

BRIDGING TAX GAP IN NIGERIA THROUGH TAXATION OF DIGITALIZED COMPANIES: ANY PROSPECT?

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Abstract

The emergence of the digital economy and digitalized transactions has been a global concern as they have raised new challenges to tax authorities. Volumes of transactions are completed by entities online without physical presence in the country. National tax laws have not kept pace with the globalization of corporations and the digital economy, thus leaving gaps that have been exploited by multi-national corporations and the digitalized companies to avoid and evade taxes. The impact has been reported widening of tax gaps, dwindling tax revenues and effective tax rates and low economic growth. Taxation of digital companies is an emerging issue for which there is scarcely any empirical study anywhere but a lot of work and reports by OECD and G20 addressing the challenge are available. The study examined the prospects of bridging tax gap in Nigeria through the taxation of digitalised companies. Desk review and analytical research approaches were adopted. Literature on the areas of tax gap as well as digitalization and taxation challenges were reviewed. Sections of available legal framework on taxation of companies were also consulted and analysed in the context of taxation of digitalized companies. Reports of works by OECD and G20 were reviewed and assessed with a view to deriving policy direction from them that may inform action in the Nigerian context. Findings reveal lack of wholistic legal and tax administrative frameworks as well as intelligence gathering structures for the taxation of digital transactions in Nigeria. The study concluded that Nigeria can leverage on the works and recommendations of OECD, G20 and EU as well as recent practices in some jurisdictions in addressing the tax challenges of the digital economy. The following imperatives for the taxation of digitalized companies in Nigeria were recommended, namely collaboration and multilateral agreements for exchange of information, fully digitalized tax administrative system with corruption resistant tax structures, robust tax laws and taxation framework and strong and equitable tax systems that can enhance taxpayers' trust in government and tax authorities.

Keywords: Tax gap, Digitalised companies, Expediency theory, Tax-to-GDP ratio, Tax revenue

Introduction

The economic development of any nation depends largely on the provision of adequate infrastructure and the creation of a secure environment that can encourage enterprise. Failure to provide such enabling environment not only slows down economic growth but also undermines efforts to improve the standard of living of the population. There have

been growing concerns that governments in Sub-Saharan Africa (SSA) have performed poorly in this direction, Nigeria not being an exception. There are evidences of decayed or total lack of basic infrastructure in every sector of our economy – education, health, housing, road and other transport sector. The level of insecurity appears to have become unprecedented in the history of the country, and in all these, dwindling revenue is being implicated.

For many decades, Nigeria has relied heavily on oil revenue as a primary source of government revenue. The present instability in the oil sector has indicated that continued reliance on oil revenue is no longer sustainable. Therefore, it is imperative that recourse to taxation is the more reliable and conceivable means of revenue generation (Oyedele, 2016). In many jurisdictions around the globe, taxes are the major source of public revenue and countries' budgets and economic policies are often based on projected tax revenue. As Danquah and Osei-Assibey (2018, p.1) submitted, “ in order to ensure sustained growth, it is desirable for every government to generate tax revenue to finance essential expenditures without recourse to excessive public sector borrowing, which often crowds out private sector investments.” Danquah & Osei-Assibey (2018) and Coullbaly & Gandhi (2018) have submitted that over the past decade, the average tax revenue to GDP ratio in the developed world was approximately 35 per cent, 15 per cent in the developing countries, and an average of 13.8 per cent in sub-Saharan Africa.

These statistics bring to the fore the grave danger of increasing tax gaps in the emerging economies like Nigeria. This tax gap highlights the inability of tax administration in the developing and SSA countries to raise the required tax revenue to support adequate public expenditure. The case of Nigeria is worrisome as it currently has the lowest tax-to-GDP ratio in SSA of 5.9% (Fiawoo, 2018). The IMF 2018 country report number 18/64 recorded tax-to-GDP ratio of 5.3% for year 2016 (IMF, 2018). The tax-to-GDP ratio is indicative of the proportion of a nation's output that is attributable to tax revenue and is a widely used measure of the efficiency of a country's tax system. No doubt, there is significant level of non-compliance by both individuals and corporations, either operating in the shadow economy and outside the tax net or just apathetic to meeting their tax obligations. For example, IMF (2018) indicated that as at 2016, only 1.95% of registered Personal income tax payers were active, 5.62% of registered Companies income tax payers were active while 5.12% of registered VAT payers were active. In addition to this, Maiye and Isiadinso (2015) submitted that other factors that contribute to low ratio include narrow tax base, tax exemption and subsidy policies and loopholes in tax laws. The Nigerian case is exacerbated by lack of adequate database and records of eligible tax payers in the country resulting in a wide gap between taxable units/individuals and actual tax payers.

