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Rethinking Taxation in the Digital Economy: Global Developments and Nigeria's Policy Response

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Abstract:

Technology and digitalization have become an integral part of the world today. It is fundamentally transforming various aspects of human life and impacting different sectors, industries, and economies. This paper considers how the adoption of technology and digitalization has facilitated the rise of remote work, e-commerce, and digital platforms that connect individuals and businesses globally, fostering economic growth and globalization. The paper also considers how the digital economy has rapidly transformed the global economic order, presenting new challenges for existing system of taxation. The rise of digital technologies and online platforms has revolutionized business models, leading to increased cross-border transactions and the emergence of intangible assets as valuable sources of revenue. This has led to challenges faced by tax authorities in determining effective taxing strategies for the digital economy and has posed significant challenges for traditional tax frameworks. The digital economy makes it hard to track transactions and enforce tax compliance which has made tax imposition and collection a daunting task for tax authorities. This paper also aims to evaluate the taxation of the Nigerian digital economy in view of the Finance Acts 2019, 2020 and 2021. Therefore, this research will answer important questions such as the meaning and nature of the digital economy, the reason for taxing the digital economy, effort has been put in place all over the world for taxation of the digital economy, and Nigeria's effort towards achieving effective taxation of the digital economy.

Keywords: Taxation, Digital Economy, OECD, Finance Act, Pillar One and Two, Significant Economic Presence, Permanent Establishment

1. INTRODUCTION

The digital economy refers to all economic activities, transactions, and interactions that are enabled by digital technologies such as the internet, mobile devices, artificial intelligence (AI), and cloud computing. It fundamentally transforms traditional business models, creating new industries and reshaping how people work, shop, and communicate.

Key Components

The digital economy can be understood through three core components:

- **E-business infrastructure:** This includes the essential hardware, software, telecommunications networks, and human capital that form the backbone of digital operations.

- **E-business:** This refers to how business is conducted using computer-mediated networks, encompassing internal processes like supply chain management and enterprise resource planning.
- **E-commerce:** This is the visible aspect of the digital economy involving the online buying, selling, and exchange of goods and services (e.g., platforms like Amazon, Airbnb, and online banking).

Driving Technologies

The rapid expansion of the digital economy is driven by several advanced technologies:

- **Artificial Intelligence (AI):** Powers automation, personalization, and data analysis to improve efficiency and customer experiences.
- **Internet of Things (IoT):** Connects everyday physical devices and sensors to the internet, enabling real-time data collection and automated processes.
- **Big Data and Analytics:** The collection and analysis of massive datasets to inform business decisions, understand customer behavior, and develop new services.
- **Blockchain:** Provides secure, transparent, and decentralized record-keeping for transactions, crucial for digital payments and supply chain management.
- **5G and Wi-Fi 6:** Enhance connectivity with faster speeds and lower latency, supporting the development of innovative applications and services.

Impact on Business and Society

The digital economy offers numerous benefits and challenges:

Benefits

- **Increased productivity and efficiency:** Automation and digital tools streamline processes and reduce operational costs.
- **Global market access:** Online platforms allow businesses to reach customers across the world, expanding their market opportunities.
- **Innovation and new business models:** The digital economy fosters constant innovation, giving rise to unique models like the sharing economy (Uber, Airbnb) and content-on-demand services (Netflix, Spotify).

Despite these numerous benefits from digital economy, taxation in this fast-growing sector has its own setback which is the focus of this study.

2. LITERATURE REVIEW

2.1. Digital Economy: The digital economy refers to the economic activities that emerge from connecting individuals, businesses, devices, data and operations through digital technology. It encompasses the online connections and transactions that take place across multiple sectors and technologies, such as the internet, mobile technology, big data and information and communications technology.

The digital economy differs from a traditional economy because of its reliance on digital technology, online transactions, and its transformative effect on traditional industries. Digital innovations such as the internet of things (IoT), artificial intelligence (AI), virtual reality, blockchain and autonomous vehicles all play a part in creating a digital economy.

