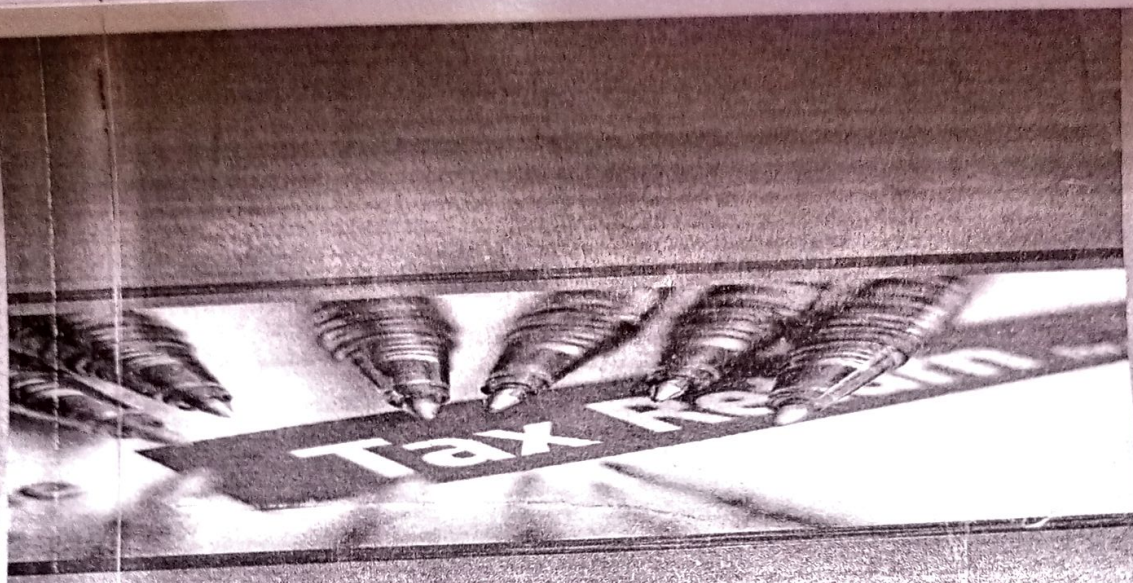


Taxation of Electronic Commerce In Nigeria

D. A. Ariyoosu

Stirling-Horden Publishers Ltd.
Gaaf Building, 110-112 Oyo Road,
Orogun, Off University of Ibadan,
Second Gate, Ibadan, Oyo State,
Nigeria.
Phone: 08023519154
stirlinghorden@ymail.com, info@stirlinghorden.com
www.stirlinghorden.com

University Post Office
Box 20984
Ibadan
Oyo State, Nigeria

7 Ikioda Street
Jattu-Uzairue
Edo State, Nigeria

© D. A. Ariyoosu

Published 2014

ISBN 978-978-032-303-5

All Rights Reserved

Apart from any fair dealing for the purpose of research, private stud
criticism or review, as permitted under the Copyright, Designs and Paten
Act of Nigeria, this publication may not be reproduced, stored or transmitte
in any form, or by any means, except with the prior permission in writing o
the copyright owner, or in the case of reprographic reproduction, i
accordance with the terms of licences issued by the Copyright Licensing
Agency.

Stirling-Horden Publishers Ltd.
Lagos, Ibadan, Benin City, Jattu-Uzairue.

Dedication

My Parents

Alhaji Samuel Adelabu Aiyeoosu
and
Alhaja Falilat Aiyeoosu

Acknowledgements

Lo! My prayer, my sacrifice, my life and my death are all for Almighty Allah, Lord of the Universe.

I wish to sincerely appreciate those who have contributed direc or indirectly to the publication of this book. My appreciation g to Professor M. T. Abdulrazaq, who nurtured and tutored me the art of book writing. He supervised my Ph.D thesis but he more than a supervisor; he is a father, a mentor and a role mod His words of encouragement are immeasurable. He al graciously and unhesitatingly accepted to write the foreword this book. May Allah in His infinite mercy continue to show His blessings on him.

My sincere appreciation also goes to Professors Waha Egbewole, Muhammed Akanbi; Drs J. O. Olatoke, I. A. Abdulqadi and I. A. Yusuf, all of Faculty of Law, University of Ilorin, fo their kind gesture and encouragement. I am also grateful to al lecturers in the Department of Business Law, Faculty of Law University of Ilorin and other lecturers in the Faculty in general I am equally indebted to the management of University of Ilorin (the 'Better by Far' University) for allowing me to pursue my Ph.D in law which eventually brought about the publication of this book. I say, forward ever, backward never.

Finally, my heart-felt gratitude goes to my dear wife and children; I sincerely salute your perseverance and understanding. I appreciate you all.

Foreword

Electronic commerce occurs in various forms and between various entities in the market. The question is how to tax it. The answer to the question is what this book attempts to answer.
This work sets out the major issues in the area of e-commerce taxation and analyses the existing Nigerian regime with regard to e-commerce taxation.

The author blazes a trail in Nigerian taxation in the treatment of this area of specialisation. He, therefore, lays the foundation for Nigerian tax authorities to examine the approach and policy towards the taxation of e-commerce more comprehensively than they have to date. He explains this intriguing concept in a simple and readable form.

This book would find favour with students of the taxation of e-commerce paper in the Chartered Institute of Taxation of Nigeria professional examinations and the relevant examinations of other professional bodies. It would also be useful to tax practitioners and all persons who have to deal with all the relevant industries that contribute to the nation's economic growth.

The author must be commended for keeping the unique qualities of the internet in the front burner and dealing with the issues of e-commerce concerning Nigerian taxation.

M.T. Abdulrazaq *LL.B (ABU), LL.M (LSE), Ph.D (ABU), BL, ACIArb, AMNIM, ACIPM, MCIA, MCMI, FCIB, FCTI, TEP*

Federal Inland Revenue Service Endowed Professor of Taxation
Faculty of Law, Lagos State University

January 2014

Preface

The idea of publishing this book is a product of my doctoral research. My desire to embark upon it was actuated by dearth of materials on the topic generally, and with particular reference to Nigeria. Even though there are lots of laws generally regulating taxation in Nigeria, both at national and state levels, there is yet no known specific Nigerian law on taxation of electronic commerce.

The world has truly become a 'global village' as a result of technological advancement. Information and Communications Technology (ICT) has become a global phenomenon that has made various transactions virtual. This has virtually affected all aspects of a given economy, and in particular taxation. Taxation is a vexed area to the government, tax practitioners and tax administrators. It is a vexed area because of the difficulties in the interpretation of the provisions of tax laws and seemingly multiple regulatory regimes. Hence, taxing physically-oriented transactions is in itself a difficult task, while taxing virtual transactions is more difficult, if not a mere mirage.

The world's transition to information age has indeed changed the mode and increased the pace of global socio-cultural and economic activities through the adaptation of electronic commerce. The reality today is that the development in ICTs has posed very great challenges to the operation of various legal systems, including the Nigerian legal system in the regulation of various economic activities such as electronic commerce. The Nigerian tax law, for instance, never envisaged the emergence of electronic commerce and the prevalence of other online economic transactions and services as subject of taxation.

This book, *Taxation of Electronic Commerce in Nigeria,* therefore, focuses on the examination of taxation of electronic commerce in Nigeria. In writing this book, a careful examination and evaluation of relevant materials and policies

on taxation of electronic commerce are made. The book is a pioneering work which deals with emerging issues in electronic commerce in the complex field of taxation. It is a veritable tool for tax practitioners, taxation students and teachings on tax. It discusses the fundamentals of Taxation of Electronic Commerce and implications of the essential attributes of electronic commerce for taxation. It also addresses double taxation treaties and global initiatives for addressing taxation of electronic commerce. Consideration is also given to various challenges facing taxation of electronic commerce.

The book is a reference material for members of professional bodies who have interest in taxation such as Chartered Institute of Taxation of Nigeria and Institute of Chartered Accountant of Nigeria. Law students, both at undergraduate and post-graduate levels, will also find the book a useful material in the course of their research. The book reveals that the existing Nigerian tax laws and regulations are inadequate to engender an efficient and effective taxation of electronic commerce.

In summary, it cannot be gainsaid that a lot of challenges are facing taxation of electronic commerce. The book, therefore, recommends a regulatory framework to address the inadequacies in the existing Nigerian tax laws in relation to electronic commerce.

D. A. Ariyoosu

LL.B, LL.M, Ph.D, PGDE, ACTI, ACIARb, Notary Public

February 2014

Table of Cases

7up Bottling Company Plc v. L.S.I.R.B (2000) 3 NWLR (pt 650) 565.

Aluminum Industries v. Inland Revenue Board (1971) 7 NSCC, 6.

General Sanni Abacha & 3 Others v Chief Gani Fawehinmi (2000) 4 S.C. (Pt II) 1.

National Bellas Hess v. Department of Revenue of the Illinois 386 U. S. 753, 1967.

Quill v. North Dakota 504 U. S. 298, 1992.

The Registered Trustees of National Association of Health Practitioners of Nigeria v Medical and Health Workers Union of Nigeria & Others (2008) 1 S.C. (Pt III) 1.

