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TAXATION OF DIGITAL ECONOMY IN NIGERIA: CHALLENGES AND PROSPECTS

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***Keyword**: Taxation, Digital Economy, Multinational Enterprises, and Nonresident Companies (NRCs)*

***Abstract:** One of the most significant sources of income for governments worldwide is taxation. But, taxing the digital economy has been a major concern for nations across the globe. Hence, this paper assesses taxation of digital economy in Nigeria by exploring it prospects and challenges. The paper has Smith's theory of taxation as its theoretical framework. The paper reviewed past literature to draw conclusion. It was revealed that taxing the digital economy in Nigeria has several prospects, including increasing tax revenue for the government, broadening the tax base, and reducing the likelihood that the government will take out loans among others. The paper comes to the conclusion that, despite Nigeria's prospects for taxing the digital economy, difficulties with tax administration, tax planning, and tax compliance have made it unlikely that these opportunities will be realized. Based on the conclusion, it is recommended that an empirical studies being conducted to investigate the effect of tax administration, tax planning, and tax compliance as dimensions of taxation of digital economy in Nigeria.*

Introduction

In recent decades, there has been a change in the pattern of business operation largely because of the introduction of numerous digital platforms. These platforms include, among others, Facebook, Twitter, and Instagram for social networking; Slack, Zoom, and Microsoft Teams for corporate collaborations; Amazon, Etsy, and eBay for e-commerce; YouTube and Spotify for content production; and Coursera, Udemy, and edX for e-learning. These platforms among others are conduit for digital economy. In the digital economy, products and services that are reliant on the usage of information technology are created, modified, marketed, and consumed with the goal of making money (Muhammad, Zaki and Hassan, 2019; Nguyen, 2023; Bui & Nguyen, 2023). Digital economy is the economy that results from conventional economic activities being digitally converted and powered

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by data, smart devices, and the internet. The digital economy is the outcome of traditional economic activity, goods, and services being transformed into digital form (Chaurasia, 2023). Chaurasia (2023) specifically distinguished three categories of digital economy operators: (i) companies that provide online platforms and allow users to interact are considered digital economy operators (ii) companies that provide digital content to users are considered digital economy operators, and (iii) Companies provide the basic infrastructure that powers the digital economy. In the digital economy, productivity gains are not what matter; rather, it is new activities and products that drive efficiency—dynamic efficiency as opposed to static efficiency. Macroeconomic growth is a phenomenon that can be defined, but never fully explained. Technology is developed and applied by a variety of individuals, which leads to economic progress. Moreover, the fusion of novel concepts produces new technologies (Limna, Kraiwanit, & Siripipatthanakul, 2022 and Chollisni, A Syahrani, Shandy & Anas, 2022).

Globally, the digital economy is a major factor in the socioeconomic development and prosperity of countries. For instance, the value of the digital economy's contribution to the US economy as a whole increased to 2.4 trillion dollars in 2021 from 2.17 trillion dollars the year before (Statista, 2023). In similar vein, the digital economy in Africa is expanding. Estimates for 2020 showed a contribution of 4.5%, or $105 billion USD. According to a 2020 research conducted by Google and the International Finance Corporation (IFC), the digital economy may boost the continent's GDP by US$712 (8.5%) billion by 2050 and US$180 billion (5.2%) by 2025 (Diplomacy, 2023).

In Nigeria, the digital economy is expanding and playing a bigger role. The market for digital payments is expected to reach US$21.32 billion in total transaction value by 2024. By 2028, the total transaction value is predicted to have increased at an annual growth rate (CAGR 2024–2028) of 10.06%, or US$31.28 billion (Statista, 2023). These trends of growth come with the challenge of taxing the businesses and individuals that operate in the digital economy. As Adeosun (2023) note that the advent of digital technologies and online platforms has brought about a revolution in business models, resulting in a rise in cross-border transactions and the recognition of intangible assets as valuable revenue streams. These developments have presented significant challenges for traditional tax frameworks and tax authorities in terms of devising appropriate taxation strategies for the digital economy, as the latter makes it difficult to monitor transactions and enforce tax compliance (Adeosun, 2023). The difficulty of taxation is made more difficult by the fact that internet businesses refuse to pay corporation taxes. According to Eyitayo-Oyesode (2023), the reason they are having trouble paying taxes is because the current tax regulations were made for traditional structures and did not account for the challenges that come with taxing

