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SIGNIFICANT ECONOMIC PRESENCE:

EXAMINING NIGERIA'S MOVE TOWARDS TAXING THE DIGITAL ECONOMY

Contents

Introduction

Digitalization has transformed data value chains in different ways, opening up channels for value addition. These channels take the form of data-driven, consumer-facing business models. The emergence of these platform-based business models has eroded the need for physical proximity to target market. It becomes necessary that, in a digital age, the allocation of taxing rights by a state can no longer be exclusively limited by reference to physical presence. In response to the need to remedy this tax challenge, Nigeria introduced a new taxing right through the concept of significant economic presence (SEP).

In a broad sense, the SEP rule gives Nigeria an opportunity to shore up her economy by widening the tax base – a move informed by a data-driven economy. This new taxing right may require businesses with substantial digital footprint but no physical presence in Nigeria to file tax returns as soon as they meet with specified thresholds. These data-driven business models have the following characteristics in common: remote presence, reliance on intangible assets, and heavy user participation. SEP expands Nigeria's tax base by taking these new business models into account.

With a focus on digital value chain, SEP creates a nexus which captures non-resident companies (NRCs) that operate using digital platforms or who perform digital services. This new nexus focuses on value creation in a digital environment. Data has become a new economic resource for creating and capturing value. Digital data are core to all fast-emerging technologies such as data analytics, Artificial Intelligence, blockchain, cloud computing and all internet based services.

SEP's impact is most seen in its modification of the traditional nexus rule, and a glaring absence of profit allocation and profit sourcing rules. These international tax rules help to stimulate global trade by enshrining tax certainty and eliminating double taxation. The provision of a nexus alone is not enough. Where there is no profit allocation and profit sourcing arrangements, among others, the new taxing right will run into the trouble of implementation. Attendant issues like double

[1] Digital Economy Report 2019 – Value Creation and Capture: Implications for Developing Countries (United Nations Conference on Trade and Development) https://unctad.org/en/PublicationsLibrary/der2019_overview_en.pdf (Last Accessed on 11th June, 2020).

implementation. Attendant issues like double taxation or tax free loopholes and inadequate provisions for dispute resolution may grind it to a halt. It would seem, then, that, in its present state, the SEP rule is not up to the task it set out to achieve.

This paper examines the features of the new taxing right, with a bid to measuring its conformity with international tax best practices as well as highlighting possible implementation issues.

Understanding SEP

SEP is best described in the context of what it aims to cure. Before now there was little need to allocate new taxing rights. Most new taxing rules are a modification of existing rules, made for administrative convenience. Other rules developed were double taxation treaties (DTT) which provide offsets relating to extraterritorial income.

However, with the evolution of technology, new business models have been developed with arrangements that defy taxing norms. These business models are mostly platform-driven and data-centric. Trade and business activities arising from these business models are arranged in a way that avoids the traditional requirement for physical presence or even registration in countries where their services are enjoyed. These businesses are either Digital companies or multinationals (MNEs) who have adopted the platform-driven, data-centric models.

The untaxed activities of these new business models have caused significant leakage of corporate income tax (CIT) in countries in which these businesses aren't resident and whose tax laws are inadequate to tax the income that is generated in their jurisdiction by these businesses. Examples of these new business models include obvious tech giants like Facebook, Google and Microsoft, and others like Alibaba and Airbnb. The SEP rule is developed to tackle the challenges that arise in taxing these MNEs. This part explores the old rules, the challenges faced; and introduces the SEP, which is devised to mitigate these challenges.

2.1. Challenges Posed by Technology-driven Businesses to Old Taxing Rules

Governments usually limit the scope of income tax imposed territorially or provide for offsets to taxation relating to extraterritorial income. In Nigeria, for example, resident companies are liable to companies income tax (CIT). Non-resident companies (NRC) are required to register first in Nigeria before conducting business . [2] In practice, an NRC may carry out business in Nigeria without first incorporating a subsidiary in Nigeria. To curb this, in accordance with CITA, NRCs are liable to tax in Nigeria on profits deemed to be derived from Nigeria.