The emergence of the digital economy has raised new challenges to tax authorities as it has further widened the tax gap. Today, some enterprises earn a large percentage of their income in a nation with little or no taxable presence. Volumes of transactions are completed by entities without physical presence in the country and there are neither good systems in place to track such taxable transactions nor clear local laws to enable tax authorities to tax such transactions if ever captured within the tax net.

Ogungbenro (2015) had lamented that “national tax laws have not kept pace with the globalization of corporations and the digital economy, leaving gaps that can be exploited by multi-national corporations to artificially reduce taxes.” Thus, the problem created by the swift development brought about by the digital economy and its impact on tax revenue for countries is real. The Organization for Economic Cooperation and Development (OECD) could not be clearer on this problem when it stated that it would be difficult, if not impossible, to 'ring-fence' the digital economy from the rest of the economy for tax purposes because of the increasingly pervasive nature of digitalization (OECD, 2015). This assertion implies that such thing as “digital economy” or “new economy” does not exist but rather “that the economy itself had become digitalised and that this trend is likely to continue” (OECD, 2019, p.1). This translates to further erosion of countries' tax bases and revenues and calls for immediate response in terms of tax laws, rules, policies and administration.

The reality and magnitude of the challenge of digitalization vis-avis tax revenues are currently seen on the global effective tax rates which are reported to have continuously been on the downward trend (Ogungbenro, 2015). Performance reports of many of these digital technology companies indicate that they outperform the traditional brick-and-mortar companies but unlike the traditional companies whose profits are taxed at value creation, it is “challenging to capture where value is created, what it is and how to measure it” (Jakurti, 2017, p.1). OECD and the G20 countries have taken bold steps to address this challenge. In 2013, these countries adopted a 15-point Action Plan to address Base Erosion and Profit Shifting (the BEPS Project). The action plan intends to ensure that profits are taxed where the economic activities that generated the income were performed and where value was created. Action plan one released in 2015 addresses the tax challenges of the digital economy and gives guidance on how countries may deal with these challenges (OECD, 2019). Unfortunately, Nigeria does not belong to any of these economic groups and currently has no robust legal framework to address this challenge.

This study examined the possibility and prospects of bridging tax gap in Nigeria through the taxation of digital companies considering the challenges thus far highlighted. The study draws from literature, especially the giant strides so far made by the OECD and G20 countries, to make policy recommendations on improving our legal framework and tax administration, including collaborating with other jurisdictions in dealing with the tax challenges occasioned by digitalization. How can profits made in Nigeria by companies with no physical establishment and taxable presence be captured and taxed? Who is the tax collection agent that should be accountable for VAT on goods and services subject to VAT in digital transactions? Does our existing VAT law envisage such a challenge? Can the country get around existing international tax rules and policies to improve on the prospects of taxing digital companies? These are some of the questions answered by this study.

The study contributes to knowledge in the following aspects: Firstly, it draws the attention of policy makers to the effect of increased tax gap and the associated negative impact on economic development that could be caused by non-taxation of digital companies.

Secondly, it underscores the urgency of amending our tax laws and the full digitalization of our tax administration in order to match the continuing trend in digital transactions. Finally, it fills part of the yawning gap in literature in this area of study.

The remainder of this paper is structured as follows: section 2 gives our approach to the study, that is, our methodology; section 3 presents the review of extant literature; section 4 provides an assessment of the prospects of taxing digital companies in Nigeria while section 5 concludes.

Methodology

This is a qualitative study and adopted a desk review and analytical research approaches. Extensive and in-depth reviews of available literature on the areas of tax gap as well as digitalization and taxation challenges are carried out. Sections of available legal framework on taxation of companies are also consulted and analysed in the context of taxation of digitalized companies. Reports of commissioned works by OECD and G20 are reviewed and assessed with a view to deriving policy direction from them that may inform action in the Nigerian context. From the reviews and analysis, the study drew conclusion and made recommendations for policy formulation and implementation with regard to taxation of digitalized companies in Nigeria.

Review of Literature

The literature review is presented in three sub-sections, namely conceptual, theoretical and empirical.

