

# Minister Of Finance Issues Order On Significant Economic Presence By Non-Nigerian Companies



## KPMG in Nigeria

The Federal Government of Nigeria (FGN) on Friday, 29 May 2020 published the Companies Income Tax (Significant Economic Presence) Order, 2020 ("the Order") in its Official Gazette No. 21, Vol 107 of 10 February 2020. The Order, which was signed by the Honourable Minister of Finance (HMoF), Budget and National Planning, Mrs. Zainab Shamsuna Ahmed, pursuant to her powers under Section 13(4) of the Companies Income Tax Act, Cap C21, Laws of the Federation of Nigeria (LFN), 2004 (as amended) [CITA], commenced on 3 February 2020.

The Finance Act, 2019 ("the Finance Act") introduced the concept of significant economic presence (SEP) to expand the scope of Nigerian tax on foreign companies deriving income from their activities in the country which were hitherto not captured in the tax net. The Order provides clarification on what would constitute a SEP for foreign companies doing business, or providing services to customers, in Nigeria, in line with Section 13(2)(c) and (e) of CITA.

Further to our [Tax Alert Issue No 5.11](#), we have reviewed the Order and provided our commentaries thereon below:

### 1. Determination of SEP for digital activities

The Order provides that a foreign company shall have a SEP in Nigeria in any accounting year, where it

- a. derives ₦25 million annual gross turnover or its equivalent in other currencies from any or combination of the following digital activities:
  - i. streaming or downloading services of digital contents, including but not limited to movies, videos, music, applications, games and e-books to any person in Nigeria; or
  - ii. transmission of data collected about Nigerian users which has been generated from such users' activities on a digital interface including website or mobile applications; or
  - iii. provision of goods or services other than those under sub-paragraph 5 of the Order, directly or indirectly through a digital platform to Nigeria; or
  - iv. provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers in Nigeria;
- b. uses a Nigerian domain name (i.e., .ng) or registers a website address in Nigeria; or

- c. has a purposeful and sustained interaction with persons in Nigeria by customizing its digital page or platform to target persons in Nigeria, including reflecting the prices of its products or services in Nigerian currency or providing options for billing or payment in Nigerian currency.

### 2. SEP and activities carried out by connected persons

The Order provides that the activities carried out by connected persons in any accounting year shall be aggregated in order to determine whether the ₦25 million annual gross turnover threshold was met. The Order also defines connected persons as:

- a. persons that are "associates" as defined in the Companies and Allied Matters Act, Cap C20, LFN 2004 (as amended) [CAMA]; or
- b. persons that are business associates in any form, such that one person participates directly or indirectly in the management, control or in the capital of the other, or the same person or persons participate directly or indirectly in the management, control or in the capital of both enterprises.

### 3. Determination of SEP for technical, professional, management and consultancy services

The Order provides that a foreign company providing technical, professional, management or consultancy services shall have a SEP in Nigeria in any accounting year where it earns any income, or receives any payment from a person resident in Nigeria, or a fixed base or agent of a foreign company in Nigeria.

### 4. Exemption from SEP

The Order exempts the activities of the following foreign companies from constituting a SEP in Nigeria:

- a. any foreign company under a multilateral agreement and consensus arrangement to address tax challenges arising from the digitalization of

the economy who will be treated under such agreement or arrangement.

- b. any foreign company making any payment, where the payment, is made:
  - i. to its employee under a contract of employment; or
  - ii. for teaching in an educational institution or for teaching by an educational institution; or
  - iii. by a foreign fixed base of a Nigerian company.

## 5. Definition of terms

The Order provided clarifications on the definition of the following terms referenced in Section 13(2)(c) and (e) of CITA:

- a. *"any other electronic or wireless apparatus"* is defined to include digital or related activities carried on through satellite.
- b. *"services of a technical nature"* means specialised services, such as advertising, training or provision of personnel other than those involved in the provision of professional, management and consultancy services.

## Commentaries

- a. Through Finance Act 2019, Nigeria has joined countries, such as India and Israel, that have codified the SEP rule into their income tax laws. The SEP concept was first documented in the Organisation for Economic Co-operation and Development (OECD)'s Base Erosion Profit Shifting (BEPS) Action 1 final report in October 2015. BEPS Action 1 seeks to address tax challenges of the digital economy. The 2015 report on BEPS Action 1 noted that beyond BEPS, digitalisation raised a series of broader direct tax challenges. These challenges mostly relate to the question of how taxing rights on income generated from cross-border activities in a digital transaction should be allocated among countries in order to secure and sustain the international income tax system and increase tax equity amongst traditional and digital businesses. However, as the world economies are at different stages of digitalization and development, there has been no consensus on the acceptable method of taxation of the digital economy. This led

to the design of the programme of work to provide a consensus-based long-term solution that will address the challenges of the digitalisation of the economy.