The above conditions would work best if an NRC either has a fixed base in Nigeria, habitually conducts its business or trade activities through an agent, or carries out engineering or turnkey projects in Nigeria. All of these involve the NRC having some ascertainable physical presence in Nigeria. it would seem then that the major test for an NRC's liability to tax in Nigeria either depends on the establishment of a fixed base or where the profits of the NRC are deemed to be derived from Nigeria.

However, technological changes and improvements have created new challenges in taxation. These challenges abound in instances where the business or trade activities of an NRC in Nigeria would not follow these traditional methods. In those cases, the Federal Inland Revenue Service (FIRS) is left without a basis for taxation.

[2] See section 54 of Companies and Allied Matters Act

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2.2. Challenges Posed by Digital Economy to other Cross-border Taxation

This challenge is seen across-the-board; whether in corporate tax or indirect tax. For example, the growing digital economy has exposed some cracks in the administration of value added tax ('VAT'), also known as goods and services tax ('GST').

There has been some controversy as to whether a Nigerian entity can charge and remit value added tax (VAT) when dealing with an NRC which is not registered in Nigeria for VAT. Section 10 of the Value Added Tax Act ('VAT Act') requires an NRC that carries on business in Nigeria to register with the FIRS using the address of the person with whom it has a subsisting contract ,[3] the NRC is also required to include VAT in its invoice to the Nigerian entity.

In the recent case of Vodacom Business Nigeria Limited (Vodacom) vs. Federal Inland Revenue Service (FiRS) (the 'Vodacom Case'),[4] service provided outside Nigeria but enjoyed by a resident entity is deemed as supplied in Nigeria and, therefore, liable to VAT. In the Vodacom case, the Tax Appeal Tribunal (TAT) held that transactions relating to the supply of satellite network bandwidth by an NRC to Vodacom are liable to VAT even though the NRC didn't register for VAT purposes under section 10 of the VAT Act, and did not issue any tax invoice to the Nigerian company incorporating VAT. Vodacom was, then, held accountable to VAT by reverse charge mechanism[5] .

In this case, Vodacom entered into a contract with an NRC based in the Netherlands for the supply of bandwidth for Vodacom's use in Nigeria. VAT was not remitted based on the transaction. The FIRS issued an additional assessment, assessing the transaction to VAT. Vodacom objected to the assessments and filed an appeal before the Tax Appeal Tribunal (TAT). The TAT ruled that Vodacom had the responsibility to charge and remit VAT on a contract between itself and the NRC for the supply of bandwidth service – even though the NRC did not register for VAT or incorporate VAT in its invoice to Vodacom. On appeal, the Federal High Court (FHC) upheld the TAT's decision. it, however, found the TAT's premise erroneous: that an entity can only carry on business in Nigeria if it has a physical presence in Nigeria. The FHC held that "systems for taxation should be flexible and dynamic to ensure that they keep pace

[3] A taxable person under the VAT Act is any person who carries out economic activity in a place for the purpose of obtaining income by way of trade or business.
[4] (2019) LPELR-47865 (CA) in this case the Court of Appeal dismissed Vodacom's appeal.
[5] Reverse charge mechanism requires the recipient of the goods/services to pay VAT instead of the supplier.

with technological and commercial developments". It interpreted the phrase 'carries on business', as provided in the VAT Act, to include a single supply of goods and services, and that, for the purpose of VAT, the main consideration in determining whether an NRC was carrying on business in Nigeria was the occurrence of a supply to a person in Nigeria and not the residence of such NRC. The decision of the FHC was appealed by Vodacom and dismissed by the Court of Appeal.

The Vodacom case, even though relating to GST/VAT tax not income tax, highlights the present reality with regards international taxation. Previously, the taxing rules available were enough to target different forms of businesses and trades or transactions in a value chain. But with technological development, this is no longer the case. In the digital era, there is a pressing need for governments to update their taxation policies.