Table of Statutes

Companies Income Tax Act, *Cap* C21 LFN 2004

Constitution of the Federal Republic of Nigeria 1999 (as amended)

Corrupt Practices and other Related Offences Act No 2 of 2000

Corrupt Practices and other Related Offences Act, *Cap* C31 LFN 2004

Economic and Financial Crimes Commission (Establishment etc) Act, *Cap* E1 LFN 2004

Personal Income Tax Act, *Cap* P8 LFN 2004

Personal Income Tax (Rates etc of Tax Deducted at Source (Withholding Tax)) Regulations 2007

Value added Tax Act, *Cap* V1 LFN 2004

List of Treaties

Avoidance of Double Taxation Agreement between Nigeria and Other Countries

List of Abbreviations

ADTAs:	Avoidance of Double Taxation Agreements
B2B:	Business-to-Business
B2C:	Business to Consumer
CAB:	Consumer Affairs Bureau
CAP:	Chapter
CD:	Compact Disc
CD-ROM:	Compact Disc – Read Only Memory
CFA:	Committee on Fiscal Affairs
DTA:	Double Taxation Agreement
DTAA:	Double Taxation Avoidance Agreement
E-Commerce:	Electronic Commerce
EFCC:	Economic and Financial Crimes Commissi
E-Mail:	Electronic Mail
EU:	European Union
GDP:	Gross Domestic Product
GST:	Goods and Services Tax
ITFA:	Internet Tax Freedom Act
LFN:	Laws of the Federation of Nigeria
MDGs:	Millennium Development Goals
MNE:	Muiltinational Enterprise
MNEs:	Multinational Enterprises
NWLR:	Nigerian Weekly Law Report
OECD:	Organisation for Economic Co-operation an
Development	
UBTI:	Unrelated Business Taxable Income

UK:	United Kingdom
UN:	United Nations
URL:	Uniform Resource Locator
USA:	United State of America
VAT:	Added Tax
WWW:	World Wide Web

Contents

Dedication
Acknowledgements
Foreword
Preface
Table of Cases
Table of Statutes
List of Treaties
List of Abbreviations

1 Introduction 1

2 Fundamentals of Taxation of Electronic Commerce

Neutrality
Efficiency
Certainty and Simplicity
Effectiveness and Fairness
Flexibility

3 Forms of Internet Taxation

Internet Access Tax
Telecommunications Tax
Bit Tax
E-Mail Tax
Bandwidth and Franchise Tax

4 Attributes of Electronic Commerce: Implications for Taxation

Ability to Establish Public and Private Global Communications System
Process of Disintermediation

The Development of Encrypted Information 14
Increased Scope for the Integration of Business Functions 14
Provision of Greater Flexibility 15
Fragmentation of Economic Activity 15

5 Why E-commerce Raises Tax Issues 17
Location 17
Nature of Products 18
New Market Techniques 18
New Types of Assets 19
Remote Workforce 19
Making Optimal Use of the Internet may Challenge Old Rules 19
Nature of Transactions 20

6 Fundamental Principles of Income Taxation *vis-a-vis* Jurisdiction to Tax 21
Source-Based Taxation 21
Residence-Based Taxation 22
Permanent Establishment 23

7 Double Taxation Treaties 25
Goals for Entering into Double Taxation Agreement 26
Avoidance of Double Taxation Agreements (DTAs) between Nigeria and Other Countries 27

8 Value Added Tax on Electronic Commerce 35
Implications of Electronic Commerce for VAT Purposes 35

Supply of Physical Goods to Business or Private Consumers

Supply of Electronic Services to Business Customers

Supply of Electronic Services to Private Consumers 3

9 Global Initiatives for Addressing Taxation of Electronic Commerce 3

Guidelines within the Framework of Organisation for Economic Co-operation and Development 41

The European Union's Approach to Taxation of Electronic Commerce 46

The United Kingdom's Tax Policy and Electronic Commerce 51

The United States' Approach to Taxation of Electronic Commerce 52

10 Implications of Conducting Electronic Commerce on Nigerian Tax 59

Implications of Nigerian Traders Conducting Electronic Commerce with Overseas Customers 59

Implications of a Non-Nigerian Electronic Commerce Trader on Nigerian Tax 61

11 Tax Residence for Tax Purposes 63

Tax Residence in Nigeria for Individuals *vis-a-vis* a Non-Nigerian Electronic Commerce Trader 64

Tax Residence in Nigeria for Companies *vis-a-vis* a Non-Nigerian Electronic Commerce Trader 64

12 Witholding Tax on Electronic Commerce Payments 67
Meaning of Withholding Tax 67
Income Arising from Supply of Digitised Goods over the Internet 67
Lack of Universality in the Procedure for Withholding Tax Deductions 68
Applicability of Regulations on Withholding Tax to E-Commerce 68

13 Challenges to the Taxation of Electronic Commerce 71
Implementation Challenges 71
Enforcement Challenges 79
Feasibility Challenges 91
Normative Challenges 97
Acceptability Challenges 98

14 Conclusion 99

Bibliography 104
Articles in Journals 104
Articles on the Internet 105
Books 108
Chapter in Book 109
Papers Presented at Conferences, Workshops and Seminars 109
Reports and Official Documents 110
Reports and Official Documents on the Internet 110
Long Essay 111
Index 112

1 Introduction

The rapid growth of electronic commerce has generated a lot of issues concerning the taxation of electronic commerce. The gradual shift from a physically-oriented commercial environment to internet-based regime poses serious legal and regulatory issues in relation to taxation regimes. The issue is, whether or not, in view of the glaring fact that internet eliminates borders between parties to internet transactions, taxes of physically-oriented commercial transactions apply to internet-based commercial transactions.

The taxation of e-commerce is a vexatious problem because it is difficult to establish the residence of buyers and sellers or where the transaction took place. The international nature of the internet brings into conflict various issues that used to be treated routinely under domestic law with a level of certainty. The taxable basis of the transaction and the jurisdiction to which it must be submitted will differ according to which domestic law one subjects it to.[1]

---

[1] Mariam Fergusson, 'An Internet Business Framework for Government Agencies' in Syed Mahbubur Rahman & Mahesh S. Raisinghani (eds), *Electronic Commerce: Opportunity and Challenges* (Idea Group Publishing, USA 2000) 375.

The present tax law in Nigeria does not specifically classify electronic commerce transactions neither does it specifically account for electronic commerce transactions. In this respect, therefore, relevant international legal and regulatory regimes shall be of relevance in this book. This book shall examine the fundamentals of taxation of electronic commerce, forms of internet taxation, taxation of electronic commerce as a developing phenomenon, tax residence, double taxation treaties, withholding tax on electronic payments, royalty payments and Value Added Tax on electronic commerce, among others. In the end, it would be determined when an e-commerce trader will be subject to the Nigerian tax and the implication of Nigerian traders conducting commerce with overseas customers.

---

[2] Overview of e-commerce in Nigeria, from the Economist Intelligence Unit' <http://

2 Fundamentals of Taxation of Electronic Commerce

A number of taxation issues have already evolved in conventional commerce, which increasingly banks on new modes of communications and progressively crosses national borders.[3] According to the Taxation Framework Conditions which were delivered at the October 1998 Organisation for Economic Co-operation and Development (OECD) Ministerial Conference,[4] the fundamental principles which should apply to e-commerce are:

Neutrality

Taxation should seek to be neutral and equitable between forms of e-commerce and between conventional commerce and e-commerce, so as to avert double taxation or unintentional non-taxation. Taxpayer in similar situations carrying out similar transactions should be subject to similar levels of taxation. Thus, similar situated taxpayers should be taxed similarly. Vendors selling goods and services online should be treated similarly to 'Main Street' vendors selling

---

[3] Taxation of E-commerce'<http:www.packet-one.com/docsp1/Taxation%20of%20e-commerce%20.pdf>accessed on 09 July, 2011.

[4] 'Electronic Commerce: Taxation Framework Conditions' Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference, 'A Borderless World: Realising the Potential of Electronic Commerce on 8 October, 1998' < http://www.oecd.org/dataoecd/46/3/1923256.pdf>accessed on 12 June, 2011.

the same goods and services and *vice versa.*[5]

Efficiency

Compliance costs for taxpayer and administration cost for the tax authorities should be minimised as far as possible. While the cost of the sales and use tax is actually imposed on the buyer rather than the seller, the compliance burden and price competition presented by the sales tax make this significant tax to vendors. Certainly, the compliance cost of the sales tax may be greater for vendors with consumer and taxable presence (nexus).[6] The tax system should also not impede or reduce the productive capacity of the economy.

Certainty and Simplicity

Similar tax rules should be clear and simple to interpret, so that taxpayers know where they stand. The taxpayer should be able to anticipate the tax consequences in advance of a transaction, including knowing them, where and how the tax is to be accounted. The tax rules should, therefore, clearly specify when tax is to be paid, how it is to be paid and how the amount to be paid is to be determined. Lack of certainty in the tax system reduces the confidence taxpayers have that their tax liability has been computed correctly. The tax law should be simple so as to enable the taxpayer understands the rules and comply with them correctly and in a cost-efficient manner. [7]

---

5 Annette Nellen, 'E-Commerce: To Tax or Not to Tax? That is the Question...Or Not' (Paper presented at Computer and Technology Conference, Software, Networks and E-Commerce, Berkeley Centre for Law & Technology and the University of Texas School of Law, San Francisco, California, 2001). See also <www.cob.sjsu.edu/nellen_a/BoaltUT6-01.pdf>accessed on 15 July, 2011. Similar

6 *Ibid.*

7 *Ibid.*

Effectiveness and Fairness

Taxation should produce the right amount of tax at the right time and the potential for tax evasion and avoidance should be minimised while keeping counter-active measures proportional to the risks involved.[8]

Flexibility

Taxation systems should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.[9] With the emergence of e-commerce, coupled with technological developments, if taxation laws, rules and policies are rigid, it may be difficult to have effective tax systems that will compete with the dynamism in the global technological environments.[10]

As the world is now in the information age where borders are not very important and intangibles and services are gradually becoming an integral part of the Gross Domestic Products (GDPs) more than they were years ago, much work is needed so that tax systems can apply to e-commerce and satisfy the fundamental principles of good tax policy.

---

[8] 'Electronic Commerce: Taxation Framework Conditions' Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference 'A Borderless World: Realising the Potential of Electronic Commerce on 8 October, 1998' < http://www.oecd.org/dataoecd/46/3/1923256.pdf>accessed on 12 June, 2011.

[9] *Ibid.*

[10] Annette Nellen, a tax professor in the College of Business at San Jose State University, identified 10 guiding principles of good tax policy in the context of whether internet commerce should be subject to tax as: Equity and Fairness; Certainty; Convenience of Payment; Economy in Collection; Simplicity; Neutrality; Economic Growth and Efficiency; Transparency and Visibility; Minimum Tax Gap and Appropriate Government Revenue. See Annette Nellen, 'E-Commerce: To Tax or Not to Tax? That is the Question...Or Not' (Paper presented at Computer and Technology Conference, Software, Networks and E-Commerce, Berkeley Centre for Law & Technology and the University of Texas School of Law, San Francisco, California, 2001). See also <www.cob.sjsu.edu/nellen_a/BoaltUT6-01.pdf>accessed on 15 July, 2011.

3 Forms of Internet Taxation

There are many conceptual issues involved in the determination of the form internet taxation should take. The form of internet taxation depends on the nature of services rendered or transaction involved. Forms of internet taxation involve internet access tax, telecommunication tax, franchise tax, bit tax, bandwidth tax and e-mail tax.

Internet Access Tax

Internet taxation may take the form of internet access tax. This normally takes the form of taxation on Internet Service Provider (ISP) access charges. The ISP levies these charges on users. Internet Access Taxes fall within the category of sales taxes and they are considered as service charges.[11]

Internet Access Tax may also take the form of use tax or excise tax levied specially in telecommunications, information services or data processing services. Taxes on internet access apply regardless of whether the tax is imposed on a provider or buyer of internet access. Access charges or tax may also include homepage, electronic mail and instant messaging services tax.[12]

---

[11] 'Internet Taxation – all about it and how it works'< http://e-commerce-journal.com/articles/internet-taxation-all-about-them> accessed on 30 July, 2010.

