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SIGNIFICANT ECONOMIC PRESENCE (SEP) AND THE TAXATION OF DIGITISED BUSINESSES

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A NEW ORDER FOR DIGITAL BUSINESSES IN NIGERIA

a. Why is there a renewed focus on Taxation of Digital Businesses?

One of the most significant impact of technology on the world has been the design of business models that rely heavily on the internet, resulting in a remarkable decline in traditional “brick and mortar” establishments. Today, world-leading technology companies run a largely digitized business with minimal or zero physical presence in their countries of operation but are still afforded the opportunity of reaching multiple locations from a single or few operational bases. This is due to the “borderless” nature of the internet as a marketplace. These types of businesses are part of the trendy “electronic commerce” club. Such a business model comes in many forms but may generally refer to the ability to perform transactions involving the exchange of goods or services between two or more parties using electronic tools and techniques.

Digital business owners typically argue that they are not within the legal jurisdiction of the countries whose residents access their services, as they are neither registered in those countries nor do they maintain any physical office. The apparent advantage to this model is that they are typically not obligated to comply with the domestic laws of these countries nor undergo registrations, pay fines, and perhaps most importantly, pay tax. It is trite at law, that for one to fall within the ambit of taxation in any given jurisdiction, the tax jurisdiction of such country must be well defined, and the law must expressly provide the basis upon which the company in question is being taxed.

The taxation of companies is typically based on the country of residence. In circumstances of a foreign company operating or generating profit from another territory, the key principle applied to bring such company within the tax net of the country is the principle of fixed based/permanent establishment. It is this tax framework that has allowed companies to provide goods and services digitally, to conduct their business, and earn revenue from multiple jurisdictions without being taxed on the income made from such countries.

With the exponential growth of electronic commerce and the increase in revenue of digital companies, states have now realized the huge revenue erosion occasioned by their inability to tax the digital businesses for the revenue generated from their country, and the need to plug this revenue gap. Despite the world recognition of the problem and several attempts at bringing a unified solution to the issues, the coordinated international response has been slow.

On this note, Nigeria, who is facing budgetary deficits, falling revenue amid the oil price crises, low external reserves, and a severe infrastructure challenge, has joined other frontline countries, in restructuring its tax laws to cater for digital businesses specifically.

b. What has Nigeria done to tax digital businesses?

Nigeria took its first step in the process of taxation of digital business with the enactment of the Finance Act 2020 (the Act) and amendment of Section 13 (2) of its Companies Income Tax Act (CITA). Under the Act, the profits of a company other than a Nigerian company from trade or business shall be deemed to be derived from and taxable in Nigeria under the following conditions:



- a. *if it transmits or receives signals, sounds, messages, images or data of any kind by cable, radio, electromagnetic systems or any other electronic or wireless apparatus to Nigeria in respect of any activity, including electronic commerce, application store high-frequency trading, electronic data storage, online adverts, participative network platform, online payments etc., to the extent that the company has a significant economic presence in Nigeria and profit can be attributable to such activity.*
- b. *if the trade or business comprises the furnishing of technical, management, consultancy or professional services outside of Nigeria to a person resident in Nigeria, to the extent that the company has Significant Economic Presence in Nigeria and profit can be attributable to such activity.*

The effect of the above is that profits made from electronic commerce, electronic data storage, online advert, to the extent that the company has Significant Economic Presence (SEP) is taxable in Nigeria.

c. What Constitutes a Significant Economic Presence (SEP) in Nigeria?

The Act empowers the Minister in charge of Finance to, by an order, determine what constitutes significant economic presence of a company other than a foreign company in Nigeria. On the 29th of May 2020, the Minister of Finance in exercising this power issued the **Companies Income Tax Order On Significant Economic Presence 2020**, (hereinafter referred to the “**SEP Order**”), thereby ushering in the commencement of the taxation of digitized businesses in Nigeria.

Under the SEP Order, a foreign entity operating a digitized business model will be deemed to have SEP in Nigeria, for taxation, where such entity:

1. derives gross turn over or income of more than N25 Million Naira or its equivalent in other currencies from carrying out the following:
 - a. Streaming or downloading of digital contents to any person in Nigeria
 - b. Transmission of data collected about Nigeria users, generated from their use of a digital interface.
 - c. Provision of goods or services directly or indirectly through a digital platform to Nigeria.
 - d. Provision of Intermediation services through digital platforms that link suppliers and customers in Nigeria.
2. uses Nigerian domain name (.ng) or registers a website address in Nigeria; or
3. has a purposeful and sustained interaction with persons in Nigeria by customizing its digital page or platform to target persons in Nigeria, such conduct will include the display of prices for goods and services in Nigerian currency.

By the provisions of the SEP Order, activities carried out by connected persons (associates or affiliates) shall be aggregated to determine whether the N25m threshold has been met. A business will be considered as an associate of another where one person participates directly or indirectly in the management, control, or in the capital of both businesses.



Also, the Act makes exempt entities covered under any multilateral agreement to which Nigeria is a party, stipulating that such an entity will be treated in accordance with the agreements. This provision envisages the coming into effect of a coordinated international treaty with respect to the subject.

For services, a foreign entity providing technical (including training, advertising, the supply of personnel), professional, management or consultancy services shall have a SEP in Nigeria in any accounting year, if it earns any income or receives any payment from a person resident in Nigeria or a fixed base or agent of a foreign entity in Nigeria. However, the following payments are exempted from this provision, i.e payment made:

- a. to an employee of the person making the payment under a contract of employment.
- b. for teaching in an educational instituting or teaching by an educational institution; or
- c. foreign fixed base of a Nigerian company

d. How will the SEP Order be enforced?

While we admit the disruptive effect of this new regime, we are yet to see how same will be enforced as most of the major players within the digitized business space are incorporated in other jurisdictions and do not have a physical presence in Nigeria. We also understand that attempts have been made to stop the operation of such businesses in the past, however, when issues of regulatory compliance were raised, the devastating effect of such moves on the micro and macro economy left a sour taste on the tongue of the citizens, who either benefit indirectly as sub-contractors or as customers. The most effective enforcement mechanism will be the employment of international corporation under a robust reciprocal international framework for taxation of digitized businesses.

However, a look at the enforcement approach adopted by South Africa for the collection of VAT on digital services, reveals that the South African tax authorities introduced the registration of digital service providers who offer goods or services to persons in South Africa for tax purposes. The registered companies are made to remit the VAT charged on goods and services supplied to persons in South Africa to the South African Tax Authority directly.

In Kenya, the passage of the Finance Act has also introduced a new tax regime for digital businesses. However, for enforcement, while the country still awaits a detailed regulation on taxation of digital businesses, the Kenya Revenue Authority (KRA) has set up a new unit to track revenues generated from every digital transaction within the country.

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