As the Vodacom case shows, previous rules requiring the establishment of physical presence of an NRC in Nigeria, either by registration, residence etc., before profits can be attributed as derived from its business and trade activities is not enough for today's world. The NRC in the Vodacom case did not have any need to physically engage with the Nigerian entity and its services were of an intangible nature too. In the Vodacom case, the rule in the VAT Act requiring NRCs carrying on business in Nigeria to register and issue an invoice was relaxed by the FHC, which held that a contrary decision in that case would be a "gratuitous escape route for VAT evasion".

2.3. What is the SEP Rule?

Simply put, the SEP rule is set out to tax the digital economy, since already existing tax frameworks have proved grossly inadequate. The SEP provides a nexus to enable a Taxing Authority charge a non-resident digital company.

The digital economy is projected to expand from 22.5 percent to 25 percent of the global economy from 2015-2015. It took 12 years for the internet to gather one billion users, but only 4 years to get to a 3 billion mark[6] Given the extent of the digital economy, countries are anxious to shore up their tax base to capture activities in digital economy.

The revenue leakage occasioned by the activities of MNEs who perform digital services or who adopt a platform-driven business model have been a cause of concern for Taxing Authorities all over the world. For most countries, their tax laws are wrought so that MNEs pay tax where they are domiciled, i.e. where their goods and services are produced rather than where they are consumed. However, these in-scope MNEs depend on mass without scale and a reliance on intangible goods and services to elude the application

[6] Phillippe Stephanny, VAT/GST and the digital economy: the untold story of global challenges; VAT/GST Treatment of Cross-border Services, 2017 Survey (KPMG International, November 2017) 2. Available at https://assets.kpmg/content/dam/kpmg/xx/pdf/2017/11/ess-survey-13-nov-17.pdf

of present tax laws. With the steady growth in number of in-scope businesses and the staggering amount of their revenue, it is obvious that there needs to be a robust tax policy change internationally.

It is against this backdrop that SEP emerges. Significant economic presence (SEP) is a concept which examines what scope of income of an NRC that accrues or arises from a particular jurisdiction can result in a 'business connection' for that NRC in the jurisdiction. The income determined from such business connection is then taxable.

The SEP rule is geared towards MNEs which provide digital services or uses platform-based, data-centric business models. Since the old tax rules are inadequate to capture the business activities of these MNEs, the SEP test determines whether an MNE/NRC has undertaken significant activities sub ject to a threshold or other guidelines to warrant paying corporate income tax in a foreign jurisdiction.

The concept is not yet widely accepted in the international community. However, the application of the SEP test cannot be done in isolation as it portends heavy issues of territoriality. Therefore, for the SEP to work, there needs to be a form of international consensus.

2.4. Multilateral Steps to Curb the Challenge

In the absence of an internationally agreed policy, some countries have taken interim steps to shore up tax revenues from the digital economy. India and Israel have introduced significant economic presence tests for creating permanent establishments. The United Kingdom and France have introduced specific tax regimes for digital enterprises. Italy and Hungary have introduced turnover taxes for digital advertising and levies on digital transactions.[7]

The effectiveness of these policy changes is doubtful, unless there is an internationally accepted standard which is widely adopted. This is because international taxation occasions double taxation and myriad specialized dispute resolution. To provide a globally accepted standard, the Organisation for Eco nomic Co-operation and Development (OECD) and G20

has been in the forefront of the ongoing search for a permanent solution to the challenges posed by these in-scope businesses.