[12] 'Internet Taxation: Issues and Legislation' <http://wikileaks.org/wiki/CRS-RL33261> accessed on 27 July, 2010.

Telecommunications Tax

There are different methods of accessing the internet fo the purpose of electronic commerce.[13] These differen methods may be subject to different levels of taxatio for a similar service. In this regard, therefore, interne access charges may be treated as telecommunication services, thus subjecting them often to hig telecommunications taxes.[14]

The types of telecommunications which are taxable include, but not limited to, messages or information transmitted through use of local, toll or wide area telephone services; private lines services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications services; specialised mobile radio; stationary two-way radio; paging services; any other form of mobile and portable one-way or two-way communications; and any other transmission of messages or information by electronic or similar means.[15]

A telecommunications tax would be levied on basic telecommunications services as a percentage of the charge to users. The risks are that it would be avoided by displacement of telecommunications companies or by the relocation of their businesses to countries without a telecommunications tax.[16]

---

[13] This could be through regular phone (wired or wireless), cable, satellite e.t.c.

[14] 'Internet Taxation – All About It and How It Works' <http://e-commerce-journal.com/articles/internet-taxation-all-about-them>accessed on 30 July, 2010.

[15] 'TelecommunicationsTax'<http://tax.illinois.gov/Businesses/TaxInformation/Excise/telecommexcise.htm> accessed on 13 July, 2011.

[16] Richard L. Doemberg and Luc Hinnekens, *Electronic Commerce and International Taxation* (Kluwer Law International 1999) 362-363.

Bit Tax

Bit tax is an internet specific tax that has no analog in the offline world. Bit tax does not discriminate between telephony, data, voice, images or other content; it would apply based on the volume of data transferred.[17] It has been held that one possible solution to the question of internet transaction is the bit tax. Bit tax is a tax on every bit of value added data transmitted and collected by telecommunication companies, satellite and cable networks and passed to the relevant treasury. The bit tax would be levied on the number of computer bits transmitted over the internet and received by its user.[18]

There are, of course, problems with bit tax; it could discourage people from using the internet. Bit tax has been opposed on the grounds that it would be an unfair tax as it would not discriminate on the basis of the nature of the data transmitted or the status of the parties involved.[19]

It has been recommended to the European Commission that the European Commission should undertake research to find out whether a 'bit tax' might be a feasible tool in achieving the aim of distributing more equally the benefits of the Information Society between those who benefit and those who lose. The idea is that the 'bit tax' would replace Value Added Tax (VAT) based systems on all information and communication services, with a transmission based tax system, i.e., a system by which the tax is levied as a

---

17 'Internet Taxation – all about it and how it works' <http://e-commerce-journal.com/articles/internet-taxation-all-about-them> accessed on 30 July, 2010. Bit tax has been specifically banned under the U.S. Internet Tax Freedom Act.

18 Richard L. Doernberg and Luc Hinnekens, *Electronic Commerce and International Taxation*, (Kluwer Law International 1999) 360.

19 Swindells C. and Henderson K., 'Legal Regulation of Electronic Commerce <http://www2.warwick.ac.uk/fac/soc/law/elj/jitl/1998-3/swindells/#a2> accessed on 28 July, 2010.

proportion of the 'intensity' of the information o communication transmission. The number of bits or byte is considered as a more representative unit to provide a indication of such transmission intensity than time o distance.

Another reason for proposing to replace Value Added Tax systems by a 'bit tax' system is that it is difficult to assess the possible value of a communication by telephone or modem. The 'bit tax' would not be related to the actua value of a communication.[20]

Ideas for how to use old and new taxes can come up in a variety of contexts and situations. There were reports that Microsoft's security officer offered that one possible way to fund computer security measures was to impose a tax on Internet usage. One solution offered for narrowing the technology gap was to create new funding mechanisms, such as a bit tax or a patent tax. These types of taxes would raise funds from people with the technology and could be used to help provide the benefits to a broader group. While a bit tax might sound like a user pays tax, it has several flaws. First, security issues are not limited to use of the Internet but could appear on software purchased on tangible media.

But bigger problems are with the principles of simplicity, convenience of payment, equity, neutrality and economic growth and efficiency:

- ***Simplicity:*** how would this be assessed? What would be the tax base? Who would collect it? How would it be enforced?

---

[20] 'Introduction of a BIT TAX?'< http://merlin.obs.coe.int/iris/1996/9/article6.en.html>accessed on 17 June, 2011.

- ***Convenience of Payment:*** these types of taxes would need to be assessed as one is incurring the tax, that is, as one is using the Internet. But that is not how things work. If it were added as a percentage of one's monthly Internet access bill, one would know about it when signing up; but if taxed on how much one uses the Internet rather than how much access fees are, one would need a usage metre on the computer (or iPhone, etc.) to know just how much tax is ringing up so as to know if payment is affordable.

- ***Equity*:** a bit tax or Internet usage tax would be regressive as it would not be tied to one's income. Thus, if a low income and high income person each have the same amount of tax, it would represent a larger percentage of the low-income taxpayer's income relative to the higher income taxpayer's income.

- ***Neutrality:*** an Internet usage tax could affect a person's decision on whether or not to use the Internet. Taxes should not play a role in decision-making.

- ***Economic Growth and Efficiency***: businesses, individuals and governments rely more and more on the Internet for operations and information transfer. If the costs go up, it increases them for everyone and might lead to reduced use of the Internet for activities that would provide benefits to many.[21]

[21] Annette Nellen, 'Internet Usage or Bit Tax?'< http://21stcenturytaxation.blogspot.com/2010/03/internet-usage-or-bit-tax.html>accessed on 14 July, 2011.

E-Mail Tax

In an effort to raise funds to boost internet technolog access to poor countries, the United Nation has, in the past considered proposing an e-mail tax. Considering 'knowledge gap' between developed countries such as th United States and underdeveloped countries, proponent of e-mail taxes believe that its potential redistributive effect make it an ideal tax for implementation on a global scale.[2

Bandwidth and Franchise Tax

The concept behind the bandwidth tax is progressivity; i would apply on a graduated scale according to the speed of one's internet connection. On the other hand, franchise taxes are traditionally levied on utilities and cable television operators.[23] The common feature of a franchise tax is tha it is not based on income; rather, the typical franchise tax calculation centres on the 'net worth' of the taxpayer Typically, the number of shares incorporations issue or, in some cases, the amount of their assets is used to make this determination. The purpose of the tax is to raise revenue for the government. On the other hand, governments with higher corporate income taxes usually have low franchise taxes and *vice versa*.[24]

---

22 'Internet Taxation – All About It and How It Works'<http://e-commerce-journal.com articles/internet-taxation-all-about-them> accessed on 30 July, 2010.

23 *Ibid.*

4 Attributes of Electronic Commerce: Implications for Taxation

There are certain characteristic attributes of electronic commerce that have significant implications for taxation. Jeffrey Owens, Head of Fiscal Affairs for the Organisation for Economic Co-operation and Development (OECD), identified six characteristics of the Internet that will influence the operation of tax system, and these are summarised below:

Ability to Establish Public and Private Global Communications Systems

An attribute of e-commerce which has implication for taxation is the ability to establish public and private global communications systems which are secure and inexpensive to operate. The opportunities that this opens up for new forms of commercial activities will not be limited to large companies. Small and medium size enterprises will find it easier to engage in international commerce. Start-up capital requirements on the Internet are typically very low. This, in turn, will lead to a rapid expansion in cross-border activities.

Process of Disintermediation

Another attribute is the process of 'disintermediation' whereby the Internet will eliminate or substantially reduce the need for intermediaries in the sale and delivery of goods and services and in the provision of information. Commerce which uses the Internet requires a small number of distribution, sales representatives, brokers and other professional intermediaries. Already, it is possible for a producer of software to sell and to deliver its products directly to the final consumer. Similarly, an airline company can deliver tickets directly to passengers. Financial and other information may become available without the intermediation of banks and other financial institutions.

The Development of Encrypted Information

The development of encrypted information which protects the confidentiality of the information transmitted on the Internet is another attribute. While it is possible to detect a message sent by one person to another over the Internet, encryption generally precludes understanding the content of the message.

Increased Scope for the Integration of Business Functions

This implies an increased scope for the integration of business functions, e.g., design and production. Private Intranet networks are now widespread in Multinational Enterprises (MNEs). Organisation for Economic Co-operation and Development (OECD) estimated that at least two-thirds of Internet transactions take this form. This development produces a closer integration of

transactions within a Multinational Enterprise and makes it increasingly difficult to separate out the functions carried out by related enterprises.

Provision of Greater Flexibility

The Internet provides greater flexibility in the choice of the organisation form by which an enterprise carries out its international activities.

Fragmentation of Economic Activity

The Internet has led to a fragmentation of economic activity. The physical location of an activity, whether in terms of the supplier, service provider or buyer of goods or user of the service, becomes less important and it becomes more difficult to determine where an activity is carried out.[25]

5 Why the E-Commerce Raises Tax Issues

E-commerce represents a new business model. As such, it creates some challenges to tax systems that were designed with a different model in mind. Some of the key reasons why e-commerce raises tax issues have been identified as follows:[26]

Location

Existing tax systems tend to determine tax consequences based on where the taxpayer is physically located. The e-commerce model enables businesses to operate with very few physical locations. An online vendor can easily sell to customers throughout the world from a single physical location. The e-commerce business model also involves more customised inventories, so storage needs (and thus the need for many physical locations) are reduced. Also, the model involves less vertical integration and more outsourcing – again, fewer physical locations are used by a vendor. Also, some business assets, such as servers, are not necessarily tied to a single physical location but can easily be relocated without any interruption to business

[26] See Annette Nellen, 'Overview to E-commerce Taxation Issues' <http://www.cob.sjsu.edu/facstaff/nellen_a/>accessed 24 July, 2011.

operations. That is, the location of the server is not relevant for business purposes and thus, may not be a logical taxing point.

Nature of Products

E-commerce allows for some types of products, such as newspapers and music CDs, to be delivered in digitised (intangible) form, rather than in tangible form. Digitised products raise issues as to whether sales tax applies and in which state income is generated for state income tax purposes. The nature of products can also raise income tax issues regarding the type of revenue generated and how it is to be reported, as well as whether digitised products are subject to traditional inventory accounting rules.

