POLICY BRIEF on DOUBLE TAX TREATY For NIGERIA

FORD FOUNDATION

actionaid

DOUBLE
TAXATION

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DOUBLE TAX TREATY for NIGERIA

A tax treaty is a bilateral agreement made by two countries to resolve issues involving avoidable double taxation of passive and active income. Such tax treaties determine the amount of tax that a country can apply to a taxpayers' income, capital, estate, and wealth. Only countries with tax havens are exempted from tax treaties. A tax treaty is also called a Double Tax Treaty (DTT).

When an individual or business invests in a foreign country, the issue of which country should tax the investors' earnings arises. Both countries – the source country and the residence country– may enter into a tax treaty to agree on which country should tax the investment income so as to prevent the same income from getting taxed twice. The source country is the country that hosts the inward investment, it is also known as the capital-importing country. The residence country or capital-exporting country is the investors' country of residence. To avoid double taxation, tax treaties may follow one of the two known models namely: The Organisation for Economic Co-operation and Development, OECD and the United Nations', UN Convention Models[1].
While DTTs can help to provide fairer tax incomes for countries which observe the treaties, they can also restrict the rights of lower-income countries to tax Multinational Corporations, resulting in losses of revenue which could otherwise be used for vital public service. For example, ActionAid International estimates indicate that Nigeria loses approximately US$27 million every year from just one clause in its tax treaties which restricts its right to tax dividends. In some cases, DTTs can also result in double non-taxation, where companies engage in 'treaty shopping' to route their funds through favorable treaty countries[2].

For instance, at the Platform for Collaboration on Tax (PCT) Conference in New York,[3] Nigeria made a strong case for the criminalisation of such tax malpractices by Multinational Corporations in developing countries. The country through its representatives at the conference recommended that tax malpractices by Multinational Corporations should be designated 'Foreign Corrupt Practices' (FCP).

> "To avoid double taxation, tax treaties may follow one of the two known models namely: The Organisation for Economic Co-operation and Development, OECD and the United Nations', UN Convention Models."

ActionAid estimates that the annual interest and dividend withholding tax revenue losses associated with tax treaties is in the region of hundreds of millions of US dollars for the first four out of fourteen developing countries. The document revealed that

Philippines losses **US$509Million,**

followed by Pakistan **US$130Million,**

Bangladesh **US$75Million,**

Nigeria **US$27Million,** in 2015[4].

This policy brief looks at the implications of Nigeria's DTTs and makes recommendations to minimise impacts of DTTs on Nigeria's ability to expand its capacity to generate more funds through increasing flows of foreign investments. It also draws references from ActionAid research conducted on double taxation treaties in Vietnam.

Taxation is a significant consideration for foreign investors seeking to do business in Nigeria. This is in addition to other factors such as security, availability and access to power and rule of law. All over the world, residence and source-based taxation are two principles which drive the taxation of foreign corporate players in international markets and economies. Accordingly, an inevitable risk for Multinational Corporations with cross-border investments/operations is double taxation.

Clearly, the search for new markets offering the best margins implies that Multinationals would continue to invest in various economies outside their home countries and markets. This makes double taxation a clear and present risk exposure for such businesses.

In order to promote world-wide economic development and to lessen the effects of double taxation on companies, the Organisation for Economic Cooperation and Development (OECD) and the United Nations' developed the Model Double Tax Treaties on Income and Capital. These models define the principles of permanent establishment, allocation of tax rights among nations and provides basis for information sharing and dispute resolution between contracting states.

Nigeria has concluded Double Tax Treaties, (DTTs) with just a handful of countries. For a DTT to be binding, Nigeria must not only be a signatory but an enforcer of its treaty provisions. To achieve high level enforcement of treaties, the relevant authorities must ensure full compliance and extend punishment on defaulters.

[1] https://www.investopedia.com/terms/t/taxtreaty.asp
[2] http://www.actionaid.org/vietnam/publications/double taxation treaties vietnam red carpet whom
[3] The PCT is an initiative of the Organisation for Economic Cooperation and Development (OECD), World Bank Group, International Monetary Fund (IMF) and United Nations.
[4] https://actionaid.nl/wp content/uploads/2018/11/The Impact of Tax Treaties.pdf

A company resident in a country with no Double Tax Treaty with Nigeria pays a flat With- holding Tax, WHT rate of 10% of the value of any revenue from a Dividend, Interest, Royalty, Management or Technical fees transaction; while their contemporaries from a DTT country pays only the rate prescribed in the treaty. Some of the DTT, even though signed, are yet to be ratified by the National Assembly and so not fully applicable in the country[5].

