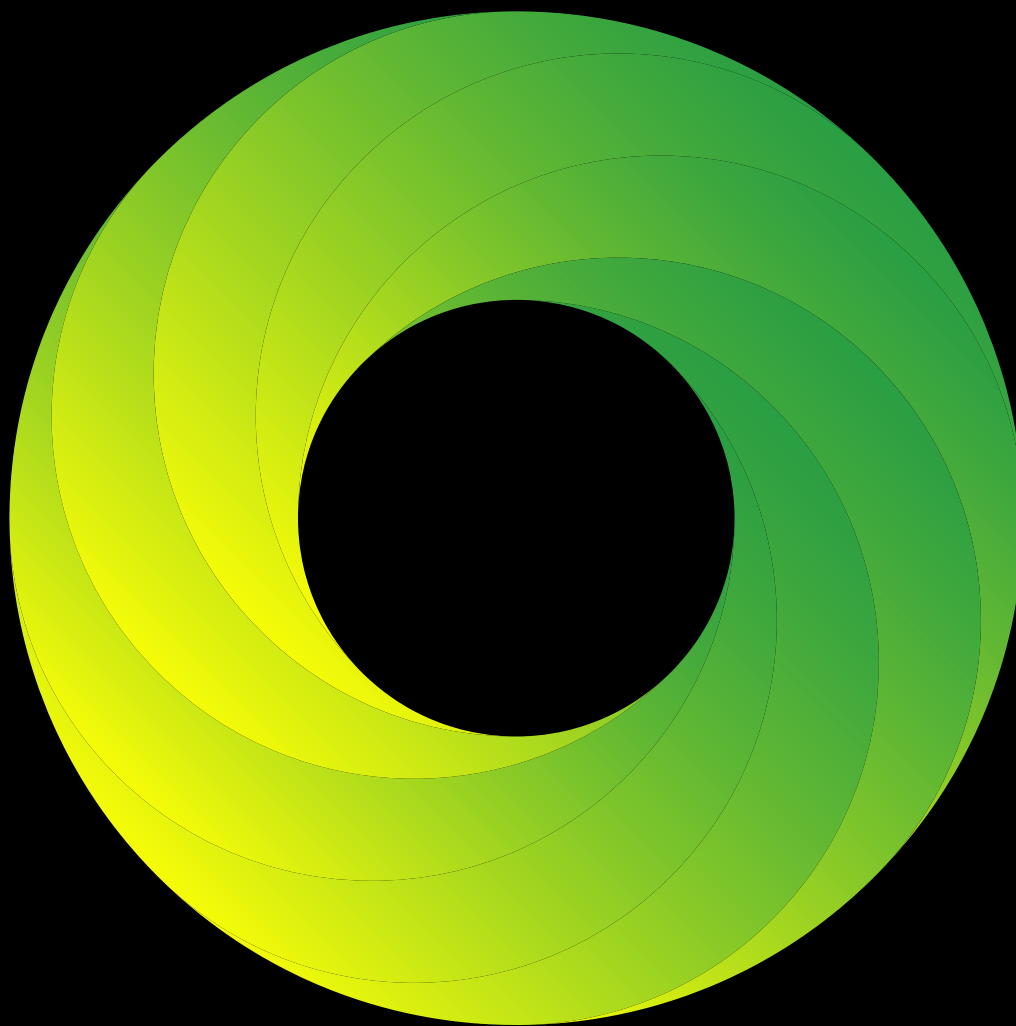


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Finance Act 2019:
Clarification on Significant
Economic Presence



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Background

The Honourable Minister of Finance, Budget and National Planning, Mrs Zainab Ahmed, recently issued the Companies Income Tax (Significant Economic Presence) Order, 2020 (the Order) to clarify the meaning of Significant Economic Presence (SEP) as contained in Finance Act 2019 (FA19). The Minister issued the Order in line with Section 13(4) of Companies Income Tax Act (CITA), as amended by FA19. The Order has a commencement date of 3 February 2020, although it was made public on 29 May 2020.

FA19 introduced the SEP concept into CITA under Section 13(2) (c) and (e). SEP qualifies the scope of profits of non-resident/foreign companies (NRCs) that are deemed to be derived from, and therefore taxable in Nigeria. Before SEP was introduced, an NRC's profits were deemed to be derived from Nigeria if the NRC had any of the following: a fixed base in Nigeria, a Nigerian dependent agent empowered to conclude contracts on its behalf, execution of a turnkey project in Nigeria or a related party transaction that was not at arm's length.





Meaning of SEP

In explaining the SEP concept, the Order categorised NRCs into two. The first category captures NRCs that operate in the digital economy (hereafter referred to as Digital NRCs). The second category encompasses NRCs that provide services that are not necessarily digital (hereafter referred to as Service NRCs).