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a digital economy. As a result, Adeosun (2023) contends that tax authorities at all levels—national, regional, and global—are working extremely hard to ensure that their tax systems are flexible enough to handle the demands and challenges brought on by the digital economy. Additionally, Bacache, Bloch, Bourreau, Caillaud, et al (2015) the digital economy presents new taxation-related difficulties. The capacity of national authorities to tax transactions and corporate profits has been impacted by the rise of strong online platforms that are revolutionizing whole industries, such as advertising and commerce. The primary players in the digital economy, who are based outside of the purview of national tax authorities, employ transfer pricing to lower their tax obligations, which results in a net reduction in corporation tax income. Going by the foregoing, the purpose of this paper is to review prior literature and publications that are primarily drawn from the arena of taxing of digital economy in Nigeria. This paper seeks to review the literature and publications in order to develop an understanding of the prospects and challenges of taxing digital economy.

Conceptual Framework

Digital Economy

According to Pratt (2023) an economy built on digital computer technology is called a "digital economy." The internet economy, new economy, or online economy is other terms used to refer to the digital economy. For Australian Law Reform Commission (2023), digital economy is defined as the global network of social and commercial activities made possible by platforms like the internet, mobile devices, and sensor networks. The digital economy is a vital innovation driver that depends significantly on information technology and data. It also looks to be a lately advancing segment. Various meanings of the digital economy, which have emerged as time goes on, have been offered by many scholars (Williams, 2021 and Limna, Kraiwanit & Siripipatthanakul, 2022). The technology-driven digital economy is one of the most important initiatives to open doors for the creation of a new economic system that makes use of a number of cutting-edge technologies, including big data analysis, blockchain, and information technology (Bukht & Heeks, 2017). The digital economy could not exist without the internet, digital automation, social media, email and other electronic communication tools, and digital payments including bank transfers, Apple Pay, Google Pay, credit cards, and bitcoin (Ulas, 2019; Limna, Kraiwanit & Siripipatthanakul, 2022). In 2014, Organisation for Economic Co-operation and Development [OECD] identified few essential traits and unique qualities of the digital economy as follows:

- Dependence on intellectual property: Intangible assets, such as intellectual property, are heavily relied upon.
- User involvement and data value: A lot of developing business models use data, user involvement, network effects, and user-generated content.

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- The capacity to have an economic presence without a significant physical presence is known as "scale without mass.

In addition, according to OECD, there are three main models into which digital businesses can be divided:

a) The Subscription Model: On websites like Amazon or Netflix, consumers pay a subscription fee to access certain services or content.
b) The advertisement model, in which people earn money by seeing advertisements on websites run by businesses like Facebook or YouTube.
c) The access model, in which Internet service providers, data brokers, and data analysts pay content and app creators to access end users' data, including App Store.

Taxation

According to the Organization for Economic Cooperation and Development (OECD) (2014), tax is a compulsory unrequited payments to general government. Taxation is a mandatory charge that the government imposes on people's income in order to raise funds for funding its operations (Oyedokun, 2020). Additionally, taxation is defined as a mandatory payment by the government. He came to the conclusion that taxpayers gain by living in a reasonably educated, healthy, and safe society even if they might not receive anything concrete in return for their contribution (Oyedokun, 2020). The government is responsible for collecting tax money as it is evident from all three definitions that tax payments are made to the government.