Conceptual Review:

Tax Gap

Tax gap is an integral part of any economy. No country is able to collect all potential taxes due to the economy, for it is either that the country's tax base is not broad enough to capture all potential tax payers or that tax payers will attempt to avoid and/or evade taxes or both. The shadow economy exists in every economy and in economies with weak institutions, it blossoms as a result of tax evasion and aggressive tax optimization practices. This increases the difference between collectible tax revenue and what is actually realized at any given period.

Tax gap is thus defined as “the difference between the tax that would be raised under a hypothetical, perfect enforcement of tax laws (potential tax) and the actual tax payments” (Danquah & Osei-Assibey 2018, p.2). Tax gap implies tax losses that are suffered by the economy and it is from this perspective that Deloitte (2016) refers to tax gap as the difference between taxes collected by government and what could ideally be collected. In a jurisdiction where there is a significant level of non-compliance by individuals and corporations and the size of informal sector is large, the gap could be very wide.

Raczkowski (2015, p.4) defined tax gap as the “degree to which the taxpayer evades taxation, which results in undue reduction of the tax base and a decrease in due contribution to the state budget.” This definition takes a narrow perspective as there are factors beyond tax evasion that contribute to tax gap for example, corrupt and inefficient

tax administration. Some authors, (for example, Giles, 1999), define tax gap from the perspective of hidden income as the product of the amount of hidden income and appropriate tax rate. This definition poses the difficulty of determining appropriate tax rate and what constitutes hidden income. However, Raczkowski and Mroz (2017, p.2) regard tax gap as “the difference between due taxes which tax payers should have paid within a specified period of time and the amount of tax that has actually been contributed to the state budget.” The size and the growth of this gap, according to these authors, is a signal that the socio-economic policy is faulty and needs fixing. It is believed that reducing this gap is a function of tax administration of a given country.

Simply put, the tax gap is the difference between the amount of tax that should, in theory, be paid to the government, and what is actually paid.

Digitalised Companies

As OECD (2019, p.2) posited, “information and communications technology has become part of the foundational infrastructure for business and society, evidenced in a heavy reliance on efficient and widely accessible online communication networks and services, data, software, and hardware.” Digital devices, smart technology and connectivity have brought significant changes that have affected business models, relationships and markets. Digitalised companies are organizations that leverage on technology as a competitive advantage in its internal and external processes and operations. Such companies may be global; they are virtual, operate based on online multi-sided platforms that facilitate transactions between sellers of goods and services and consumers, which occur outside of traditional business structures and thus have significant economic presence in many jurisdictions but little or no physical presence (KPMG, 2018; OECD, 2019).

As information technology (IT) continues to reshape the infrastructure and operations of enterprises, digital company has continued to assume different meanings. At the emergence of the Web, for example, the term became associated with business activities or new business models that incorporated digital technology, such as the purchase of goods from online sites as we have with JUMIA in Nigeria or Amazon.com. Today, digitalized companies are known by their value creation process across different digitalized business models and according to OECD (2018) have the basic features of “scale without mass”, (that is, significant economic presence without physical presence), reliance on intangible assets and data and user contributions. It is expected that the term will continue to evolve as more business processes, products and business models are transformed by digitized information.

Theoretical Underpinning

The underpinning theories for this study are Adolph Wagner's socio-political theory (1872) and the expediency theory of Alfred G. Buehler, 1936.

The proponent of Socio-Political theory, Adolph Wagner believed that social and political objectives should be the overriding factors in selecting taxes to be paid by citizens. The theory does not agree that a tax system should be designed to serve

individuals, but should be used to cure the numerous ills of society as a whole. Though the society is made of individuals, it is a sovereign entity and thus more than the sum total of its individual members. The state therefore needs to preserve its existence and solve its problems. Therefore government's power of imposition of tax is not dependent on the conferment of benefit, but is essentially an exercise of sovereign power. Tax systems should thus be designed to serve as fiscal policy measures not only for the purpose of raising income for government but also for reducing income inequalities and unemployment in a nation state.

Modern extensions of this theory have emphasized broadening the tax net and the tax base, improving tax compliance level and refining tax administration and tax laws to embrace modern technology. In this regard, the socio-political theory finds appropriate application in this study.

In its earliest form, Buehler believed that expediency is a major principle in distributing the costs of governance and presented expediency as the principle of taxing as circumstances seem to warrant and with regard to the more immediate and pressing considerations. He noted that taxes are employed not only to raise revenue but also to regulate industry and promote economic, political and social ends.