In Nigeria, the OECD model has served as the basis on which most of the DTTs with other countries have been formulated except in certain areas such as taxation of Royalty and Technical Service Fees.

Nigeria currently has DTTs with thirteen countries namely: Canada, Pakistan, Belgium, France, Romania, The Netherlands, United Kingdom, China, South Africa, Italy, Philippines, Mauritius, South Korea,[6]. All the treaties are comprehensive except the treaty with Italy which covers Air and shipping agreement only[7].

The Organisation for Economic Co-operation and Development (OECD) is a group of 34 rich countries with a drive to promote world trade and economic progress. The OECD Tax Convention on Income and Capital is more favourable to capital-exporting countries than capital- importing countries. It requires the source country to give up some or all of its tax on certain categories of income earned by residents of the other treaty country.Two countries will benefit from such agreement if the flow of trade and investment between the two countries is reasonably equal, but Nigeria loses when residence country taxes any income exempted by the source country[8]. United Nations' Model Double Taxation Convention between Developed and Developing Countries gives favourable taxing rights to the foreign country of investment, while developing countries receiving inward investment. This model is more beneficial to Nigeria in terms of her DTTs with developed nations compared to OECD model adopted.

> “Nigeria currently has DTTs with 13 countries”

[5] http://lawnigeria.com/Treaties/Taxation-and-Related-Matters-%20Treaties.php
6http://www.mondaq.com/Nigeria/x/724560/tax+treaties/Nigeria+and+Ghana+have+concluded+a+double+taxation+avoidance+treaty
[7] https://www2.deloitte.com/ng/en/pages/tax/articles/inside-tax-articles/improved-double-tax-arrangements-in-nigeria.html
[8] https://www.investopedia.com/terms

Recent Executive Order (008) which took effect on October 2018 on Voluntary Offshore Assets Regularisation Scheme (VOARS)[9] was initiated based on this model for persons who hold offshore investment/assets and income who are expected to declare voluntarily within 12 months and pay either a one-time levy of 35 percent or the applicable taxes plus penalties and interests.

In line with the role of taxation as a tool for wealth and employment creation, the National Tax Policy (NTP) of Nigeria identifies international and regional treaties as a way of attracting Foreign Direct Investments to Nigeria. To this end, it is imperative that Nigeria leverages on its status as the largest economy in Africa and take advantage of the benefits DTTs offers.

Meanwhile, it is note-worthy that Nigeria's DTTs with only 13 countries is low compared to the network of countries which other developed and developing countries partner with. For instance, the UK currently has DTTs with 131 countries, Canada has 92 DTTs, Ireland has 74 DTTs[10] and Malaysia has 68 DTTs. Current statistics have shown that there is a positive correlation between DTT and the level of Foreign Direct Investment inflow to Nigeria. Accordingly, and in order to accelerate Nigeria's growth objective to being one of the top 20 economies in the world, it is crucial for the country to widen its current DTT network.

The government through the Federal Inland Revenue Service (FIRS) is developing a new model tax treaty which would make the establishment of new DTTs much easier.

DELAY IN RATIFICATION OF TREATIES

In Nigeria, when treaties are signed with other countries, they do not automatically have the force of law. Section 12 of the 1999 Constitution of the Federal Republic of Nigeria expressly provides that before a treaty between Nigeria and another State shall have the force of law, it must be enacted into law by the National Assembly.

As earlier established, a company resident in a country with no Double Tax Treaty with Nigeria pays a flat With-holding Tax, WHT, rate of 10 percent of the value of any revenue from a dividend, interest, royalty, management or technical fees transaction while their contemporaries from a DTT country pays only the rate prescribed in the treaty[11].

Nigeria currently has many DTTs that are yet to be ratified. Most of these treaties are long overdue for ratification. A delay in the ratification of any treaty would give room for uncertainty among the treaties' stakeholders. No doubt, the delays in the ratification of the DTTs with these countries are currently holding back the flows of certain Foreign Direct Investment into Nigeria.

To this end, it makes economic sense for Nigeria to speed up the process of ratifying the already signed treaties in order to avoid double taxation and other incidences which may arise as consequences of delay.