But, the issue of permanent establishment (PE) was a concern in taxing digital business in Nigeria as well as the global business environment. According to Isiadinso and Omoju (2019), showing that an organization has a taxable presence or a permanent establishment (PE) in Nigeria is normally the general rule under Nigerian tax rules for taxing the profits of foreign firms in a particular jurisdiction. The revenue from the transaction could not be recognized in the jurisdiction where it is obtained since digital transactions need little to no physical presence of the transacting parties(Isiadinso & Omoju, 2019). This explains why Oluwole (2020) argues that the notion of "significant economic presence" (SEP) was established by the Finance Act, which went into effect on January 13, 2020, and serves as a new foundation for taxing digital and online transactions made by non-resident corporations. Oluwole (2020) further notes that non-resident corporations were only subject to taxation in Nigeria prior to the Finance Act if they had a fixed base or permanent establishment there. This meant that internet businesses that offered products and services without having a physical location in Nigeria were exempt from paying income tax there. This paper is therefore set out to assess taxation of digital economy in Nigeria by exploring its prospects and challenges.

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Theoretical Perspective

The paper is anchored on Smith's theory of taxation as the theory established that harnessing the potential of taxing digital economy as well as overcomes the challenges by adhering to certain principles

Smith's Theory of Taxation

This theory, as the name implies, was propounded by Adam Smith in 1776. As per Smith's (1776) assertion, a tax system designed to accomplish certain goals must conform to a set of principles known as its features. Smith was curious in how an economy might increase its revenue in order to maintain itself or fulfill its obligations to the general population. He believed that since the private sector was more effective than the state sector, it should bear the main burden of fostering economic expansion (Bhatia, 2002). Additionally, he argued that the private sectors need to be given the greatest amount of economic authority and the greatest amount of autonomy to carry it out effectively. The only other factors that need to be taken into account are enough money for the state to maintain itself, defend itself, enforce the law, and pay for social overhead, as well as a fair allocation of the burden. Smith established a few taxation principles that must be followed in order to accomplish a successful and efficient tax administration with this goal in mind (Bhatia, 2002).

Adam Smith argued that the four guiding principles of taxes should be efficiency, convenience, certainty, and fairness. In order to be fair, taxes should take into account the circumstances of the taxpayers, including their capacity to make payments that meet their personal and family requirements. Certainty should imply that the purpose and method of taxation be made evident to taxpayers (Smith in Future Learn, 2023). Convenience is related to how simple it is for taxpayers to comply: To what extent is tax collection and payment an easy process? Lastly, efficiency has to do with tax collection. To put it simply, the way taxes are collected should neither interfere with how resources are allocated and used in the economy, nor should it be more expensive than the taxes themselves (Smith in Future Learn, 2023). These principles are contained in the amended or newly introduced concept of "significant economic presence" ("SEP") as a new basis for the taxation of digital and online transactions by non-resident companies.

The principles of taxation, as this tax theory is known, have a very good philosophical foundation since they meticulously adhere to an efficient and successful tax administration, which is easily achievable when taxing the digital economy. The idea also sheds light on the consequences and practical issues of tax administration. If some components of this theory are not followed, a tax system that does not meet these requirements cannot generate enough income for the government, or to put it another way, it cannot reach its maximum potential in terms of revenue collection through taxing.

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Methodology

For this paper, secondary data analysis based on scholarly literature and peer-reviewed publications were carried out. Data utilized were acquired in both print and online versions from reliable sites and databases. This gave the researcher the opportunity to evaluate and compare different assumptions and important points made by different authors on the topic, giving a better understanding of what digital taxation actually entails and how it can be used to both enhance economic development and address the difficulties that come with implementing it in Nigeria. Additionally, documents such as Significant Economic Presence (SEP) system of 2020 and the 2021 Financial Act were also used. Hence, this paper solely depended on secondary sources of data to arrive at the conclusions made. Data ad conclusions reached were derived from extensive consultation of textbooks, journals, periodicals, magazines, newspapers, blogs and a host of other online materials. Therefore, explanation is built mostly on the work done by others.