Generally, the expediency theory holds that a basic consideration in every tax proposal is the practicability of its administration (imposition and efficiency of collection). Economic and social objectives of the state and the effects of a tax system should not be considered relevant in the design of a tax system (Bhartia, 2009). In the words of Chigbu, Akujobi and Appah (2012, p.31), "this proposition has a truth in it, since it is useless to have a tax which cannot be levied and collected efficiently. There are pressures from economic, social and political groups. Every group tries to protect and promote its own interests and authorities are often forced to reshape tax structure to accommodate these pressures." For example, there are currently strong arguments by concerned groups against digital services tax as they believe that users do not create value and that such tax violates existing tax rules.

The existing tax administrative structure in Nigeria may not be adequate to deal with the current situation.

Empirical Review

There are not many empirical studies in the area of tax gaps and the taxation of digital companies in Nigeria. Few empirical studies on tax gap and its measurement exist in other climes but not associated with taxation of digital entities. Taxation of digital companies is an emerging issue for which there is scarcely any empirical study anywhere but a lot of work and reports by OECD and G20 addressing the challenge are available. This section of our review is based on such existing works.

Tax Gap and Digitalisation

Maiye and Isiadinso (2018) in their examination of Nigeria's unchanging tax-to-GDP ratio submitted that the tax gap is a measure of the collectible tax revenue that is lost and when related to GDP of any nation gives an indication of the country's output that can be

attributed to tax receipts. Viewed from this perspective the tax-to-GDP ratio becomes a tool for gauging the efficiency of a country's tax policies and system. This study identified narrow tax base, unorganized informal sector, government tax incentives and exemption framework and loopholes in tax laws as the causative factors for wide tax gap and low tax-to-GDP ratio. While recommending the expansion of the tax base to capture the large informal sector, including digital and entertainment sectors, the study concluded that the current tax administrative system and the Nigerian economy as a whole need serious overhaul.

Tax avoidance and tax evasion have been equally identified as important factors contributing to the tax gap (Bekoe, Danquah, & Senahey, 2016; Danquah & Osei-Assibey, 2018; Ebeke, Mansour, & Rota-Graziosi, 2016). Some of these studies on tax revenue losses due to tax avoidance and tax evasion in developing countries distinguish between a domestic component (which they attribute to the growing domestic shadow economy) and an international component (in which the aggressive tax optimization strategies, including profit shifting, of the multi-national companies are implicated). These studies have not specifically evaluated the contribution of the emergent digitalized companies on the tax revenue losses.

The submission by Deloitte (2016) indicated the difficulty of ascertaining the exact level of tax gap in most developing countries, but stated that the ratio of non-oil tax revenue to GDP in Nigeria is lower than 10%. In addition to factors earlier identified, perceived lack of tax justice and poor records of taxable units are believed to be responsible. Again, this study has not dealt with the influence of digitalized companies on the tax gap.

Other studies on tax gap, (for example, Khlif and Achek, 2015; Raczkowski and Mroz, 2017) include factors such as insufficient efficiency of state authorities, unfair tax competition, supranational character of contemporary business activity due to globalization as well as cross-border character and exceptional mobility of the underground economy, as being responsible for the ever widening tax gap. However studies by Akpo, (2009), Everest-Phillip and Sandall(2007) and Modugu, Eragbhe and Izedonmi (2012) concluded that good governance and accountability result in voluntary tax compliance and reduction in tax gap. The tax implications of digitalization have not been specifically addressed by these studies.

OECD (2019) has asserted that it is doubtful whether the existing tax rules remain fit for purpose following the digital transformation of the economy. The identified main tax challenges of the digital economy which have progressively widened the tax gap include lack of nexus (or taxable presence in a jurisdiction), income characterisation, spread of multi-sided business models, in which the buyer and seller are in different jurisdictions, and the expansion of e-commerce. These features make it difficult to capture digitalized companies into the tax net using the existing tax laws and policies in Nigeria. Folarin, Arowolo and Olugbenro (2019) observed that the tax administration system is unable to adequately capture the arising large direct and indirect taxes payable on ecommerce transactions and this has left leakages in the tax system. Thus, there is the perception that

digital companies pay lower taxes than traditional companies and in some cases completely evade and/or avoid tax which defeats the fairness canon of taxation. In this regard, Hadzhieva (2019, p.16) documented that “the quest for fairness was justified by the EU Tax Commissioner Pierre Moscovici as he highlighted that digital companies pay an average of 9% effective tax rate in the EU compared to other firms that pay 21%.”

The calls for fairness, broadened tax base and increased tax revenue to fund government expenditure and properly regulate the economy have heightened the clamour for the taxation of digitalised companies.