New Marketing Techniques

The Internet has allowed for new ways of selling and buying goods and services. For example, individuals can offer their unwanted items to a worldwide group of potential buyers via auction sites, such as E-Bay. The Internet can also be used to easily link business buyers and sellers through exchange web sites where buyers post what they have to sell and sellers match up with them or *vice versa*. Such sites can almost operate without human intervention for the matching function. In addition, the Internet has increased the use of bartering, most notably with respect to exchange of web banners that serve as advertisement. These new techniques raise various tax issues at all levels. For income tax purposes, issues include whether an exchange intermediary or broker should be accounting for inventory and what amount of information reporting should be required for low-value bartering transactions and how such

transactions should be valued. Another issue raised by changes or elimination of intermediaries is that some intermediaries collected excise tax. When buyers interact directly with a foreign manufacturer, rather than a domestic retailer, the excise tax may go uncollected.

New Types of Assets

Some of the new assets created by commercial use of the Internet are domain names (Uniform Resource Locators (URLs)) and web sites. For income tax purposes, issues exist as to how to treat the costs of creating or acquiring such assets, as well as the characterisation of any gain or loss generated upon disposition of the asset. Sellers of such assets may face uncertainty in the law as to how to characterise the gain or loss generated from the disposition (capital or ordinary).

Remote Workforce

The workforce of an Internet company may be scattered throughout a state or country rather than working in a single work location together. This can raise issues as to whether the presence of the employee in a particular state creates tax obligations for the employer in that state.

Making Optimal Use of the Internet may Challenge Old Rules

One area where use of the Internet has potentially raised some tax issues involves how some tax-exempt organisations are using the Internet. For example, a tax-exempt organisation might allow donors to be listed on the organisation's Web site. This may cause the entity to face issues as to whether the listing is merely an acknowledgement

or whether it is advertising that may result in unrelated business taxable income (UBTI) for the organisation. Another issue may exist where an organisation that primarily operates on the web, such as a non-profit information exchange, meets the tax definition of a tax-exempt organisation. Also, the Internet may allow for more efficient interactions between a tax-exempt organisation and its donors, yet existing rules were not written with such interactions in mind.

Nature of Transactions

The Internet allows for paperless transactions and the potential for the use of electronic cash. This raises administrative concerns for the tax authority as to whether transactions were properly reported, whether an audit trail exists and whether new reporting rules are needed. The Internet provides new ways for tax administrations to improve the ease and transparency of tax collection. But new technology also raises certain problems. In a world where cyber-transactions are growing at a rapid pace, tax administrations face the challenge of adapting existing tax systems to an economy that increasingly ignores physical borders. In such a world, it will be easier for companies to avoid tax collectors by operating worldwide through web-sites based in jurisdictions that are unwilling to share taxpayer's information.[27]

---

[27] Annette Nellen, 'Overview to E-commerce Taxation Issues' <http://www.cob.sjsu.edu/facstaff/nellen_a/>accessed 24 July, 2011.

6 Fundamental Principles of Income Taxation *vis-a-vis* Jurisdiction to Tax

The most significant issues raised by the advent of electronic commerce for income tax regimes are those relating to jurisdiction to tax and the characterisation of income. Countries generally exercise jurisdiction to tax income on the basis of residence or source. Both of these concepts are likely to become more elusive in the context of electronic commerce. The issue of permanent establishment is also relevant as a fundamental principle of income taxation.

Source-Based Taxation

A source-based approach[28] entitles the source country to tax the income of non-residents that is earned within its borders. Entitlement to tax at source is the bedrock of most international tax treaties, which recognise the right of a jurisdiction to tax all income arising within its borders as a right. This permits a country to share in the gains that are generated in cooperation with its own inputs.[29] The jurisdiction-to-tax difficulties confronting taxing authorities relying on residence-based taxation in the electronic commerce context are equalled if not exceeded by the

[28] Sometimes referred to as a 'territorial approach.'
[29] Subhajit Basu, *Global Perspectives on E-commerce Taxation Law* (Ashgate Publishing Limited, England 2007) 36.

jurisdictional issues confronting taxing authorities relying on source-based principles in asserting jurisdiction to tax income from electronic commerce earned by non-residents.[30]

Residence-Based Taxation

Taxation based on residence is partly grounded on the benefit principle, which means that the taxation should occur in the jurisdiction where the tax payer benefits from the social welfare, infrastructure and other governmental activities paid from the revenue. Under a residence-based system, a country asserts jurisdiction to tax the worldwide income of its residents regardless of source.[31] An individual or corporate taxpayer's residence – whether defined in terms of domicile, place of incorporation or seat of effective management – bears no necessary relationship to the electronic commerce in which the taxpayer engages.

Accordingly, insofar as the jurisdiction is relying on the residence principle as the basis for taxation, taxpayers will enjoy enhanced opportunities in the context of electronic commerce to move income out of high tax jurisdictions into low-tax or no-tax jurisdictions assuming the taxpayer is properly treated as the resident of such a jurisdiction. Although, these opportunities have long existed with respect to conventional commerce, they are magnified in an environment in which the human or legal actors involved

---

30 Walter Hellerstein, 'Electronic Commerce and the Challenge for Tax Administration' (Paper presented at Seminar on Revenue Implications of E-Commerce for Development, Geneva Switzerland, 2002). See also <www.wto.org/english/tratop_e/devel_e/sem05_e/hellerstein.doc> or <http://unpan1.un.org/intradoc/groups/public/documents/un/unpan001065.pdf>accesed on 19 August, 2010.

31 Subhajit Basu, *Global Perspectives on E-commerce Taxation Law*, (Ashgate Publishing Limited, England 2007) 38.

can be largely insulated from the electronic aspects of the relevant transactions.[32]

Permanent Establishment

A Permanent Establishment (PE) is a fixed place of business which generally gives rise to income or value added tax liability in a particular jurisdiction. The term is defined in many income tax treaties and most European Union Value Added Tax systems. The tax systems in some civil law countries impose income and value added taxes only where an enterprise maintains a PE in the country.[33]

A permanent establishment exists where an enterprise has a fixed place of business located in a foreign jurisdiction. The enterprise must carry on business in the Contracting State through a fixed place. The term 'fixed' implies a certain degree of permanence as opposed to temporary. Construction projects, for example, which last for more than twelve months, are considered permanent. This does not imply that businesses need to have duration of longer than twelve months to be deemed permanent. However, if the place where business is conducted is often changed, even a long period of activity does not lead to a permanent establishment.[34]

The concept of a permanent establishment is not limited to a fixed place of business; it may extend to include an agent who is legally separate from an enterprise but

---

32 Walter Hellerstein, 'Electronic Commerce and the Challenge for Tax Administration.' See also 'Taxation in the Age of E-Business, Protecting Revenue, Seizing New Opportunities' <www.acicuda.org/slideshows/e-tax.ppt >accessed on 20 July, 2011.

33 'PermanentEstablishment'<http://en.wikipedia.org/wiki/Permanent_establishment> accessed on 24 July, 2011.

34 'Permanent Establishment'< http://umling.tripod.com/id17.html> accessed on 23 July, 2011.

sufficiently connected and dependent upon the enterprise so that a permanent establishment is implied to exist, through the actions of that agent. The concept of a permanent establishment is intended to be a condition necessary for the taxation of business profits under the residence and source principles.

A permanent establishment is liable to tax on its income and assets by the State in which it is located. This liability to tax is based on the resident principle unless the enterprise has a permanent establishment in another State to which income is attributable. States look for the existence of a permanent establishment as a prerequisite to attach fiscal liability. Treaties look to permanent establishments to allocate the States' right to tax.[35]

The permanent establishment concept is important because it distinguishes between enterprises that are trading with a country and those trading within a country. This is an important distinction since enterprises trading within a country are subject to taxation on the income and assets derived from its physical presence through a permanent establishment. This ensures that business activities will not be taxed by a State unless there is a significant economic relationship between the permanent establishment and the State.[36]

---

[35] *Ibid.*
[36] *Ibid.*

7 Double Taxation Treaties

It is common for a business or individual who is resident in one country to make a taxable gain (earnings or profits) in another. Such business or individual may find that he is obliged by domestic laws to pay tax on that gain locally and again pay in the country in which the gain was made. Because of the inevitable unfairness and inequity generated by the effect of the double taxation, many nations make bilateral double taxation agreement with each other.[37]

Double taxation is the imposition of two or more taxes on the same income, asset or transaction. The mitigating force behind double liability is, therefore, tax treaties between countries. These tax treaties are entered into to avoid double taxation. Double taxation can also happen within a single country.[38] This typically happens when sub-national jurisdictions that have taxation powers and jurisdictions have competing claims.[39]

---

37 'Double Taxation' <http://en.wikipedia.org/wiki/Double-Taxation> accessed on 03 March, 2011.

38 *Ibid.*

39 Nigeria is a Federal State; hence, taxation powers and jurisdictions of each federating unit may be different since each state has residual powers to make tax laws relating to the specific area of its jurisdiction. Therefore, any of the federating units may agree with any other state to enter into double taxation agreement.

Goals for Entering into Double Taxation Agreement

Many countries have agreed with other countries in treaties to limit taxation. Tax treaties tend to reduce taxes of one country for residents of the other treaty country in order to reduce double taxation of the same income. Thus, most tax treaties define which taxes are covered and who is a resident and eligible for benefits. They also reduce the amount of tax withheld from interest, dividends and royalties paid by a resident of one country to residents of the other country. Tax treaties also limit tax of one country on business income of a resident of the other country to that income of a permanent establishment in the first country. Circumstances which income of individuals resident in one country will be taxed in the other country are also defined through tax treaties. In order to prevent or address disputes that may ensue between countries engaging in international trades, tax treaties provide procedural frameworks for enforcement and dispute resolution.[40]

The goals for entering into tax treaties often include reduction of double taxation, eliminating tax evasion and encouraging cross-border trade efficiency. It is generally accepted that tax treaties improve certainty for taxpayers and tax authorities in their international dealings.[41]

In the Nigerian context, if the tax authority declares that arrangements have been made with the government of any country outside Nigeria with a view to affording relief from double taxation in relation to tax imposed on income charged by the Personal Income Tax Act and any tax of a similar character imposed by the laws of the country, by

---

[40] 'Tax Treaty'< http://en.wikipedia.org/wiki/tax-treaty> accessed on 03 March, 2011.
[41] *Ibid.*

the effect of Section 38 of the Personal Income Tax Act, the arrangements shall have effect if it is expedient that those arrangements should have effect notwithstanding anything in the Act. Similar provision is contained in Section 45 of the Companies Income Tax Act.