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http://www.nationalplanningcycles.org/sites/default/files/planning_cycle_repository/nigeria/nigeria-vision-20-20-20.pdf

[9] https://pwcnigeria.typepad.com/tax_matters_nigeria/2018/10/executive-order-on-voluntary-offshore-assets-regularisation-scheme-voars.html

[10] https://www.revenue.ie/en/tax-professionals/tax-agreements/double-taxation- treaties/index.aspx 11

MUTUALLY BENEFICIAL

TREATIES

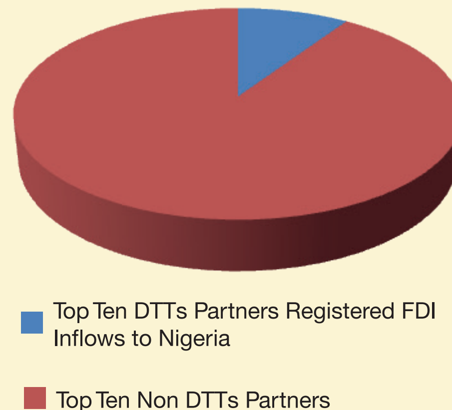
Countries enter into DTTs / agreements on the basis that it would ultimately be mutually beneficial. However, this is not always the case as some countries benefit more than the other from DTT arrangements.

In order to ensure mutual benefit, the Federal Government should review the existing tax treaties it had ratified with other countries to determine if the country truly benefits from the DTTs. Where it is established that Nigeria is not mutually benefiting from the treaties, re-negotiations and amendments of key clauses should be implored.

It is imperative for Nigeria to strategically leverage its economic status as the 26th largest economy in the world and the biggest in Africa by proactively harnessing every potential, promise and prospects in the continent and globally through useful economic partnerships contained in double tax arrangements[12].

Nigeria receives most of her Foreign Direct Investment from DTT partners. The principal sources of FDI inflows to Nigeria measured in terms of new projects are United States, United Kingdom, the Republic of South Africa, India and France. Besides, in terms of capital invested, we have United States, Canada, France, China and India. 6 of the 23 top providers of FDI to Nigeria have a DTT with Nigeria. Registered capital of Nigeria's major top ten FDI providers accumulated valid projects as at 2nd quarter of 2018 stood at US$5127.923Million with the share of US$481.003Million registered capital by top ten countries that do not have DTTs with Nigeria. This figure is just 9.4 percent of the total inflow of FDI to Nigeria in the second quarter of 2018 from non DTTs countries[13].

FDI Inflows to Nigeria from Top Ten Highest



Source: NBS quarterly Report, 2018

Only few DTTs partner countries have large volume of investment and trade in the country and they are basically developed nations taking advantage of the OECD model as it is more favourable to them.

[12] https://www2.deloitte.com/ng/en/pages/tax/articles/inside tax articles/improved double tax arrangements in nigeria.html

[13] National Bureau of Statistics of Nigeria, Capital importation Report by country origin, 2nd quarter 2018.

ActionAid further reiterates that the treaties may look good in theory but could rarely favour the country in practice. The OECD model limits the taxing right of Nigeria on dividends, interests and royalties and this potentially reduces the tax base of the country which will impact negatively on the revenue generation[14].

While this suggests that DTTs are influential in attracting FDI, they constitute only one of the many determinants of foreign investments – which also includes overall tax rate base on the debt profile of the country, regulatory environment, infrastructure, political risk and skills. The existence of a DTT can also provide more flexibility for foreign investors to choose the jurisdiction through which to enter Nigeria, potentially leading to more FDI flowing through treaty partner countries, even where they are not the source of the investment.

Compared with other developing nations, Nigeria's treaties are generally more protective of its own right to tax with some significant exceptions. The ActionAid Tax Treaties Dataset (which compares key features of 538 DTTs) provides each treaty with a 'Source Index' score between 0 and 1, where a higher number means the developing country has kept more taxation rights under the treaty. Nigeria's DTTs with G20 members such as France, South Africa, Canada etc. has a higher average source index (that is, are more protective of Nigeria's right to tax) than many other developing nations[15]. Nigeria's DTTs have also become more protective over time, with the Source Index value of its treaties progressively increasing.