Taxation of Digitalised Companies

Digitalisation has been acknowledged as an important source of entrepreneurship. In addition to lowering barriers to entry, it has affected the business environment as it brings down transaction costs, increases price transparency and improves productivity. Thus, digitalisation continues to transform our lives and economy as it continues to evolve. The rapid growth in information and communication technology (ICT) in Nigeria has brought with it a lot of opportunities and changes in the way businesses are transacted. It is much easier now to communicate with suppliers, customers, and employees using Internet based tools, and these developments in ICT are also leading to the emergence of new and transformed business models. A number of business deals are consummated using mobile devices and online payment platforms. This paradigm shift from a physical to an 'invisible' business framework comes with many challenges, one of which is tracking transactions for taxation purposes (Folarin, Arowolo & Olugbenro, 2019; OECD 2019). This is because digitalization currently enables both local and cross-border transactions to be completed without the tax authorities being aware of them.

This development became a concern globally as effective tax rates for digitalized companies took a nosedive and tax gaps in many jurisdictions started increasing. The debate is still ongoing as to the appropriateness of taxing the digital economy. Even among the proponents, there are still some issues that are not fully resolved. These include whether: Internet sales should be taxed; consumption of digital goods should be taxed; the consumer who purchased wireless devices and personal computers should be taxed; the providers of digital platforms, such as Google and Facebook, should be taxed at the country where revenues are generated, or whether they should benefit from international rules that allow them to take corporate tax exemptions in certain locations and whether Internet service providers should pay taxes the same way as telecommunication carriers (Katz, 2015).

Among the proponents of digital taxation, there are still two opposing groups in terms of digital taxation policy namely, countries that expect to maximize their revenue generation from the exponentially growing digital flows and are putting in place mechanisms to maximize collection in these domains of economic activity and countries that believe that lowering taxation on the digital companies not only benefits consumers and businesses, and consequently, economic growth, but also triggers spillovers that are larger than the foregone taxes (Katz, 2015).

However, the opponents submit that the arguments justifying digital service taxes are flawed. This section of the review examines these arguments and issues. From the proponents' angle, the 2018 interim report of the OECD/G20 Base Erosion and Profit Shifting project has taken the bold step of giving guidance on how to address the tax challenges arising from digitalisation, as a follow up on the 2015 Action 1 report. The guidance requires that policy makers should “restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created”(OECD, 2018). This introduces a new rule, 'Significant Economic Presence' (SEP), rather than the restrictive 'Permanent Establishment' (PE) rule. This will necessitate changes in international tax rules, enhancements and amendments to domestic laws and treaty provisions that will enable profits to be reported where the economic activities that generate them are carried out and where value is created. In addressing the direct tax challenges raised by digital economy the Action 1 report, in addition to the creation of new nexus through significant economic presence, suggested withholding tax on certain digital transactions, and excise tax or levy (Hadzhieva, 2019).

It should be noted that these were options suggested with none being recommended. Other concerns addressed include how to allocate taxing rights on income generated from cross-border activities among countries (the 'nexus rules') especially with regard to scale without mass and reliance on intangible assets, two of the three basic features of digitalized businesses (OECD, 2019).

To address the area of indirect taxation, the implementation of the 2017 guidelines on VAT is currently being encouraged. The guideline posited that VAT neutrality in international trade is generally achieved through the implementation of the “destination principle” designed to “ensure that tax on cross-border supplies is ultimately levied only in the jurisdiction where the final consumption occurs, thereby maintaining neutrality within the VAT system as it applies to international trade” (OECD, 2017).

For lack of general consensus on how to tax digitalized companies and digital transactions, many countries have introduced unilateral tax measures in their different jurisdictions. Some experts in the field, for example Dancey (2019), have however warned that unilateral action will only result in increased complexity, uncertainty and double tax, which will impair cross border trade and impede growth. The European Union (EU) in a bid to protect the direct and indirect tax bases of member states came up with short term solutions. These include “equalization tax on turnover of digitalized companies which is a tax on all untaxed or insufficiently taxed income generated from all internet-based business activities, including business-to- business and business-to-consumer, creditable against the corporate income tax or as a separate tax; withholding tax on digital transactions, a standalone gross-basis final withholding tax on certain payments made to non-resident providers of goods and services ordered online and interim tax on revenues generated through online placement of advertisement, sales of collected user data and other digital services and digital platforms that facilitate interaction with users (Bauer, 2018; Adediran & Adeyemi, 2018).