Avoidance of Double Taxation Agreements (DTAs) between Nigeria and other Countries

Nigeria has an extensive network of double taxation treaties with other countries[42] which seek to prevent a taxpayer from being taxed in more than one jurisdiction upon some benefits or gains. Except for the names of the countries involved, the avoidance of DTA between Nigeria and other countries contain virtually the same contents. However, for ease of reference, avoidance of DTA between Nigeria and United Kingdom of Great Britain shall be cited as an example.

Article 1 of the agreement deals with the personal scope of the agreement. The agreement applies to persons who are residents of either Nigeria or UK.[43] Article 2 covers the taxes covered by the agreement. Thus, in the UK, the agreement covers the Income Tax, the corporation tax, the capital gains tax and the petroleum revenue tax. In Nigeria, it covers the Personal Income Tax, the Companies Income

---

[42] Nigeria has bilateral avoidance of Double Taxation Agreements (DTAs) with the following countries: Belgium, Canada, France, Netherlands, Pakistan, Philippines, Romania, South Africa and United Kingdom of Great Britain. See Avoidance of Double Taxation Agreements (DTA) between Nigeria and Other Countries< www.firs.gov.ng/ DETAILED_COPIES_OF_THE_PUBLISHED_DATA_BETWEEN_ NIGERIA_AND_OTHER_COUNTRIES.doc>accessed on 30 September, 2010.

[43] See also Article 1 of the Agreement between the Government of the Federal Republic of Nigeria and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, made in Brussels on 20th November, 1989; Similar provisions are contained in Article 1 of each of the similar agreements reached by the Federal Republic of Nigeria and Canada, France, Netherlands, Pakistan, Philippines, Romania and South Africa.

Tax, the Capital Gain Tax and the Petroleum Profits Tax.[44] The agreement also applies to any identical or substantially similar taxes which are imposed by Nigeria or UK after the date of signature of the agreement in addition to or in place of existing taxes. It behoves the competent authority of the contracting states to notify each other of any substantive change which has been made in their respective taxation laws.[45]

While Article 3 defines certain words and phrases, in general definitive perspectives, Article 4 makes comprehensive provision for Fiscal Residence. It defines resident of a contracting state as:

> Any person who, under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature.

However, where an individual is a resident of both Nigeria and UK, then he shall be deemed to be a resident of the state in which he has a permanent home available to him but if he has permanent home in both states, he shall be deemed to be a resident of the state with which his personal and economic relations are closer (that is centre of vital interest).

---

[44] See also Article 2 of the Agreement between the Government of the Federal Republic of Nigeria and the Governments of the Kingdom of Belgium, Canada, France, Netherlands, Pakistan, Philippines, Romania and South Africa.

[45] In Nigeria, the term 'Competent Authority' in relation to Avoidance of Double Taxation Agreements is the Minister of Finance or his authorised representatives. Each of the contracting states has its own competent authority. In Belgium, the competent authority is also the Minister of Finance or his authorised representative; in Canada, he is the Minister of National Revenue or his authorised representative; in France, he is the Minister in charge of the Budget or the authorised representative; in Netherlands, the competent authority is Minister of Finance just like Nigeria or his authorised representative while in Pakistan, it is the Central Board of Revenue or its authorised representatives. In Philippines, the competent authority is the Secretary of Finance or his authorised representatives while in South Africa, it is the Commissioner for the South

If, however, the state in which he has his centre of vital interest cannot be determined, he shall be deemed to be a resident of the state in which he has a habitual abode. If he has a habitual abode in both states or in neither of them, he shall be deemed to be a resident of the state of which he is national. However, if he is a national of both states or of neither of them, the competent authorities[46] of both states shall settle the question by mutual agreement. Where a person other than an individual is a resident of both countries, then the competent authorities of both countries shall settle the question by mutual agreement.[47]

Article 5 makes extensive provision for permanent establishment. It defines the term 'permanent establishment' as it relates to the agreement and what the term does not entail. It defines permanent establishment to include a fixed place of business used as sales outlet.[48] However, the term does not include:

- the use of facilities solely for the purposes of storage, display or delivering goods or merchandise belonging to the enterprise;
- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivering;

Africa Revenue Services or his authorised representatives. In the UK, it is the Board of Inland Revenue or its authorised representatives. See generally the General Definition Article in each of the Avoidance of DTA between Nigeria and each of these countries.

46 *Ibid.*

47 Agreement between the Government of the Federal Republic of Nigeria and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains. See also Article 4 (3) of the Avoidance of DTA between the Government of the Federal Republic of Nigeria and the Governments of Belgium, Canada, France, Netherlands, Pakistan, Philippines and South Africa.

48 *Ibid,* Article 5 (4).

- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise; and
- the maintenance of a fixed place of business solely for the purposes of carrying on for the enterprise any other activity of a preparatory or auxiliary character.[49]

Article 6 deals with taxation of income from immovable property of the contracting state. Immovable property in this sense has the meaning ascribed to it under the law of the contracting state in which the property in question is situated. The provision applies to income derived from the direct use, letting or use of any other form of immovable property. It also applies to income from immovable property of an enterprise and that which is used for the performance of independent personal service.[50]

Article 7 is on taxation of business profits of enterprises of the contracting states while Article 8 talks about tax exemption in respect of profits and gains derived from the operation of ships and aircraft in international traffic.[51]

---

[49] *Ibid,* Article 5 (3). The term has also been defined in Article 5 (1) to include especially a place of management; a branch; a factory; a workshop; a mine; an oil or gas well, a quarry or any other place of extraction of natural resources; a building site or construction or assembly project which exists for more than three months; the provision of supervising activities for more than three months on a building site or construction or assembly project; and installation to the sale of machinery or equipment where the charges payable for such activities exceed 10% of the free on board sale price of the machinery or equipment.

[50] Income derived from immovable property in this sense includes income derived from agriculture or forestry situate in the other contracting state.

[51] Thus, the profits of an enterprise of a contracting state are taxable only in that state unless the enterprise carries on business in the other contracting state through a permanent establishment situated therein.

While Article 9 is concerned with taxation of profit of associated enterprises, Article 10 is on taxation of dividend derived from a company which is a resident of a contracting state by a resident of the other contracting state. Thus, where a company which is a resident of a contracting state derives profits or income from the other contracting state, that other state may not impose any tax on the dividends paid by the company and beneficially owned by persons who are not residents of the other state or subject to the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in that other state.[52]

Article 11 and 12 discuss taxes on interest arising in a contracting state and paid to a resident of the other contracting state[53] and royalties arising in a contracting state and paid to a resident of the other contracting state respectively.[54]

Subject to the provision of Article 8 of the agreement, which exempts a resident of a contracting state to pay tax in the other contracting state in respect of profits or gains derived from the operation of ships and aircraft in international transport, Article 13 allows a contracting state to tax capital gains in accordance with the provisions of its

---

[2] However, the provision of Article 10 does not apply if the right giving rise to the dividends was created or assigned mainly for the purpose of taking advantage of the Article and not for bona fide commercial reasons.

The word 'internet' is defined in Article 11 to mean income from debt claims of every kind whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profit.

The word 'royalties' in Article 12 means payment of any kind received as consideration for the use of, or for the right to use, any copyright of literacy, artistic or scientific work, including cinematography films and films or tapes used for radio and television broadcasting; any patent, trademark, design, model, plan, secret formula or process or for the right to use industrial, commercial or scientific equipment.

domestic law.[55] Article 14 provides for taxation of independent personal services. Thus, any income derived by a resident of a contracting state in respect of professional services[56] or other independent activities of a similar character is taxable only in the state unless he has a fixed base regularly available to him in the other contracting state for the purpose of performing his activities, in which case so much of the income may be taxed in that other contracting state as is attributable to that fixed base.[57]

Articles 15, 16, 17 and 18 border on taxes on dependent personal services, director's fees, artists and athletes and pensions and amenities respectively. Article 19 provides for taxes on remuneration on government service. Thus, remuneration other than pension paid by a contracting state or political sub-division or a local authority thereof to an individual in respect of service rendered to that state or sub-division or authority is taxable only in that state, except if the services are rendered in that other state and the individual is a resident and a national of that state.[58]

Articles 20, 21 and 22 exempt students, trainees and teachers from double taxation in respect of education, training, study or research. Article 23 prevents subjecting nationals of a contracting state to taxation more than the taxation to which nationals of the other contracting state in

---

55 Capital Gains Tax accrues on an actual year basis and it pertains to all gains accruing to a taxpayer from the sale or lease or other transfer of proprietary rights in a chargeable asset which are subject to a capital gains tax of 10%. Such chargeable assets may be corporeal or incorporeal and it does not matter that such asset is not situated in Nigeria. However, where the taxpayer is a non-resident company or individual, the tax will only be levied on the amount received or brought into Nigeria.

56 The term 'Professional Services' is defined in the Article to include especially independent scientific, literary, article, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

57 It appears that other professionals performing independent activities are also within the purview of the Article, rendering professional services.

58 This provision does not, however, apply to pension.

the same circumstances are or may be subjected.[59] Article 24 is on mutual agreement procedure while Article 25 makes provision for exchange of information between the contracting states through their respective competent authorities.

Article 26 provides for inapplicability of the agreement to fiscal privileges of diplomatic agents and consular officials under the general rules of international law or under the provisions of special agreement[60] while Article 17 provides for the need of each of the contracting state to notify the other contracting state of the procedures required by its law for the bringing into the completion of the agreement.[61] Article 28 is the concluding Article and deals with termination of the agreement. Although, the agreement was signed on 9th day of June 1987[62] and remains in force indefinitely, either contracting state may terminate it through the diplomatic channel by giving notice of termination to the other contracting state at least six months before the end of any calendar year.[63]

The situation as it stands is that on international level, income from e-commerce is taxed under the various double tax conventions which may or may not be based upon the

---

[59] 'Taxation' in this Article means taxes of every kind and description.

[60] An individual who is a member of the diplomatic, consular or permanent mission of contracting state or any third state which is situated in the other contracting state and who is subject to tax in that other state only if he derives his income from source therein, shall not be deem to be resident of that other state.

[61] Article 27 (a) and (b).

[62] The Nigerian Avoidance of DTA with Belgium was made on 20th November, 1989; Canada on 4th August, 1992; Netherlands on 11th December, 1991; Pakistan in 10th October, 1989; Philippines on 30 September, 1997 and Romania on 21st July, 1992.

[63] It is hoped that the terms of the agreements would be respected by all contracting states.

OECD Model.[64] Several governments and organisations have proposed model treaties to use as starting points in their own negotiation. The OECD model treaty is often used as such a starting point. It is, therefore, hopeful that since Nigeria has also entered into avoidance of double taxation agreement, cross-border trade efficiency would be encouraged and there would be improvement in certainty for taxpayers and tax authorities in their international dealings.