Discussion

As earlier established in this paper, the digital economy presents new taxation-related difficulties. The capacity of national authorities to tax transactions and corporate profits has been impacted by the rise of strong online platforms that are revolutionizing whole industries, such as advertising and commerce (Bacache, Bloch, Bourreau, Caillaud, et al, 2015). In this section, the taxation of Digital Economy in Nigeria is examined, the prospects and challenges of Digital Economy in Nigeria is also explored.

Taxation of Digital Economy in Nigeria

Determining the meaning of digital taxes has proven to be difficult and contentious (Bacache, Bloch, Bourreau, Caillaud et al, 2015). Different scholars define taxes differently, and their nature and structure differ depending on the country. The term digital tax has different meanings in different countries. According to Kelbesa (2020), digital tax refers to direct taxes imposed on non-residents who merely have customers and users and have no physical presence in the taxing country. As a result, Megersa (2020) argues that different nations have different digital tax laws and policies. Different governments have adopted different strategies when it comes to identifying companies that, in connection to their consumers using digital services inside their borders, would be legally required to pay corporation taxes in those countries. Mpofu (2022), for example, asserts that Nigeria taxes the revenues of online businesses to the degree that such gains are substantially connected to the business's economic presence in Nigeria when comparing the digital taxes of various nations. In an attempt to address the issues relating to digital taxation in Nigeria, Section 13(2) of Finance Act 2019 was amended in 2020. However, because it was designed or established using the conventional taxation framework, it is hard to adequately regulate or oversee businesses that operate in the digital sphere

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(Olowoyo, 2022). According to Oluwole (2020) the Companies Income Tax Act ("CITA") was revised by the Finance Act 2019 by adding a new paragraph (c) that requires non-resident corporations to pay companies income tax in Nigeria on their digital and online transactions. According to Oluwole (2020), Section 13(2)(c) of the CITA states that if a non-Nigerian business meets the following requirements, it would be presumed to have drawn income from Nigeria and as such, be subject to Nigerian taxation:

- the company sends and receives signals, sounds, messages, pictures, or data to Nigeria via cable, radio, electromagnetic systems, or any other type of electronic or wireless device in respect of ANY activity including the following:
    - electronic commerce;
    - application store;
    - high frequency trading;
    - electronic data storage;
    - online adverts;
    - participative network platform;
    - Online payments.
- profit is attributable to such activities; and
- The company has a significant economic presence in Nigeria.

The non-resident firm cannot be taxable in Nigeria until all three of these requirements are met.

The approach adopted by Nigeria in developing taxation rules for the digital economy saw the emergence of the concept of "Significant Economic Presence" ("SEP") (Akhator, Ezike & Erhuen, 2024). Based on the SEP Order, a non-resident entity will be deemed to have a SEP in Nigeria if it:

1. receives gross revenue or income from any of the following sources in Nigeria each year, amounting to more than NGN 25 million or its equivalent in other currencies:
    - Downloading or streaming media such as games, apps, movies, music, or books.
    - Transfer of information gathered from user activity concerning Nigerian users.
    - Delivery of products and services to Nigeria using an online platform.
    - Offering intermediation services in Nigeria between suppliers and customers via a digital platform, website, or online application.
    - Connected people's activities will be added together to establish the NGN 25 million threshold.
2. uses a Nigerian domain name (.ng) or registers a website address in Nigeria, or
3. Maintains intentional and ongoing relationships with Nigerians by tailoring its digital platform to their needs (e.g., by listing the cost of its products or services in naira) (Akhator, Ezike & Erhuen, 2024).