Italy introduced a web tax with effect from January 2019. “The 3% tax is applicable to Internet services distinguished by minimum human intervention and use of technology,

provided both by Italian resident and non-resident entities to local business recipients. The new tax will be settled by the buyers of the service” (Hadzhieva, 2019, p.39). France, with effect from 2018 introduced 2% tax on the advertising revenue by resident or non-resident platforms broadcasting free or paid videos online, such as YouTube or Netflix as well as the GAFA (acronym for Google, Apple, Facebook and Amazon) tax to ensure these global internet giants pay a fair tax. UK has her 25% Diverted Profit Tax (DPT), conceived as a response to BEPS activities facilitated by digital businesses. This tax is payable upfront.

Other reactions include India's surcharge tax on payments to foreign companies for online advertising services when such companies have no PE in India as well as subjecting companies with SEP in India but with no physical presence to Indian tax. Israel's PE rule with effect from 2016 has been expanded to include non-resident online businesses which sell or provide services through Internet to Israeli residents. Such companies are subject to income tax and VAT (Isiadinso & Omoju, 2019; Hadzhieva, 2019). Many more countries have altered their nexus rules or introduced revenue and profit taxes to counteract the effect of the taxation challenges posed by digital companies.

There have been criticisms about these measures. It is contended that these new taxes breed legal uncertainty and defy clear classification for tax treaty purposes as they combine elements of taxes on profits with elements of consumption taxes. This is taken to signify hybridization, the mismatch of which Action 2 of the BEPS project cautions against (Ogungbenro, 2015). The majority of the unilateral measures are based on new nexus, equalisation levy and withholding tax, which were already mentioned under BEPS Action 1 as possible policy options without any of them being recommended. Again, some of the taxes, for example, UK's diverted profit tax and the French GAFA Tax, raise tax treaty compatibility, compliance, legal uncertainty, and double taxation issues. The new tax regimes that are revenue-based may actually be taxing companies with negative profit margins. Some also argue that the selective focus by UK “on digital companies that are big on “stock markets” mixes up market capitalization with corporate income. A focus on the world's “top 100 companies by market capitalisation” and the world's “top 5 e-commerce companies” hardly reflects the reality of the digital economy and profit levels among different firms. Hence, when the governments present low effective tax rates of digital corporations as the heart of the problem, they are conflating the digital economy with the alleged tax rates of a few firms” (Bauer, 2018, p.6; Hadzhieva, 2019). There is a further argument that tax on digital revenues stands in opposition to tax efficiency and neutrality and undermines digitalization. Many digital companies make huge investments in IT and software technology, advertising and product diversification to increase customer value-added so as to ensure sustainability. Taxes on their revenues put further pressure on the low or negative profit margins of the entities.

Kennedy (2019) described digital services taxes as a bad idea whose time should never come. According to this author, the argument that users are creating value and therefore that value should be taxed where users reside is flawed. Companies create much of the value through investments in improving software code and in research and development.

More so, taxing profits based on where users reside violates standing international agreements by taxing income more than once and imposing an ad valorem tax that primarily targets imports. It is further argued that taxing revenues may mean that companies cannot deduct such taxes from their CIT in their source country. The implication of this will be increase in the total taxes the companies pay with its negative impact on overall global digital innovation.

No matter how strong the arguments of the opponents may be, it does appear that digital taxes have come to stay. As Dancey (2019, p.1) submitted, “a sustainable and vibrant global economy is one that will be efficiently, effectively and fairly taxed.” What may be needed at this point is international harmonization of the isolated measures to avoid double taxation and double non-taxation as well as violation of existing tax treaties. How does Nigeria fit into this scheme and what are the prospects of taxing digitalized companies in Nigeria?

Assessment of the Prospects of Taxing Digitalised Companies in Nigeria

The challenges posed by the digital economy and the activities of digitalized companies, particularly with respect to tax base and impact on revenue, is not peculiar to Nigeria. In many jurisdictions tax policy is top at the agenda in a bid to counteract any negative effects of the new economy. However and as noted in section 1 of this study, Nigeria is not a member of any of these active economic groups and it has also been observed that unilateral actions may not produce the best results for the global economy. What then are the prospects of taxing digitalized companies in Nigeria?