8 Value Added Tax on Electronic Commerce

The Nigerian law does not make specific provisions for Value Added Tax (VAT) on electronic commerce. However, because of the borderless nature of electronic commerce, what obtains in the international environment shall be of a guide in determining what will be VAT on e-commerce. Where goods or services are supplied to an e-commerce customer whether the business is obliged to account for VAT will depend upon whether the supply is of goods or services, where the supply is treated as made.

Implications of Electronic Commerce for VAT Purposes

The implications of e-commerce for VAT purposes can be examined in the context of three types of transaction and these are:

- supplies of physical goods to business or private consumers;
- supplies of electronic services to business customers; and
- supplies of electronic services to private consumers.[65]

[65] 'Taxation of e-commerce' <http://www.out-law.com/page-7512 accessed on 03 March, 2011.

Supply of Physical Goods to Business or Private Consumers

Supplies of physical goods are generally deemed to be made in the place where the goods are located when they are dispatched. Where, however, the goods are merely ordered using electronic communications, this will not affect the way in which they are treated for VAT purposes. The location of goods and therefore their place of supply for VAT purposes will not be altered by internet ordering.[66]

Supply of Electronic Services to Business Customers

Supplies of digitised products are treated as supplies of services rather than goods. Individuals receiving supplies in a personal capacity are treated as belonging to where they have their usual place of residence and businesses are treated as belonging to where they have a business or fixed establishment which has the benefit of the service.[67]

Supply of Electronic Services to Private Consumers

Private consumers will generally not be registered for VAT and, therefore, it would be impracticable to require them to account for VAT.

The place of taxation with respect to goods is determined upon the physical location of the goods concerned regardless of where the parties reside. The meaning of a supply of goods has received judicial

---

[66] *Ibid.*
[67] *Ibid.*

consideration. It has been held that supply for such purposes in relation to goods from one taxable person to another, either immediately or at a future date, implies the existence of the goods at such time of transfer.[68]

[68] Theotrue case cited in Subhajit Basu, Global Perspectives on E-commerce Taxation Law (Ashgate Publishing Limited, England 2007) 71.

9 Global Initiatives for Addressing Taxation of Electronic Commerce

Electronic commerce has the potential to be one of the greatest economic developments of the 21st century. It provides a fundamentally new way of conducting commercial transactions. It has potentially far-reaching economic and social implications on many facets of life including the environment, the nature of work and the role of governments. The economic distance between producers and consumers shrinks; new products and markets will be created; traditional intermediaries are being replaced and new and far closer relationships will be forged between businesses and consumers and between the different parts of global enterprises. Revenue authorities have a role to play in realising this potential. There is, at least on the general conceptual level, a wide consensus about the need for such a set of higher tax principles and even about their general identification. While much of the attention on e-commerce taxation is focused on state sales and use tax, a lot of work is being done on the international income taxation of e-commerce.[69]

---

[69] Nikitas A. Assimakopoulos, George K. Kotsimpos, Anastasios N. Riggas, 'International E - Taxation of E - Commerce using Systemic Analysis' <http://www.afscet.asso.fr/resSystemica/Crete02/Assimakopoulos, Kotsibos,Riggas.pdf>accessed on 23 July, 2011.

E-commerce has become a hot topic for researchers and policy makers over the years. It has really posed some significant problems for them. This new phenomenon of contractual relationships between unknown buyers and sellers, whose only common link is the e-platform which offers them facilities of their interaction, has really rendered obsolete the concept of 'identity of parties' in contractual law terms. But nonetheless, the system is thriving fast, laws or no-laws to govern it and is fast becoming the norm for both business and individual transactions worldwide.

This has also led to the problem of taxation (though some consider that tax is a problem in itself) of such transactions which take place through the electronic medium and thus are not only hard to trace but also hard to take into account and apply the traditional jurisdictional-based regimes of taxation of such transactions and the income derived therefrom.

The first and foremost approach towards dealing with such situations can be attributed to the Ottawa Conference on Electronic Commerce (1998) organised at the behest of Organisation for Economic Co-operation and Development. While the Conference as such was one simply focusing on e-commerce and the re-thinking required to be done in the legal arena in regard to this emerging area was not one specifically meant to shape the principles or policy basis for taxing such transactions, nonetheless, the outcome of the Conference did shed some light on that aspect as well.[70]

---

[70] 'Taxation of E-commerce: Traversing the Principles Route' <http:// legalperspectives.blogspot.com/2008/02/taxation-of-e-commerce-traversing.html> accessed on 10 July, 2011.

Taxation of e-commerce has become a major concern to the international environment. It is instructive to note that the Organisation for Economic Co-operation and Development (OECD), the European Union (EU) and the American, Australian and Canadian governments, among others, have issued reports identifying the critical issues raised by the advent of electronic commerce for the world's taxing regimes and they are engaged in ongoing efforts to address those issues. In some cases, they have even proposed tax policies on Internet commerce. Nigerian tax authorities are yet to make any such definitive move in this respect.[71] In this regard, the OECD guidelines, UK, European Union and American approaches to taxation of e-commerce shall be examined.

Guidelines within the Framework of Organisation for Economic Co-operation and Development (OECD)

In 2010-2011, the OECD celebrated its 50th anniversary. Over the last half-century, the OECD has demonstrated its ability to act as a forum in which both member and non-member countries can work together to share experiences and seek solutions to common problems, including in the tax area.[72] The OECD countries agreed to work on ways in which countries can improve their VAT relief methods and procedures while ensuring that there are proper safeguards against fraud. As a first step, draft guidelines on neutrality were published on the OECD website in December 2010 for public consultation. These guidelines are based on three main principles:

---

[71] Oduntan Olugbemi Adebayo, 'Taxation of Electronic Commerce: Prospect and Challenges for Nigeria' (LL.B Long Essay, University of Lagos, Nigeria 2010) 48-49.

[72] Alain Charlet and Stéphane Buydens, 'The OECD's Draft Guidelines on Neutrality for Value Added Taxes' (2011) 61(6) *Tax Notes International*, 443.

- foreign businesses should be neither disadvantaged nor advantaged compared with domestic businesses in the jurisdiction where VAT is due or paid;
- governments may choose from a number of approaches to implement this principle in practice; and
- when specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden.[73]

Taxation of e-commerce has become a major concern for international agencies and tax authorities worldwide. In Europe, North America and Australia and in many Asian countries, substantial research has been conducted on the impact of e-commerce on taxation. Among the plethora of books, reports, articles and papers produced on the topic, the work of OECD stands out as the most significant. The theme underlying throughout OECD work done is that government is to successfully meet the challenges posed by e-commerce for taxation systems and a global co-ordinated approach is required to tax a truly global phenomenon.[74]

In November 1997, the OECD organised a joint government and business conference in Turku, Finland entitled "Dismantling the Barriers to Global Electronic Commerce"; the title which underscored the OECD's overall approach. A key principle overlaying all the OECD's work on electronic commerce is the creation of an

---

[73] *Ibid*, 444.

[74] Dayana M. K, 'E-commerce and Taxation' <http://articles.manupatra.com/PopOpenArticle.aspx?Id=f3c75cea-57c1-4b7e-a881-3c5a339eddc7&txtsearch=> accessed on 10 July, 2011.

environment in which electronic commerce can develop its full potential. For tax, this has required a fiscal environment that strikes a balance between development of electronic commerce and the need to secure the revenue base on which so much government expenditure is based. The Ottawa OECD Ministerial Conference in 1998 'A Borderless World – Realising the Potential of Electronic Commerce', which brought together OECD and non-OECD governments and the business community, furthered this through the adoption of the Ottawa Taxation Framework Conditions, which included a set of broad taxation principles that should apply to e-commerce.[75]

The OECD, with its long history of developing practical solutions to international tax regimes, has reacted to taxation of electronic transactions and by 1998, it had agreed the Ottawa Taxation Framework Conditions. These set out a number of principles that governments should adopt in their approach to taxation of electronic commerce. Since 1998, the work of the OECD's Committee on Fiscal Affairs (CFA) has continued to develop these principles into practical guidance for international application. In particular, the OECD established Working Parties in an attempt to craft an international tax policy.

The OECD has prescribed certain guidelines that governments should consider in formulating new provisions for the regulation of taxation of e-commerce. These guidelines are summarised as follows:

- the technologies underlying e-commerce offer governments significant new opportunities to improve

[75] 'Implementation of the Ottawa Taxation Framework Conditions' <http://www.oecd.org/dataoecd/45/19/20499630 >accessed on 22 July, 2011.

taxpayer service, and that those opportunities should be pursued;

- taxation principles that guide governments in relation to conventional commerce should quite properly guide governments in relation to e-commerce: those principles being neutrality; efficiency; certainty and simplicity; effectiveness and fairness, and flexibility;[76]
- taxation principles can be implemented for e-commerce through existing tax rules with some adaptation of the existing tax rules;
- there should be no discriminatory tax treatment of e-commerce;
- application of the taxation principles should maintain fiscal sovereignty of countries, ensure a fair sharing of the tax base between countries and avoid double and unintentional non-taxation;
- the process of putting flesh on these principles should involve intensified co-operation and consultation with economies outside of the OECD area, with business and with non-business taxpayer groups, and
- when required, government intervention should be proportionate, transparent, consistent and predictable, as well as technologically neutral.[77]

The OECD proceeded to implement the taxation framework by establishing five Technical Assistance Groups (TAGs)

---

[76] See discussion on these principles in Chapter Two (supra).

[77] Richard Jones and Subhajit Basu, 'Taxation of Electronic Commerce: A Developing Problem' (Paper presented at 16th BILETA Annual Conference, 2001) 8. See also http://www.bileta.ac.uk/01papers/rjones.html> accessed on 16 December, 2009.

in January 1999 for two years to allow them time for a thorough consideration of all the issues. These comprise government officials from OECD as well as non-OECD states and representatives of the international business community. [78]

In its latest progress report on the Implementation of the Framework conditions, the OECD's Committee on Fiscal Affairs confirms that the most frequently quoted principle during the analysis has been that of neutrality of taxation between electronic commerce and conventional commerce. However, it has also noted that this principle may be breached if the taxation of e-commerce continues to be studied in isolation to international tax issues impacting conventional commerce.[79]

In 2003, the OECD's Consumption Tax Technical Advisory Group (TAG) released a report on e-commerce implementation issues[80] which considered two further issues high on the political agenda. These further issues are the potential for double taxation or non-taxation as a result of conflicting place of supply rules, conflicting definitions, conflicting tax results arising from differences in verification requirements between jurisdictions and incompatible approaches to 'bundling' issues.[81] That report identified different approaches which have been taken by countries to the taxation of cross-border services and intangibles in national tax systems.[82] The emerging international view

---

[78] *Ibid.*

[79] Graham J. H. Smith, *Internet Law and Regulation* (4th Ed. Sweet & Maxwell, London, 2007) 1036.

