companies with no physical presence in the country within the tax net. Countries such as the United Kingdom and France respectively introduced 'Diverted Tax Profit' or 'Bandwidth tax' to tax the income of MNCs having significant business/economic activity but with no physical presence in both countries.
7. The Nigerian government should mandate foreign digital companies with significant digital presence the country to register for VAT with the FIRS.
8. The provision of section 2 of the VAT Act should be amended to extend taxable goods and services to cover digital supply of goods and services. This will streamline with the provision of section 46 VAT Act which defined a taxable person to include 'person exploiting tangible and intangible property for the purpose of obtaining income there from by way of trade or business'.
9. These recommendations should be target to foreign multinational companies that have significant digital presence in Nigeria but with no taxable or physical presence in the country.
10. The Nigerian government should not wait for the international community to come out with a suitable mode of taxing digital and e-commerce companies before it can act. Countries in European Unions have taken steps in this regard. For instance, the United Kingdom and France have introduced specific taxation for digital and e-commerce companies. It is therefore high time Nigeria acted in this regard to prevent the tax base of the country from being eroded.

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