The BEPS Action 1 work has evolved over the last 5 years into what is now known as Pillars 1 and 2. While Pillar 1 focuses on the allocation of taxing rights, Pillar 2 deals with global anti-base erosion mechanism (global minimum tax). It is expected that BEPS Action 1 will be finalized by the end of this year when a consensus approach will be agreed upon among the over 130 countries (including Nigeria) involved in the negotiations.

- b. One of the main challenges discussed under Pillar 1 work programme is the administration of taxing right. The work programme recommended developing a collection mechanism for withholding tax, new reporting obligations and information dissemination to the tax authorities, and modalities for addressing technical and practical issues that may arise in determining and reporting the location of sales.

However, there is no clear provision in the Order that addresses any of these issues as it affects the implementation of SEP in Nigeria. It is unclear how the Order is to be administered particularly as self-assessment may not be the appropriate means of efficient administration for businesses not used to or not aware of tax obligations in Nigeria.

- c. There are concerns about the interplay between Nigerian Double Tax Treaties (DTTs) and the Order. Based on international norms, the provisions of the DTT supersede local tax laws. Hence the Order, being an extension of CITA, should not apply to companies based in countries with which Nigeria has a DTT. Hence, the need for revisions to be made to existing treaties to address this new nexus.
- d. The Order did not give any guidance on whether the CIT returns filed by qualifying companies will be based on actual or deemed income basis. This is very important given the recent disputes between the FIRS and non-resident companies (NRCs) since the FIRS' 2015 directive requiring NRCs to file their CIT on actual income basis just as Nigerian companies. However, there has been recent cases where the FIRS has disregarded the actual income-based CIT returns and assessed the NRCs to CIT on deemed income basis because it yielded a higher tax collection.

Further, there is no provision that addresses withholding tax compliance on qualifying online transactions with corporate customers. It is, therefore, important that adequate clarifications are provided on the above issues to minimise disputes by the affected taxpayers with the FIRS.

- e. The Order limited its definition of “*connected persons*” to only associates as defined by the CAMA or business associates, i.e., persons controlled by or under common control. This appears to be at variance with the definition of connected persons in Paragraph 6(a) of the Seventh Schedule of CITA which is more expansive, and includes any person under common control, ownership or management, any person not connected but receives implicit or explicit guarantee or deposit for a debt and any related party as described in the Income Tax (Transfer Pricing) Regulations, 2018. Therefore, there is a risk that the above varying definitions could result in potential disputes between the taxpayers and the FIRS. In the final analysis, if the definition of the term in the Order is not revised, the definition in Paragraph 6(a) of the Seventh Schedule to CITA would prevail to resolve the conflict.
- f. The Order was silent on the ownership or control of the electronic or wireless apparatus such as satellite or other connected servers, receivers or transponders used in the provision of digital services. This is a significant omission given the complexity of the value chain of digital services involving the use of satellites and associated equipment.
- g. Unlike India that deferred the implementation of its SEP rule until 2021 (pending the outcome of the current round of negotiations at the OECD), the issuance of the Order signals the operationalisation of the SEP rule in Nigeria. Interestingly, Paragraph 3 of the Order appears anticipatory of the future consensus approach on BEPS Action 1 to be adopted by the OECD. This has not only provided for a seamless transition but potentially eliminates the administrative process of issuing another Order to implement the consensus in Nigeria when it is finally announced by OECD. However, until such a time when the consensus is reached, the SEP rule will hold sway.
- h. The Order has a commencement date of 3 February 2020 whereas it was published on 29 May 2020. Thus, it would be impossible to expect Nigerian companies to retrospectively account for WHT on payments already made to foreign vendors subject to the SEP rule. We, therefore, expect that an operational date would be communicated for effective transition and compliance with the provisions of the Order. Nonetheless, it is advisable that companies begin to plan and comply with the provisions of the Order immediately to avoid any potential exposure to penalty for default.

## Conclusion

It is remarkable that the Federal Government has taken unilateral action to address the taxation of the digital economy in its quest for widening its tax net. Paragraph 3 of the Order has also evinced the intention of the Government that this is an interim measure which will be overridden by a consensus approach to taxation of the digital economy at the end of the current round of OECD negotiations. Before then, it is hoped that the FIRS will issue an information circular that will clarify some of the issues highlighted above.

Meanwhile, taxpayers would need to review their transactions in line with the provisions of the CITA and the Order and ensure that they discharge their responsibilities accordingly to avoid unnecessary exposures.

Please click [here](#) to download a copy of the Order and [here](#) to read our e-book on *Finance Act, 2019: Impact Analysis*

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