Despite this general trend, some original treaties signed in 1987, 2002, 2009, 2011 with UK, China, Spain and Kuwait respectively are comparatively very restrictive on Nigeria's right to tax foreign investments.

Considering Nigeria's treaties with higher-income countries, the treaty with Kuwait is the most restrictive with 0.28 points, followed by UK with 0.38 points, Spain with 0.39 points and China with 0.44 points. There is therefore need to urgently renegotiate double tax agreements with DTTs partners and adopt the UN convention model.

SLOWER GROWTH OF TAX REVENUE FROM CAPITAL IMPORTATION

Capital importation has increased significantly in Nigeria since 2000 as a result of many factors, including democratic system, tax system reforms, land and infrastructure incentives, incentives provided under Free Trade Agreements and potentially the existence of DTTs. The largest amount of capital importation was received through Portfolio investment, which accounted for 74.7% ($4,119.5Million) of total capital importation, followed by other investments, which accounted for 20.5% ($1,132.8Million) of total capital, and then Foreign Direct Investment FDI, which accounted for 4.7% ($261.4Million) of total capital imported in the second quarter of2018[16].

However, tax revenues contributed by foreign private investments have grown at much slower pace.

The diminishing tax returns from foreign private investments put more pressure on domestic resources to meet the needs of the population and provide the public services. At the same time, revenues from corporate income tax are falling as a proportion of the overall budget, with VAT (a tax that impacts the poor proportionally more than other taxes) making up much of the difference. Revenue generated from Value Added Tax (VAT) increased by 8.96 per cent in the fourth quarter of 2018[17]

The combined pressures on the budget from the above factors make it increasingly important to derive tax revenue from the growing pool of foreign private investments. This highlights the need to carefully consider any agreement which have the potential to reduce Nigeria's ability to raise taxes from foreign companies as observed by ActionAid Nigeria[18].

RECOMMENDATIONS

- In order to accelerate Nigeria's growth objective to be one of the top 20 economies in the world, it is crucial for the country to radically widen its current DTT network.
- The government through the Federal Inland Revenue Service (FIRS) should develop a new model tax treaty which will make the establishment of new DTTs much easier.
- Nigeria needs to speed up the process of ratifying the already signed treaties in order to avoid double taxation and other incidences which may arise as consequences of delay.
- It is imperative for Nigeria to strategically leverage its economic status as the 26th largest economy in the world and the biggest in Africa by proactively harnessing every potential, promise and prospects in the continent and globally through useful economic partnerships contained in double taxation arrangements.
- Nigeria needs tourgently renegotiate double tax agreements with DTTs partners and adopt the UN convention model.

CONCLUSION

Nigeria has signed relatively few numbers of DTTs, compared to other developing countries and considering the size of her economy, this may not be helpful in attracting the much-needed capital importation to the country. However, there are potential risks, including provisions in some treaties with major capital exporting by DTTs partner countries, this restricts the tax that Nigeria can derive from foreign companies, based on OECD model as the basis for agreement.

This in turn impacts on the ability to provide public services to poor and vulnerable people, particularly women and girls. As an implication, Nigeria should carefully review the impacts of existing and new DTTs. While the country has derived benefits from its effective integration into the world economy, including measures to attract and facilitate foreign investment, it has reached a stage where a focus on “optimal integration”, rather than “maximal integration”, may be appropriate to ensure that the country stands to benefit maximally from the economic integration.

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[14] https://economicconfidential.com/2017/02/actionaid-cautions-nigeria-treaties/
[15] https://www.ictd.ac/dataset/action-aid-tax-treaties-dataset/
[16] https://www.nigerianstat.gov.ng/andersentax.ng/presidency-signs-two-instruments-of-ratification//t/taxtreaty.ap

http://www.nationalplanningcycles.org/sites/default/files/planning_cycle_repository/nigeria/nigeria-vision-20-20-20.pdf
[17] https://www.premiumtimesng.com/business/business-news/314474-nigerias-vat-collection- rose-8-96-in-2018-fourth-quarter-nbs.html
[18] https://economicconfidential.com/2017/02/actionaid-cautions-nigeria-treaties/

ActionAid is a global movement of people working together to further human rights for all and defeat poverty. We prioritise works with the poor and excluded, promoting values and commitment in civil society, institutions and governments with the aim of achieving structural changes to eradicate injustices and poverty in the world.

ActionAid Nigeria believes that a Nigeria without poverty and injustice is possible.

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