2.2. Taxation is the process by which a government or governing authority imposes and collects mandatory financial charges (taxes) from individuals and businesses to fund public expenditures and services. It is a fundamental mechanism in modern economies that transfers wealth from the private sector to the public sector to support the general welfare and development of a nation.

2.3: **Challenges in Taxing Digital Economy**

The primary challenges of taxing the digital economy stem from the fact that current international tax rules were designed for a physical economy and struggle with the lack of physical presence of digital businesses, the intangible nature of digital assets, and the difficulty in tracking cross-border transactions.

Key Challenges

- **Absence of Physical Presence (Nexus):** Traditional tax law generally requires a company to have a physical presence, or "permanent establishment," in a country to be subject to corporate tax there. Many large digital companies can generate significant revenue in a jurisdiction without any physical footprint, making it difficult to establish a taxable nexus.
- **Intangible Assets and Value Creation:** A large portion of the value in the digital economy comes from intangible assets like data, algorithms, and brand reputation, as well as user participation. It is difficult to determine where this value is created and how to allocate profits across different countries, allowing multinational enterprises (MNEs) to shift profits to low-tax jurisdictions.
- **Difficulty in Identifying Taxable Entities and Transactions:** The decentralized, cross-border, and sometimes opaque nature of online transactions (including the use of cryptocurrencies) makes it challenging for tax authorities to track revenue streams and verify income. Identifying the actual taxpayer, especially in informal or peer-to-peer transactions, is a significant administrative hurdle.
- **Inadequate and Fragmented Tax Laws:** Existing national tax laws are often outdated and lack specific guidelines for digital activities such as online advertising, cloud services, and e-commerce. This results in a patchwork of unilateral national digital services taxes (DSTs), creating complexity for businesses and increasing the risk of double taxation or unintentional non-taxation across different jurisdictions.
- **Limited Capacity of Tax Authorities:** Many tax authorities, particularly in developing countries, face infrastructural and resource constraints that hinder their ability to monitor and audit complex digital business models effectively. They often lack the advanced technology and skilled personnel required to enforce tax laws in the digital space.

  Resistance from Businesses

  Many online businesses, especially startups and small enterprises, view taxes as a burden that could stifle innovation. The imposition of new taxes on the digital sector is often met with resistance, as businesses argue that high taxes could discourage entrepreneurship and slow the growth of Nigeria's digital economy.

3. PROPOSED STRATEGIES FOR ADDRESSING THESE CHALLENGES

A. Develop a Specific Tax Regime for Digital Businesses

Nigeria could benefit from creating a distinct tax regime that reflects the unique characteristics of digital businesses. This would involve revising tax laws to encompass businesses that generate significant economic activity within the country without a physical presence. A Digital Services Tax (DST) could target revenues from multinational tech companies that serve Nigerian users.

- The Federal Inland Revenue Service (FIRS) stated a four-plan action that the Federal Government of Nigeria has put into place to solve the ongoing challenge of the digital economy, and they are:

- 1.The tax law will be amended globally to reflect current global economic realities
- 2. Technology to help track digital transactions will be deployed. is coupled with the significant economic presence rule will record positive impacts. According to the FIRS, companies like Twitter, Facebook, and Netflix who have no physical presence in Nigeria and hereto not paying tax have now registered for tax purposes and are now paying tax accordingly.
- 3. Data-4-Tax initiative – a blockchain technology which the FIRS is currently developing with the internal revenue authority of the 36 states in Nigeria and the FCT under the supervision of the joint tax board. When completed, the project will enable the seamless viewing and assessment of all economic activities of individual and corporate bodies in Nigeria, including digital commerce.
- 4.A specialized office – The Non-Resident Persons Tax Office will be set up to manage the taxation of non-resident persons and cross-border transactions, including all tax treaty operational issues and income derived from Nigeria by non-resident individuals and companies.