For example, with regards GST/VAT taxation, the FHC, in the Vodacom case, adopted reverse charge mechanism in enforcing the VAT in that transaction. The so called reverse charge mechanism was invoked to curb a situation in which the NRC had executed a transaction without observing the condition

[7] KPMG, Taxing the Digital Economy: Top-of-mind issues for tax leaders https://home.kpmg/xx/en/home/insights/2018/07/taxing-the-digital-economy.html (last accessed 12th June, 2020).

precedent to VAT: i.e. neither registering under section 10 of the VAT Act nor incorporating the VAT in its invoice. The application of reverse mechanism or other nationally accepted methods introduces uncertainty in the international tax system. To this end, the OECD published VAT/GST Guidelines (the 'Guidelines') .[8] The Guidelines are designed to espouse the principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility in the administration of VAT/GST in cross-border transactions. To achieve this, it proposes the application of 'destination principle' in international VAT transactions instead of the erstwhile 'origin principle'. The destination principle achieves neutrality in international trade. According to this principle, exports are free of VAT and imports are taxed on the same basis and with the same rates as local supplies. [9] In effect, all VAT revenue accrues to the jurisdiction where the supply to the final consumer occurs. In 2015, the OECD published its updated Guidelines which was endorsed by 100 jurisdictions.

Addressing the tax challenge brought on by digitalization has been the top priority of OECD/G20 Inclusive Framework and a key area of focus for the Base Erosion and Profit Shifting (BEPS) Project. The Inclusive framework groups 137 countries and jurisdictions on an equal footing for multilateral negotiation of international tax rules. During its 29-30 January 2020 meeting, the Inclusive Framework delivered a statement on a Two-Pillar Approach to address the tax challenges arising from the digitalisation of the economy. The two 'pillars' are: a revised profit allocation and nexus rules (Pillar One); and a global anti-base erosion proposal for a minimum level of taxation (Pillar Two). Specific recommendations from the Statement[10] published by the OECD/G20 Inclusive framework is mentioned below

[8] OECD, International VAT/GST Guidelines. Available at http://oecd.org/tax/consumption/international-vat-gst-guidelines.pdf
[9] Ibid. p4.
[10] OECD, Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy. Available at https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf

The SEP Rule in Nigeria

The SEP rule was initiated in Nigeria through the amended Companies Income Tax Act[11] (CITA) by the Finance Act, 2019 and was further developed in the Companies Income Tax (Significant Economic Presence) Order, 2020[12] (the 'Order'), which commenced on 3rd February, 2020. The Order specifies conditions under which NRCs that provide digital services; or technical, professional, management, or consultancy services to Nigerians may be liable to tax in Nigeria. NRCs that meet the conditions set out will be deemed to have a taxable nexus.

In accordance with the CITA, NRCs are liable to tax under any of the conditions in section 13(2). The section provides that profits of NRCs will be deemed to be derived from Nigeria under the following conditions:

a. If the NRC carries on business in Nigeria through a fixed base, to the extent that the profit is attributable to that fixed base;

b. If the NRC habitually operates a trade or business in Nigeria through an agent, to the extent that the profit is attributable to the business or trade or activities carried on through that agent;

c. If the NRC provides digital services in Nigeria, to the extent that the NRC has significant economic presence in Nigeria and profit can be attributable to such activity*;

d. If the trade or business or activities of the NRC involves executing a turnkey project in Nigeria, the profits from that project;

e. If the trade or business activity of the NRC comprises the furnishing of technical, management, consultancy or professional services to a person resident in Nigeria to the extent that the NRC has significant economic presence in Nigeria [13]*; or

f. Where an NRC fail to price their related party transaction at arm's length, so much of the profit adjusted by the FIRS to reflect arm's length transaction.

From the foregoing, to introduce SEP, the Finance Act[14] amended the CITA by expanding the conditions given under section 13(2) by inserting new subsections (c) and (e). It also provided for a new section 13(4) which empowers the Minister of Finance, Budget & National Planning to make an order determining what constitutes the significant economic presence of an NRC. [15]

3.1. Amendments

The Finance Act made two salient amendments which introduced the SEP rule, and these amendments were complemented by provisions of the Order stipulating the threshold for determining what amounts to significant economic presence. These provisions are discussed below.