We start our assessment from the angle of direct taxation. We observe that at the moment, there is no clear consensus on the most effective way of taxing digital transactions. The nexus rule for taxing the income of foreign companies is physical presence (permanent establishment). Section 13(2a) of our Companies Income tax Act (CITA) provides that “the profits of a company other than a Nigerian company from any trade or business shall be deemed to be derived from Nigeria if that company has a fixed base of business in Nigeria to the extent that the profit is attributable to the fixed base.” The implication of this section is that if a company derives whatever level of her income in Nigeria but has no fixed base or permanent establishment in Nigeria, as is the case with the highly digitalized companies such incomes are not subject to Nigerian CIT. It becomes a challenge to determine the exact point non-resident companies that provide services to Nigerians and earn fees/incomes, will be judged to have conducted business in Nigeria since they do not require to be physically present in Nigeria to conclude their transactions. In some cases also, the customers that complete the transactions on online platforms may not even be aware of the exact location of the digital goods and services they are consuming. In some other cases, the jurisdiction with the taxing right may be in dispute as the residence of the seller may be different from the location of the goods being sold. Another important challenge is that many of these digital transactions are initiated and concluded online without the knowledge of the tax authorities.

The FIRS in some circumstances has tried to get around this challenge by trying to extend the interpretation of existing legislation to tax digital transactions. The authority, for example, contends that the provision of S.9 (1) of CITA, that 'the tax for each year of

assessment be payable on the profits of any company accruing in, derived from, brought into or received in Nigeria' should be applicable to digital transactions of non-resident companies. The argument is that the income of digitalized companies is derived from Nigeria and therefore liable to tax in Nigeria. It is difficult to state how far this argument can go as it appears that provision of section 9(1) may be subject to the provision of section 13 (2a) of CITA which gives further guidance on how non-resident companies should be taxed.

It is necessary that there is clear legal guidance on how the profits of digitalized companies will be taxed in Nigeria.

In the indirect tax frontier, it is the practice that a Nigerian customer/taxpayer who transacts business with a non-resident company should deduct the applicable VAT and remit to FIRS. It becomes a challenge where VAT was not charged to the Nigerian customer by the non-resident company, as the Nigerian customer can deny obligation to account for the tax since he was not charged. More so, non-resident providers of products and services have no obligation to collect and remit VAT on concluded transactions since they have no physical presence in Nigeria. The reverse charge mechanism can come to the rescue since the customer will be mandated to account for VAT on the transaction. The reverse charge mechanism is particularly helpful where the goods and services are tax exempt in their country of origin as it will prevent double non-taxation. Our current VAT Act has no provision for reverse charge and will require amendment to close this gap. Given tax payers low compliance behaviour in the country, enforcement may also be a problem post-amendment of the Act and may require full digitalization of our tax administration, such that can track the transactions online and tax them digitally (Adediran & Adeyemi, 2018). The prospects of taxing digitalized companies in Nigeria will be brighter if we have proper legislation on taxation of digital transactions, especially if such legislation creates a platform whereby the tax authorities can work with banks to identify payments relating to digital transactions with non-resident companies that should be subject to tax. Furthermore, and as posited by (Isiadinso and Omoju, 2019), tax authorities should leverage the automatic exchange of information between jurisdictions and employ innovative technology to secure a proper database of the various online suppliers of goods and services.

OECD has equally advised that jurisdictions can improve their prospects of taxing digitalized companies through improving taxpayer education “aimed at providers of goods and services as this could make an important impact to ensure effective taxation of activities facilitated by online platforms” (OECD, 2019, p.5). When there is uncertainty among platform users about their tax liabilities, including whether the activity is taxable, and the income thresholds that are taxable, their voluntary compliance level may be low. Again when the tax payer education is combined with improving access to information by tax administrations, there could likely be improvement on effective self-reporting of tax obligations in respect of digital transactions. In the area of obtaining tax data about transactions facilitated through platforms, OECD (2019) has also counseled on introducing legislative measures which require platforms or other third parties to report

payments and the identity of data users and/or mandate compliance to information requests by tax administrations for information needed to improve compliance or to enhance selection of cases for audit. For non-resident digital companies, this will require exploring the possibility of a multilateral agreement between countries to facilitate access and exchange of such information on a more consistent basis. Though the country is not a member of OECD, leveraging on this guidance will improve the prospects of taxing digitalized companies and digital transactions in Nigeria.

Conclusion and Recommendations

The perceived negative impact of the digital economy on tax gaps and effective tax rates is real and is a global concern. It is not peculiar to Nigeria. Some economic and regional groups, for example, OECD and G20 have taken bold steps to mitigate and if possible contain the negative influence of the digital economy on tax revenue and economic development. Many countries have even taken unilateral steps to improve on their tax laws and policies in order to counteract the masquerading effect of digital companies and transactions on their economies, but not much has been done by the Nigerian government along this line. The country can however leverage on the recommendations of these bodies in addressing the tax challenges of the digital economy.