[80] OECD 'Implementation Issues for Electronic Commerce'<www.oecd.org/dataoecd/38/42/5594899.pdf>accessed on 20 July, 2011.

[81] That is where an e-commerce supply involves a number of different elements.

[82] Graham J. H. Smith, *Internet Law and Regulation* (4th Ed. Sweet & Maxwell, London, 2007) 1036.

is that such different approaches have increased the potential for double taxation and unintentional non-taxation, not just for e-commerce but in the broader context of international trade in services and intangibles where consistency between countries is increasingly essential.[83] Consequently, focusing on e-commerce issues as a separate category of services alone may mean that issues affecting other internationally traded services will be missed out or lead to further international conflicts. It has appeared, therefore, that the OECD[84] is adopting a more holistic approach to taxation rather than on specific aspects of e-commerce.[85]

The international view is that the OECD Framework Conditions will remain valid as they broadly reflect the philosophies and policy goals of existing tax rules in most countries. However, the Framework Conditions and related work on e-commerce are now being incorporated into the committee's mainstream work on international commerce issues.[86]

The European Union's Approach to Taxation of Electronic Commerce

The European Union (EU) E-Commerce Directive provides that for electronically delivered services, the supply will be treated as being made in the EU if the recipient belongs there. Supplies to EU member state recipient will, therefore, be subjected to the state's VAT regardless of where the supplier belongs.[87]

---

[83] *Ibid,* 1037.

[84] Through its committee on Fiscal Affairs.

[85] This does not, however, mean that the Framework Conditions are no longer relevant although they were designed in the context of e-commerce.

[86] Graham J. H. Smith, *Internet Law and Regulation* (4th Ed. Sweet & Maxwell, London, 2007) 1037.

[87] New European E-Commerce VAT Rules <http://www.fdcpa.com/VAT.rules.htm> accessed on 03 March, 2011.

It is submitted that since there is no specific legal framework for VAT on e-commerce in Nigeria, the position stated in the EU Directive can be served as a guide to VAT on e-commerce in Nigeria. More importantly, the VAT rules for non-EU suppliers selling to customers in the EU will remain unchanged, with the VAT paid by the importing company under self-assessment arrangements.[88] Reference to EU Directive as a guide is an important factor for consideration in taxation of e-commerce generally and VAT on e-commerce specifically.

This is because EU is the first significant tax jurisdiction in the world to develop and implement a simplified framework for consumption taxes on e-commerce in accordance with the principles agreed within the framework of the Organisation for Economic Co-operation and Development (OECD). The Directive, therefore, complements the international process of OECD.[89]

In 1999, the European Commission issued a Working Paper to revise the current tax rules of the VAT Directives for both goods and services, regardless of the medium through which these items are sold. The paper also recognised the need to apply existing taxation rules effectively. It acknowledged that VAT procedures tend to be complex and the delays in obtaining refunds of VAT

---

[88] 'VAT on E-Commerce' <http://www.expartax.nl/vatecommerce.htm> accessed on 03 March, 2011. Note that the OECD principles on the taxation of e-commerce were agreed at a 1998 conference in Ottawa. These principles establish that the rules for consumption taxes (such as VAT) should result in taxation in the jurisdiction where consumption takes place. See generally OECD Electronic Commerce: Taxation Framework conditions, A Report by the committee on Fiscal Affairs as presented to Ministers at the OECD Ministerial Conference, 'A Borderless World: Realising the Potential of Electronic Commerce' (Ottawa, 1998).

[89] 'VAT on Electronic Services'<http://ec.europa.eu/taxation_customs/taxation/vat/traders/e-commerce/index_en.htm> accessed on 22 July, 2011.

paid in other member states are major disincentive to cross-border trade.[90]

In June 2000, the European Commission presented a proposal for a directive to modify the rules for applying VAT to certain services supplied by electronic means as well as subscription-based and pay-per-view radio and television broadcasting. The objective of the proposal is to create a level playing field for the taxation of digital e-commerce in accordance with the OECD principles. The proposal mainly concerns the supply over electronic networks of software and computer services generally. The proposal would ensure that when these services are supplied for consumption within the European Union, they are subject to EU VAT but when these services are supplied for consumption outside the European Union, they are exempted from VAT.[91]

In 2002, Council Directive 2002/38/EC on the VAT arrangements applicable to radio and television broadcasting services and certain electronically supplied services was adopted on 7 May, 2002 and entered into effect on 1 July, 2003. Effective July, 2003, the European Union's directive on electronic communications requires all non-EU companies selling digital goods and services online to consumers within the EU to register with an EU tax authority and charge, collect and remit VAT. Non-resident businesses can register under an interim 'special scheme' arrangement with one EU member state, which will operate a form of clearinghouse to ensure each EU member state receives

---

[90] Richard Jones and Subhajit Basu, 'Taxation of Electronic Commerce: A Developing Problem' (Paper presented at 16th BILETA Annual Conference, 2001) 8. See also http://www.bileta.ac.uk/01papers/rjones.html> accessed on 16 December, 2009.

[91] *Ibid.*

its appropriate amount of VAT due to it. After remittance, the member state will redistribute the VAT to the appropriate EU countries in which the digital goods and services were sold.[92]

In 2006, Council Directive 2006/58/EC was adopted on 27 June, 2006; Council Directive 2006/138/EC was adopted on 19 December, 2006 and Council Directive 2008/8/EC was adopted on 12 February, 2008. These VAT arrangements were extended until 31 December, 2009. As far as electronically supplied services are concerned, Council Regulation (EC) 792/2002 temporarily amending Regulation (EEC) 218/92 on administrative co-operation in the field of indirect taxation (VAT) subsequently included in Regulation (EC) 1798/2003 introduces additional measures necessary for the registering for VAT purposes of e-service traders not established within the Community and for distributing the VAT receipts to the Member States where the services were actually used. Under these new rules, EU suppliers are no longer obliged to levy VAT when selling on markets outside the EU, thereby removing a significant competitive handicap. Previously under tax rules drawn up before, EU suppliers had to charge VAT when supplying digital products even in countries outside the EU.[93]

The changes eliminate an existing competitive distortion by obliging non-EU suppliers to charge VAT as EU suppliers when they are providing electronic services to EU non-taxable persons, something which EU businesses had been actively seeking for some time. The VAT rules for non-EU

---

92 Oduntan Olugbemi Adebayo, 'Taxation of Electronic Commerce: Prospect and Challenges for Nigeria' (LL.B Long Essay, University of Lagos, Nigeria 2010) 53.

93 'VAT on Electronic Services' <http://ec.europa.eu/taxation_customs/taxation/vat/traders/e-commerce/index_en.htm> accessed on 22 July, 2011.

suppliers selling to customers in the Union remain unchanged, with the VAT paid by the importing company under reverse charge arrangements.

It follows from Directive 2008/8/EC that the rules introduced by the Directive 2002/38/EC would be extended from 1st January, 2010 as a permanent measure. This Directive also provides that VAT on telecommunications, radio and television broadcasting and electronic services supplied by a supplier established within the Community to non-taxable persons also established within the Community will be charged in the Member State where the customer belongs from 1st January, 2015.[94]

According to the European Union, therefore, the existing rules do not adequately address the supply of services delivered online by digital means, notably as regards such services traded between EU and non-EU countries since they were not envisaged at the time the current legislation was established. As a result, application of the current tax rules to electronically delivered services produces discriminatory results.

In summary, even though the European Commission hopes to be able to tax trade in digitised goods, it is likely that a substantial part of the sales of such goods will escape taxation. For physical goods, however, the EU seems on a more promising track with the main revenue problem being one of redistribution among the member states.[95]

---

[94] *Ibid.*

[95] Oduntan Olugbemi Adebayo, 'Taxation of Electronic Commerce: Prospect and Challenges for Nigeria' (LL.B Long Essay, University of Lagos, Nigeria 2010) 55.

The United Kingdom's Tax Policy and Electronic Commerce

In October 1998, the former UK Inland Revenue and Her Majesty (HM) Customs and Excise published a joint paper on tax policy regarding e-commerce. Not surprisingly, the paper was almost identical in content with that of the OECD Framework Conditions. In April 2005, the Inland Revenue and Her Majesty's Customs and Excise merged departments to become 'Her Majesty's Revenue & Customs.' Following the merger, the UK's 1998 joint paper regarding e-commerce has been withdrawn but as an active contributor to the development of international tax policy, the UK has continued to support and implement into its own tax regime the approaches taken by the OECD and EU on taxation of e-commerce.

So, on purely domestic level, UK tax policy seeks to promote the OECD Framework Conditions, particularly the principle of neutrality to ensure that UK residents conducting business via the internet in the UK are taxed in the same way as persons running a traditional, physical business.[96]

In the UK, taxes are imposed on the worldwide income of any person tax resident in the UK or on income arising in the UK of any person not resident in the UK. The starting point is that a company incorporated in the UK is a UK tax resident, although it may instead be treated as being tax resident in another jurisdiction under the terms of a relevant tie-breaker provisions in a double taxation treaty with such jurisdiction. A company incorporated outside the UK may, however, also be UK tax resident if it is 'centrally managed

[96] Graham J. H. Smith, *Internet Law and Regulation* (4th Ed. Sweet & Maxwell, London, 2007) 1037-1038.

and controlled' from the UK; and this is also subject to the provisions in a double taxation treaty. [97]

The United States' Approach to Taxation of Electronic Commerce

In the US, the challenges posed by taxation of electronic commerce have constitutional as much as technical connotations. Design and operation of federal, state and local taxes must be within various constitutional parameters. Thus, state and local taxes can be struck down if they impede interstate commerce in violation of the Commerce Clause of the U.S. Constitution. Hence, efforts have been directed at these through the harmonisation of legal, constitutional and technological approaches.[98]

The US does not have a VAT but rather has sales taxes imposed by most but not all states and by many local governments. Sales taxes paid by the consumers are collected by merchants. The problem comes when a business is not physically located in a State but sells to residents of that State.[99] The controversy surrounding Internet taxation resulted from court decisions that exempted from taxes mail order sales to out-of-town residents. In two landmark court cases of *National Bellas Hess v. Department of Revenue of the State of Illinois*[100] and *Quill v. North Dakota*[101], the U.S. Supreme Court concluded that requiring merchants to calculate, collect and remit the appropriate tax to the appropriate authorities would constitute an undue

---

[97] 'Taxation of E-commerce' http://www.out-law.com/page-7512 accessed on 03 March, 2011.
[98] *Ibid.*
[99] *Ibid.*
[100] 386 U.S. 753, 1967.
[101] 504 U.S. 298, 1992

burden because of the approximately 35,000 state and local tax rates in effect. The Court decided that merchants were only required to collect sales taxes from customers that reside in a state where the merchant had a 'nexus'.[102]

The Supreme Court's decisions effectively absolved merchants of their responsibility for tax collection on out-of-state sales but responsibility for the remittance of the tax remained for consumers. Most states require the remittance of 'use' taxes for goods bought from out-of-state vendors. The rate of these use taxes was usually identical to the state sales tax rates for goods sold within the state. It was the responsibility of individual consumers to report to their state governments how much tax they owed and pay accordingly.