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[11] Cap C21, LFN 2004.
[12] Available at https://assets.kpmg/content/dam/kpmg/ng/pdf/tax/companies-income-tax-(significant-economic-presence)-order-2020.pdf
* New provision.
[13] Provided that when an NRC carries on technical, management, consultancy or professional services, the withholding tax applicable to income made from such service shall be the final tax, if the NRC does not otherwise fall into the scope of the preceding paragraphs.
* New provision.
[14] Finance Act 2019.
[15] See s. 4(c) or the Finance Act, which inserted a new subsection 4

3.1.1. Requirements for Digital or Platform-based NRCs (In-scope Businesses)

This is contained in the new section 13(c). It makes provision for a new nexus rule. By this rule, the profits of an NRC will be deemed to be derived from Nigeria if it supplies digital services or goods, i.e. If it transmits, emits 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 and so on, to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity. (First Category)[16]

Threshold

The Order specifies that NRC in the first category shall be deemed to have significant economic presence in Nigeria where it:

i. Derives gross turnover or income of more than ₦25 million or its equivalent in other currencies, in that year, from providing digital goods or services to Nigerian users, whether directly or indirectly, or through the provision intermediation services;

ii. Uses Nigerian domain name (.ng) or registers a website address in Nigeria; or

iii. Has a purposeful and sustained interaction with persons in Nigeria by customising its digital page or platform to target persons in Nigeria, including reflecting the prices ofits products or services in Nigerian currency or providing options for billing or payment in Nigerian currency [17]

3.1.2. Requirements for NRCs who provide technical, management, consultancy or professional services

Additionally, it provided that the profits of an NRC will be deemed to be derived from Nigeria if they provide technical, management, consultancy or professional services, i.e. 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: provided that the withholding tax applicable to income under this provision shall be the final tax on the income of a non-resident recipient who does not otherwise fall with the scope of subsection (2)(a)-(e). (second category). [18]

Threshold

For the second category, the Order specifies that an NRC shall have a significant economic presence in Nigeria in any accounting year where it earns any income or receives any payment from:

i. A person resident in Nigeria; or

ii. A fixed base or agent of an NRC.[19]

3.1.3. Exemptions in the Order

The Order allows exemption of the operation of SEP from the following payments:

i. Payments made to an employee under a

[16] See s. 4(a)(ii) of Finance Act, which inserted a new paragraph 'c' to s. 13(2) of CITA.
[17] See s. 1 (1) (a)-(c) of the Order.
[18] See s. 4(b) of the Finance Act, which inserted a new paragraph 'e' to s. 13(2) of CITA
[19] See s. 2 (1) (a)&(b) of the Order.

contract of employment;
ii. Payments made for teaching in an educational institution or for teaching by an educational institution; and
iii. Payments by a foreign fixed base of a Nigerian company.[20]

3.2. Application of the New Nexus Rule

The new nexus rule in which we are interested is the section 13(2)(c), which targeted at the businesses in the first category. It creates a new taxing right which focuses on value creation rather than source. There is no requirement for physical presence. All that is required is a purposeful and sustained interaction with persons in Nigeria or significant economic presence in Nigeria. Even though the CITA and the Order mentions NRC broadly, it seems that the target scope of this new tax right are those data-driven, platform-based or consumer-facing business models. To a large extent, therefore, the NRCs in-scope are digital businesses.

Digital business models are now being widely adopted by big companies. According to the United Nations Digital Economy Report 2019[21] (the 'UN Digital Economy Report'), seven 'super platforms': Microsoft, Apple, Amazon, Google, Facebook, Tencent, Alibaba account for two thirds of the total market capitalization value of the world's 70 largest digital platforms. Digital platforms provide the mechanisms for bringing together a set of parties to interact online.

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[20] See s. 2
[21] Supra (n.1)

3.2.1. Examples of In-scope Businesses

The UN Digital Economy Report recognizes two major types of these digital platforms: Transaction platforms and Innovative platforms.

Transaction platforms are two/multi-sided markets with an online infrastructure that supports exchanges between a number of different parties. They have become a core business model for (a) major digital corporations such as Amazon, Alibaba, Facebook and eBay; as well as (b) corporations that are supporting digitally enabled sector such as Uber or Airbnb.