The way forward will require collaboration with other countries and economic groups especially in the area of exchange of information. As noted in section 4, the need for multilateral agreements between countries to facilitate access and exchange of information on digital transactions on a consistent basis cannot be over-emphasised. This will help in tracking digital transactions initiated by platforms outside the country. It is true that national governments have sovereignty over tax policy, and that nations have unique needs and public opinion contexts surrounding taxation, collaboration in this matter will benefit the global economy as it will avoid regulatory fragmentation and easy resolution of taxing rights when the issue arises.

Full digitalization of our tax administration system is important. A robust online platform is needed to address the realities of the time. The required system should be capable of tracking transactions online, facilitate exchange of information with other jurisdictions and financial institutions through which digital payments are made as well as minimize the tax compliance burden by tax payers. To drive this, capacity building through both soft and technical training of personnel is germane. Reliance on the use of consultants for sustainable capacity building should only be a stop gap measure. As observed by ICAEW (2019), digitalisation efforts in tax administration are in their infancy in Nigeria. Howbeit, Nigeria is currently investing heavily in the use of technology to drive its tax administration and processes but as Adediran and Adeyemi (2019) observed, much is needed to be done in the domains of intelligence gathering, developing a wholistic framework for taxing digital transactions and the seamless collection of taxes due.

Currently there are gaps in our tax laws requiring to be closed to be able to tax digitalized companies effectively. Amendments to our tax laws or more appropriately new legislation on taxation of the digital economy that will also provide clarity to taxpayers

on the taxation of digital transactions are urgently needed. The Federal Executive Council (FEC) in 2018 approved draft orders and bills proposed to amend existing laws and the issuance of country by country regulation by FIRS. This appears to mean that the government is determined to review existing tax laws in response to the dynamics of the global economy.

Finally, as posited by Dancey (2019) it is important to develop a tax policy that enhances trust. Equity in tax systems is necessary in maintaining public trust in government, tax authorities and other institutions throughout the economy. This is particularly necessary when it comes to the digital economy, where the inability of tax systems to keep pace with evolving business models has shaped public and government opinion in recent decades. Government and people are concerned about aggressive tax optimization/minimization, and whether multinational companies are paying enough tax. At the same time, citizens are concerned about transparency, inequity and complexity in the tax system, especially lack of tax justice on the part of government in using tax revenue to meet social needs of the citizenry. It is important then that taxing institutions and policies are redesigned through putting in place what Slemrod (2006) calls “corruption resistant tax structures” as this will be central to any efforts being made towards bridging the tax gap through taxation of digital companies in Nigeria. Corruption is a major challenge in Nigeria and the FIRS itself is no exception. (ICAEW, 2019) documented that the report of UN Office on Drugs and Crime research shows that 27.3% of interactions with tax and customs officers in Nigeria include a request for a bribe. There is need to do away with this label so as to enhance trust in the country's tax policies.

The imperatives for efficient and effective taxation of digitalized companies and digital transactions are summarized in figure 1 below.

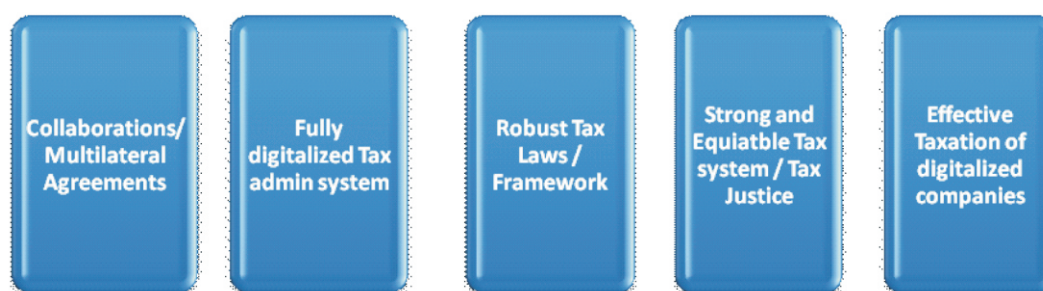


Fig. 1: Conceptual Model

Source: Authors' Desk Research (2019)

Digital revenue streams will continue to grow over time and it is necessary that the taxation framework is got right the first time to prevent avoidable distortions in our economy.

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