As provided in the Order, a Digital NRC will have an SEP in Nigeria, and therefore liable to tax, where it:

a.

Derives gross turnover of more than N25million (or foreign currency equivalent), in an accounting year, from any combination of the following:

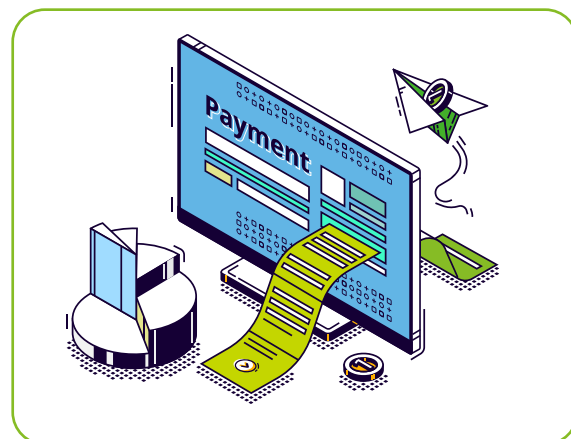
 <p>Streaming or downloading services of digital contents, including but not limited to movies, videos, music, applications, games and e-books to any person in Nigeria,</p>	 <p>Transmission of data collected about Nigerian users which has been generated from such users' activities on a digital interface including websites and mobile applications,</p>	 <p>Provision of goods and services, directly or indirectly, through a digital platform to Nigeria, other than those provided by connected persons¹, or</p>	 <p>Provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers in Nigeria;</p>
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b.

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

c.

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 of its products or services in Nigerian currency or providing options for billing or payment in Nigerian currency.



The Order mentions that where Nigeria has a multilateral or consensus agreement to address the tax challenges arising from the digitalisation of the economy, the provisions of such agreement shall override the provisions of Section 13(2)(c) of CITA, from the effective date of such agreement. This exemption only applies to Digital NRCs.

With respect to Service NRC, it will be deemed to have an SEP in Nigeria where it earns income or receives payments from a person resident in Nigeria or the fixed base of another NRC. This is in connection with carrying on the trade or business of providing consultancy, technical, management or professional services. It is important to note that the N25m threshold applicable to Digital NRCs does not apply Service NRCs. As provided under Section 13(2)(e) of CITA, the income of Service NRCs will be subjected to withholding tax (WHT), at 10%, which in this case is the final income tax.



Exclusions

The following are excluded in the determination of SEP of a Service NRC:

1. Payments made to NRCs for teaching in an educational institution or for teaching by an educational institution are exempted from the scope of SEP.
2. Payments made by a foreign fixed base of a Nigerian company to an NRC.
3. Payments made under an employment contract.



Implications

1. NRCs that have an SEP in Nigeria, by virtue of this Order, will be required to register for income taxes, make up financial statements for their Nigerian income and file income tax returns, as provided by Section 55 of CITA.
2. Resident taxpayers are required to deduct WHT from income earned by/payment made to Service NRCs covered under Section 13(2)(e) of CITA. With respect to Digital NRCs, resident taxpayers have to, on a case by case basis, examine the requirement to deduct WHT from payments made.



Safeguards for NRCs

Double Tax Agreement:

- a. Service NRCs that are resident in countries that have Double Tax Avoidance Agreement (DTA) with Nigeria appear shielded by the SEP concept, as the provisions of DTAs overrides the provision of Section 13(2) of CITA. The conventional permanent establishment (PE) concept for taxing business profits in those DTAs will continue to be the basis of determining whether an NRC is subject to tax in Nigeria until those DTAs are renegotiated.
- b. The above notwithstanding, all NRCs that seek to rely on the provision of the relevant DTAs may need to engage FIRS prior to claiming treaty benefits. The NRCs need to be mindful of this – as soon as they execute agreements that would benefit from the DTAs.



Administrative concerns

It will be interesting to understand how Federal Inland Revenue Service (FIRS) intends to enforce compliance, particularly for Digital NRCs, without burdening their local customers with any WHT cost.

Another administrative concern relates to the effective date of the Order (3 February 2020). Considering that it was just made public on 29 May 2020, we trust the Minister and FIRS would issue administrative circulars to ensure all transaction/payments that had been completed before the public release of the Order would not be subject to adverse review or imposition of penalties.



Conclusion

The release of the Order is a welcome development as it provides taxpayers with the necessary clarifications on SEP. We expect FIRS to issue an administrative circular to guide how the new categories of taxpayers should comply with their Nigerian tax obligations.

Please click [here](#) to download the Order. If you require further clarification or seek to understand how this would impact your business, please reach out to NGTaxPartners@deloitte.com.

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