Innovative platforms create environments for code and content producers to develop applications and software in the form of operating systems (e.g. Android) or technology standards (e.g. MPEG video).[22]

A careful look at the SEP rule will show that it is wide enough to capture the activities of NRCs with the above business models, whether the activities happen in or is remotely directed at the Nigeria market jurisdiction .[23]

3.3. Issues Associated with SEP

From the analysis above, the SEP rule has successfully established a nexus for the new taxing right created, taking into account new business models. The inclusion of a threshold avoids or minimizes additional compliance, especially in situations where an NRC is not already physically present in Nigeria's market jurisdiction or has not specifically targeted that market abroad.

However, it is not enough to simply create a nexus rule. For digitalized businesses to be successfully taxed in Nigeria, new provisions and further clarifications are needed to ensure certainty, enable implementation and eliminate international conflict. Some of the missing provisions include profit allocation, double taxation and dispute resolution.

3.3.1. Profit Allocation

Allocation in taxing rights is a fundamental issue which must be examined in light of what constitutes a fair allocation, and what promotes stability and an overall balance of treaties. Suffice to say, it cannot be decided unilaterally. Now that a new taxing right has identified, there arises the question of attribution of profit to this right.

As has been pointed out, in a digital age, with scale without mass and unparalleled reliance on intangible goods and services, in-scope NRCs can carry out digital business activities in several market jurisdictions from a remote state. Therefore, the profits attributable to these NRCs may traverse hundreds of market jurisdictions. For example, Facebook is available worldwide to up to two billion active users. There is then the problem of the quantum of profits to which a market jurisdiction, like Nigeria, can lay claim.

[22] Ibid.

[23] Market jurisdictions are jurisdictions where an NRC sells its products or services, or in the case of digitalised businesses, provide services to users or solicits and collects data or content contributions from them.

The new section 13(2)(c) CITA provides that the in-scope NRC's profit shall be deemed to be derived from Nigeria to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity. This begs the question, what profit? How will the Federal Inland Revenue Service (FIRS) determine the quantum of the in-scope NRC's profit that is attributable to the Nigerian market jurisdiction?

It is important that new allocation and sourcing rules need to be put in place to ensure certainty and boost investor confidence. A favourable trend is the allocation of taxing rights based on a globally agreed formula, where the quantum of attributable profits is determined through formulary apportionment (FA). An allocation key will be required to distribute the profit among eligible market jurisdictions.

Then, there ought to be clear and administrable rules that will source revenues to market jurisdictions with reference to different digital business models. For example, for online advertising, such rules may deem revenue to arise in the jurisdiction where the advertising is viewed rather than the jurisdiction (if different) where the advertising is purchased.[24]

3.3.2. Double Taxation

Current international tax framework is based on separate accounting (SA) – accounts of a multinational enterprise (MNE) group are separated between the entities operating in different countries. This is based on the traditional source-based taxing rights. To prevent tax avoidance through transfer-pricing, most countries rely on arm's-length principle (ALP), which stipulates that internal prices that would prevail between independent parties.[25]

Where allocation rules are made based on FA, it is important that there are appropriate mechanisms in place to eliminate double taxation. Since most of the in-scope NRCs are MNEs, attributing profits based on FA will give rise to an overlay – as the ALP already allocates the full MNE group profits.

Additionally, FA is a significant deviation from current norms. If Nigeria chooses to establish profit attribution by FA, it will be implemented through domestic law, with their reallocation supported by tax treaties. It is important, therefore, to design ensuing policies with a view to avoid double taxation (or under taxation).[26]

3.3.3. Dispute Resolution

It is envisaged that a change in allocation rules and consequential implementation will lead to disputes. Any dispute between two jurisdictions over the attributable profits will likely affect the taxation of said profit in multiple jurisdictions.

It will be chaotic to allow all affected tax authorities to assess and audit an MNE's assessment and allocation of the attributable profit. Therefore, the prevention of disputes with respect to the quantum of attributable profits will begin with the design of clear and simple rules.[27]

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[24] Supra (n.10)

[25] Ruud De Mooij, Li Liu, and Dinar Prihardini, IMF Working Paper – An Assessment of Global Formula Apportionment (International Monetary Fund, 2019), p 6.