It should be emphasized, nonetheless, that Olowoyo (2022) states that activities by related individuals would be combined in order to ascertain if the ₦25 million barrier has been reached. According to the Nigerian Finance Ministry Order, "connected persons" include "associates" as that term is defined by the

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Companies and Allied Matters Act, or business associates, in which case a single individual is involved in the capital, management, and control of two different companies, or one company is involved in the capital, management, and control of another company (Olowoyo, 2022). There are some exemptions to the implement of SEP order. According to Akhator, Ezike and Erhuen (2024) companies covered by any multilateral agreement to which Nigeria is a party are not subject to the SEP Order and would be handled in line with the applicable multilateral agreement. According to the SEP Order, non-resident entities that offer technical, professional, management, or consulting services will also be considered to have established a SEP in Nigeria during any given accounting year if they receive any payment or income from a Nigerian citizen, fixed base, or agent of a foreign entity in Nigeria (Akhator, Ezike & Erhuen, 2024).

Prospects of Digital Economy in Nigeria

The value of the digital economy is over $16 trillion, and digitally transformed businesses are expected to contribute $55.3 trillion this year—more than 50% of the global GDP—to the global economy. As such, Nigeria must concentrate its efforts in this area to take advantage of the unrealized potential for the sector's prosperity (Statista 2019 cited in Elebeke, 2023). In Nigeria, like in other countries throughout the world, the digital economy is quickly emerging as the most inventive and expansive economic sector. For instance, it is anticipated that the digital assets market in Nigeria would generate €49,170.00k in revenue by 2024. Revenue growth (CAGR 2024–2028) is predicted to be 11.59% annually, with a projected total of €76,230.00k by 2028 (Statista, 2024). Robo-Advisors lead the market among the different companies, with an estimated $4,723.00 million in total transaction value in 2024. As more investors become aware of Nigeria's potential for growth in the IT industry, the country is witnessing a spike in digital investment (Statista, 2024). These digital economic activities such as electronic commerce, application store, high frequency trading, electronic data storage, online adverts, such non-resident company has significant economic presence in Nigeria and such profit will be chargeable to tax in Nigeria (Finance Act 2019 in Uchenna, 2023). Some of the prospects that taxation of digital economy offers Nigeria according to Uchenna (2023) has been highlighted and adopted in this paper as follows; (i) the government will get more revenue from taxes on the digital economy; (ii) the tax system will be expanded; (iii) taxing the digital economy would decrease the likelihood that the Nigerian government will borrow money; (iv) taxing the digital economy will decrease the amount of public debt servicing; (v) taxing the digital economy will shift Nigeria from an oil-based economy to a tax-based one; and (vi) digital economy taxes will advance the use of electronic tax administration practices, including electronic tax filing, registration, payment,

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receipt, clearing certificate, stamping, and collection.

Challenges of Digital Economy in Nigeria

One of the most significant sources of income for governments worldwide is taxation. The government utilized this tax revenue to fund operations including upholding law and order, thwarting foreign threats, and safeguarding businesses to preserve social and economic stability.

One of the primary agenda items for tax revenue collection is increasing government expenditures and services that promote positive macroeconomic stability via economic growth and development, as well as paying down the national debt (Fakunmoju, 2022). As a result of the economy's transition toward digitization, government development and governance depend on the money generated by the digital economy. However, digital taxation has been a controversial subject giving rise to unilateral actions by different countries. Failure to appropriately tax digital earnings generated by Multinational Enterprises (“MNEs”) or Non-resident companies (“NRCs”) normally gives rise to base erosion in market jurisdictions (Odinkonigbo & Ikefuna, 2022). In an attempt to resolve the controversial associated with taxation of digital economy, on October 2021 agreement reached by 136 members of the Organization for Economic Cooperation and Development/G20 Inclusive Framework (“OECD/G20 IF”) came up with two pillars: (i) Pillar One: provides taxing rights to market jurisdictions on part of the residual profits earned by MNE groups with an annual global turnover exceeding €20 billion and 10 percent profitability, and (ii) Pillar Two requires MNE groups with an annual global turnover exceeding €750 million to pay at least 15 percent tax (OECD, 2015). Only Nigeria and Kenya refused to support the Agreement, despite the fact that other nations and blocs submit ideas to the OECD in an effort to reach a positive agreement (Odinkonigbo & Ikefuna, 2022). Nigeria refused to sign the agreement because, in the opinion of Odinkonigbo and Ikefuna (2022), the Two-Pillar solution's contents were not as advantageous as they should have been. Nigeria does not benefit from the Agreement because only MNEs with global revenue exceeding 20 billion euros, a profitability threshold above 10%, and a minimum annual turnover of one million euros from Nigeria are subject to taxation under Pillar 1. Since the MNEs involved in Nigeria's digital economy typically don't match the requirements, Nigeria could not gain much from the taxation authority granted to it under Pillar 1 (Odinkonigbo & Ikefuna, 2022).