Strengthen Tax Enforcement Mechanisms

Improved enforcement mechanisms are essential for the success of any digital tax regime. The FIRS should invest in technologies such as data analytics and blockchain to enhance the tracking of digital transactions. Additionally, stronger cooperation between tax authorities and digital businesses can help ensure compliance.

Companies Income Tax (Significant Economic Presence) Order, 2020

Before the Companies Income Tax (Significant Economic Presence) Order, 2020 (SEP Order), there was no threshold of what significant economic presence meant. Therefore, this meant that Nigeria was not properly positioned to tax the activities and profits of Digital enterprises. However, with the introduction of SEP Order a threshold and According to Section 1(1) of the Order, a foreign company will be subject to tax under section 13 of the Companies Income Tax Act if it has a significant economic presence in Nigeria. For a company to be said to have a significant qualification criterion have been provided. economic presence and thus liable to tax it must:

1. Derive a gross turnover or income of more than N25,000,000 (twenty-five million naira) or its equivalent in other currencies, in that year from any or in combination of any of the following.

a. Streaming or downloading services of digital content, including but not limited to movies, videos, music, applications, games, and e-books to any person in Nigeria.

b. Transmission of data collected about Nigerian users which has been generated from such users' activities on a digital interface including websites and mobile applications.

c. Provision of goods and services directly or indirectly through a digital platform in Nigeria.

d. Provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers

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

f. 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 billings or payment of Nigerian currency.

Section 2(1) of the Order provides that for a company to be subject to taxation under section 13(2)e of the Companies Income Tax Act, A non-Nigerian company carrying on services of specialized nature (including advertising) shall have a significant economic presence in Nigeria in any accounting year, where it earns any income or receives payment from:

a. A person resident in Nigeria

b. A fixed base or Agent of a company other than a Nigeria company.

Companies Income Tax Act

The Finance Act also sets the tone for the taxing of non-Nigerian companies with a significant economic presence (SEP) in Nigeria. Section 4(2)(c) (of the Finance Act, 2021 amended the Companies Income Tax Act (CITA) by including digital enterprises. Accordingly, in Section 13 of CITA:
The profits of a company other than a Nigerian company from any trade or business shall be deemed to be derived from or taxable in Nigeria 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; 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. With this strategy, the basis for taxation profits received in Nigeria from digital services offered by Non-Resident Companies (NRCs) has been increased by stipulating those earnings of a company, other than a Nigerian company, from any trade or business, should be regarded to be derived from Nigeria. Thus, the NRCs which have customers resident in Nigeria but previously had no tax obligations in the country may be deemed to have a fixed base of SEP and may be required to register for taxes and le income tax returns with the Federal Inland Revenue Service (FIRS). It also allows the tax payable on the activities stated above to be limited to the withholding tax deducted by the Nigerian recipient of the service.

C. Enhance Public Awareness and Compliance

A public awareness campaign could educate online business owners on their tax obligations and the importance of compliance. A more transparent tax environment would encourage businesses to file their taxes correctly and avoid penalties.

D. Participate in International Efforts

Nigeria should actively engage in international efforts to address the digital economy's taxation challenges. Collaborating with bodies like the OECD and the African Tax. Administration Forum (ATAF) would allow Nigeria to adopt effective policies and frameworks for taxing online businesses.

4. Conclusion

In conclusion, the study provides an overview of the challenges facing Taxation of digital Economy. It highlights the difficulties of taxing digital goods and services. These challenges can be divided into three main categories: tax compliance, tax planning, and tax administration. As digital Economy continue to grow, they will face new more tax challenges, the government must adopt a comprehensive strategy to ensure fair taxation without stifling growth. By developing targeted digital tax policies, improving enforcement mechanisms, and collaborating with international partners, Nigeria can successfully address the challenges of taxing online businesses while securing much-needed revenue for national development.

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