[26] Ibid, p 7.

[27] Supra (n.1), p 17.

OECD's 'Unified Approach' to SEP

It is obvious that a unilateral address of challenges posed by digital economy will lead to myriad international taxation complexities and disputes. Achieving consensus will require careful planning consideration and collaboration on all sides – a uniform global approach is likely to offer better outcomes for both governments and businesses in the long run. It is clear, therefore, that the best approach to a taxing the digital economy is in adopting and a multilateral agreement. What is required is a consensus-based solution.

In response to the issues highlighted above, The Statement approved by the OECD/G20 Inclusive Framework[28] at the January meeting adopts a unified approach under Pillar One includes rules for profit allocation.

The 'Unified Approach' proposes a three-tier mechanism, which are listed as follows:

- Amount A – a share of deemed residual profit allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right.
- Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdictions; and
- Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the Unified Approach, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

This three-tier mechanism developed by as a unified approach is designed for two categories of businesses as identified by the OECD Statement[29] :

a. Automated digital services: these are businesses that generate revenue from the provision of automated digital services that are provided on a standardised basis to a large population of customers or users across multiple jurisdictions. For example:

- Online search engines;
- Social media platforms;
- Online intermediation platforms, including the operation of online marketplaces, irrespective of whether used by business or consumers;
- Digital content streaming;
- Online gaming;
- Cloud computing services; and
- Online advertising services.

b. Consumer-facing businesses: these are businesses that generate revenue from the sale of goods and service of a type commonly sold to consumers, i.e. individuals that are purchasing items for personal use and not for commercial or professional purpose. For example:

- Personal computing products (e.g. software, home appliances, mobile phones);
- Clothes, toiletries, cosmetics, luxury goods;
- Branded foods and refreshments;
- Franchise models, such as licensing arrangements involving the restaurant and hotel sector; and
- Automobiles.

Some businesses are out of scope of the three-tier mechanism, and they include: extractive industries and other producers and sellers of raw materials and commodities, activities of the financial services sector (including insurance activities), and airline and shipping businesses.

[28] Supra (n.12).
[29] Ibid p10.

Recommendations

Nigeria has taken the first step in her bid to tax the digital economy by creating a new nexus rule, different from the source rule which took center stage in the 'mortar and brick' era. The next step will require care consideration and consultation to arrive at a solution to the challenges of profit allocation, and consequential issues of double taxation and dispute resolution. In light of the myriad international tax issues envisaged by the operation of SEP, for the rule to work, new regulations will need to be backed by consensus, instead of a unilateral action. Such consensus starts from adopting a global formula.

On the international scene, the United States in June 2020 broke off the longstanding international tax negotiations with Europeans countries. It warned that it will retaliate if they move on with plans to impose new taxes on American technology companies like Amazon, Facebook and Google.[30] This move was met with disappointment in Europe, with France threatening to go on to tax digital giants if a deal is not reached by the end of the year.

The three-tier mechanism promises increased tax certainty in a digital world. Where Nigeria decides to adopt the unified approach proposed by the OECD Secretariat, additional regulations will be made to support the already existing SEP rule. Special consideration shall also be given to effective computation of the quantum of Amount A, and the application of the new nexus rule will involve additional thresholds[31] (apart from the threshold created in the Order).

Where a unilateral approach is taken, tax administration is difficult and can lead to double taxation. There could also be reprisals from the home country, for example, the United States has threatened retaliatory tariffs in response to France's decision to tax digital companies resident in the United States. Therefore, the adoption of a global approach is the key toward effectively taxing digital companies.

[30] U.S. Withdraws from Global Digital Tax Talks. New York Times, June 17, 2020. Available at https://www.nytimes.com/2020/06/17/us/politics/us-digital-tax-talks.html Accessed on July 9, 2020.
[31] Ibid p12.

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