Nigeria established the Significant Economic Presence (SEP) system in 2020 as a means of taxing Nonresident Companies (NRCs) that do not have a physical presence in Nigeria, in response to the discontent with the OECD's two-pillar approach (Olowoyo, 2022; Mpofu, 2022; and Adeosun, 2023). Nigeria is able to tax MNEs providing digital, technical, and professional services to Nigerian clients because to the SEP Regime, which establishes a type of DST. At the

outset of the SEP Regime, the Federal Government of Nigeria declared that the new legislation would enable it to expand the tax net of the nation and eliminate physical presence as a barrier to tax collection (Odinkonigbo & Ikefuna, 2022). Furthermore, the 2021 Financial Act permits taxes to be imposed on a just and reasonable portion of the revenue of businesses with SEP in Nigeria (Companies Income Tax Act cited in Odinkonigbo & Ikefuna, 2022). However, researchers have established some challenges for taxing digital economy in Nigeria despite the introduction Significant Economic Presence (SEP) system in 2020 and the amended Financial Act section 13. For instance, Adeosun (2023) identified some of the challenges of taxation of digital economy thus; allocation of taxing rights, cross border income and transactions, base erosion and profit shifting and double taxation. Additionally, The distribution of taxing power between the source and resident jurisdictions, the difficulty of identifying the revenue and profits of non-resident companies, the lack of precise data, the absence of a specialized court, and other issues have continued to be cankerworms eating away at the foundation of the tax system (Imam, 2023).

The challenges highlighted above are those associated with policymaking. Nevertheless, the digital economy has brought up a number of administrative challenges. According to Anselm and Oko-Egwu (2023) the transnational character of the digital economy gives rise to particular administrative challenges including firm identity, activity scope assessment, data collecting and validation, and consumer identification. Global business structures in the digital economy have traditional identification challenges, but these issues are made worse by the challenge of identifying remote sellers, which might ultimately make tax collection challenging.

Conclusions and Recommendations

The review revealed some prospects and challenges associated with taxation of digital economy in Nigeria. Based on the review, this paper has established that taxing the digital economy in Nigeria has several prospects, including increasing tax revenue for the government, broadening the tax base, and reducing the likelihood that the government will take out loans. Additional prospects of taxing the digital economy include a reduction in the amount of public debt service; taxing the digital economy will change Nigeria's economic structure from one reliant on oil to one based on taxes; and taxing the digital economy will promote the use of electronic tax administration techniques, such as electronic tax filing, registration, payment, receipt, clearing certificate, stamping, and collection. From the review, this paper has detailed some of the tax challenges facing digital enterprises. It draws attention to the problems associated with handling double taxation and cross-border transactions, in addition to the difficulty of taxing digital products and services. These difficulties fall into three primary groups: tax

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administration, tax planning, and tax compliance. Digital businesses may encounter new tax issues as they expand. These difficulties include withholding tax, value-added tax, and capital income tax concerns. Consequently, this paper comes to the conclusion that, despite Nigeria's prospects for taxing the digital economy, difficulties with tax administration, tax planning, and tax compliance have made it unlikely that these opportunities will be realized. Based on the conclusion, it is recommended that more empirical studies should be conducted to investigate the effect of tax administration, tax planning, and tax compliance as dimensions of taxation of digital economy in Nigeria.

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