While use taxes provided governments with a legal basis to collect revenue on out-of-state purchases, such collection rarely occurred. Compliance with use tax was very low, as most consumers were unaware that they were required to pay them. Few states attempted to collect them from individual consumers. States that took measures to collect use taxes met with little success.

Several states, such as New Jersey, had a separate line for use taxes on residents' income tax forms. In 1997, less than 1% of New Jersey residents reported use taxes. Although, the inability to collect use taxes on catalog sales had not led to new tax legislation, the rise of the Internet significantly changed perceptions about the scale of purchases potentially free from state and local taxes. As more transactions migrate to the web, state and local governments fear a substantial erosion of their tax bases.[103]

[102] A nexus, loosely defined, is a physical presence, such as a warehouse or retail outlet,

Fears of dwindling revenues were accompanied by the concerns of off-line main street merchants who felt that the tax advantage of online stores gave them a significant advantage. These issues led to the introduction of bills in several state legislatures, all of which were aimed at providing some form of tax collection on online sales at least from their own residents. On-line merchants, however, argued that they had to bear delivery costs, which, as with catalog sales, offset the tax exclusion. The online merchants also argued that they did not use state resources other than for delivery and hence should not be required to pay state taxes.

While state and local governments were clamouring for action, the federal government was effectively putting on the brakes. The Internet Tax Freedom Act (ITFA) 1998, introduced in Congress by Representative Christopher Cox and Senator Ron Wyden, was passed as part of the Omnibus Appropriations Act of 1998. Placing a three-year moratorium on new Internet taxes, the ITFA also created the Advisory Commission on Electronic Commerce in April 2000.[104]

The Advisory Commission presented to congress the results of its 10-month study of taxation and internet issues. The proposal of the Commission includes:

- extending the current moratorium on Internet taxes for five years;
- prohibiting the taxation of digitised goods and products and their non-digitised counterparts;
- banning all taxes on internet access;
- abolishing the federal excise tax of three percent on telephone calls;

---

[104] 'Internet Taxation'<https://gsbapps.stanford.edu/cases/documents/P36.pdf>accessed on 10 July, 2011

- encouraging state and local governments to reform industry-specific telecommunications taxes;
- establishing firm 'nexus' rules for electronic commerce to make it clear when state and local governments could levy taxes on vendors of interstate commerce;
- encouraging state and local officials to work together to simplify their sales tax collection systems and make them more uniform; and
- establishing a new Advisory Commission to monitor the ongoing efforts and to determine whether states and localities should be allowed to collect taxes on out-of-state Internet vendors once tax code simplification code is complete.[105]

The commission's proceedings helped widen public awareness of the issue and provided an exceptional framework for debating complex tax issue.[106]

In November 2001, new legislation was passed to extend the moratorium introduced by the 1998 ITFA for a further two years and in November 2003, the US House of Representatives passed the Internet Non-Discrimination Bill, a piece of legislation designed to permanently extend the moratorium. The Bill was, however, not approved by the US Senate and a compromise Bill was subsequently passed in December 2004 which extended the moratorium by four years.[107]

---

[105] Richard Jones and Subhajit Basu, 'Taxation of Electronic commerce: A Developing Problem' (Paper presented at 16th BILETA Annual Conference, 2001) 8. See also http://www.bileta.ac.uk/01papers/rjones.html> accessed on 16 December, 2009.

[106] *Ibid.*

[107] Graham J. H. Smith, *Internet Law and Regulation* (4th Ed. Sweet & Maxwell, London, 2007) 1038.

While the US government strives to evolve appropriate methods for taxing e-commerce,[108] consumers and technology vendors largely take opposite view. They view that there should be no new internet taxes. The Internet Tax Fairness Coalition in the US has argued that imposing additional taxes on internet sales could severely hamper existing small and midsize resellers and retailers and could forestall others from entering the market. They feel that interstate commerce and the economy are burdened by multiple, confusing and discrepant state tax rules. Therefore, development of a simple and consistent system is critical. They, therefore, support the following objectives:

- Establish simple and uniform sales and use tax rules that abridge compliance burdens for all taxpayers;
- Enact nexus standards for business activity taxes that do away with the potential for double taxation;
- Advance availability of the Internet to all by prohibiting taxes on access fees; and
- Preclude multiple and discriminatory taxation by extending the application of traditional tax rules to electronic commerce.[109]

The United States generally taxes the U.S. source income of non-resident individuals and foreign corporations. With respect to income that arises from a trade or business, however, the United States generally asserts jurisdiction only with respect to 'taxable income' which is effectively connected with the conduct of a trade or business within the United States. Moreover, under income tax treaties

[108] Likely based on the residence of the consumer.
[109] 'Taxation of E-Commerce' <http://packet-one.com/docsp1/Taxation%20of%20e-commerce%20.pdf> accessed on 09 July, 2011.

which the United States has entered into with 48 countries, the United States generally asserts its right to tax the U.S. source trade or business income of foreign individuals and corporations only when such income is attributable to a 'permanent establishment' or 'fixed base' in the United States.

The application of these basic principles of the U.S. income taxation to electronic commerce creates a number of problems. First, the question whether or not a foreign person engaged in electronic commerce is conducting a trade or business 'in the United States' is difficult to resolve by reference to the traditional criteria for resolving that issue. The concept of a U.S. trade or business evolved in the context of conventional commerce, which has typically been conducted through identifiable physical locations.

Secondly, even if a foreign person engaged in electronic commerce with the U.S. customers is deemed to be engaged in a U.S. trade or business, it may be even more problematic to suggest that such a person has a 'permanent establishment' in the United States in the many cases that will be governed by the U.S. tax treaties. Since electronic commerce can (and often will) be conducted without a fixed place of business in the United States, income that might have been subject to the U.S. tax were it earned through more traditional commerce may escape the U.S. taxation when earned through electronic commerce.[110]

[110] 'Electronic Commerce and the Challenges for Tax Administration'< http://unpan1.un.org/intradoc/groups/public/documents/un/unpan001065.pdf> accessed on 23 July, 2011.

10 Implications of Conducting Electronic Commerce on Nigerian Tax

Nigerian traders engaging in e-commerce transactions must take cognisance of the relevant Nigerian laws with regard to their internet activities, especially the Value Added Tax Act to know which goods and services are taxable and which ones are exempted from taxes under the Value Added Tax Act. Similarly, the implications of a non-Nigerian electronic commerce trader on Nigerian tax must be taken into consideration by a non-Nigerian trading with Nigerians in e-commerce transactions.

Implications of Nigerian Traders Conducting Electronic Commerce with Overseas Customers

E-commerce transactions are not specifically provided for under the VAT Act as being exempted from tax.[111]

It is submitted that any goods through e-commerce transaction are taxable goods under the Nigerian VAT Act

[111] The following are goods exempted from tax in the First Schedule to VAT Act, Cap V1 Laws of the Federation of Nigeria 2004: all medical and pharmaceutical products; basic food items; books and educational materials; baby products; fertiliser, locally produced agricultural and veterinary medicine and farming transportation equipment; all exports; plant and machinery imported for use in the Export Processing Zone; plant, machinery and equipment purchased for utilisation of gas in downstream petroleum operations; tractors, ploughs and agricultural equipment and implements purchased for agricultural purposes; medical.

except those goods listed in the First Schedule to the Act.[112] Similarly, all services rendered through the e-commerce transactions are taxable services under the VAT Act except services listed in Part II of the First Schedule to the VAT Act.[113]

It is the hope that when considering legislation or further amendment to legislation on taxation, the legal implications of taxation of e-commerce transactions would be put into consideration so as to have a separate legal regime for taxation of goods supplied and services rendered electronically. And even if a separate legal regime cannot be had of taxation of electronic commerce, the existing taxation laws should be amended to reflect the legal implications of Value Added Tax on electronic commerce.

Where Nigerian-based businesses, therefore, conduct electronic commerce with overseas customers, they need to consider whether their activities will bring them within the scope and purview of the Nigerian taxation laws. Internet traders in Nigeria must be certain of the position of the law within the Nigerian context in determining the implications of their activities on the internet. In this sense, the various tax laws in Nigeria will have to be considered as well as keeping abreast of international regulatory regimes on taxation of electronic commerce.[114]

---

[112] The following are services exempted from tax in the First Schedule to VAT Act: medical services; services rendered by community banks, people's bank and mortgage institutions; plays and performances conducted by educational institutions as part of learning and all exported services.

[113] Such as European Union and Organisation for Economic Co-operation and Development (OECD).

[114] 'Tax Residence' <http://en.wikipedia.org/wiki/Tax-residence>accessed on 03 March, 2011.

Implications of a Non-Nigerian Electronic Commerce Trader on Nigerian Tax

In the Nigerian tax environment, taxes generally are imposed on the income of any individual, community and families chargeable with tax under the Personal Income Tax Act. Also for the purpose of companies taxation, companies in Nigeria are categorised into Nigerian companies and non-Nigerian or foreign companies. Thus, taxes are imposed on the worldwide income of any person, legal or corporate, tax resident in Nigeria or on income arising in Nigeria of any person not tax resident in Nigeria.

11 Tax Residence for Tax Purposes

Definitions of residence for tax purposes vary considerably from country to country. For individuals, physical presence in a country is an important factor. Some countries also determine residency of an individual by reference to a variety of other factors such as the ownership of a home or availability of accommodation, family and financial interests. For a corporate entity, residency is determined by reference to its place of management. Some countries use both a place-of-incorporation test and a place-of-management test.[115]

Residence as defined in double taxation treaties is also different from residence as defined for domestic tax purposes. In most cases, however, a resident of a country is any person that is subject to tax under the domestic laws of that country by reason of domicile, residence, place of incorporation or similar criteria.[116] From the foregoing, it can be said that tax residence in Nigeria can be discussed in terms of tax residence in Nigeria for individuals and tax residence for companies. This clarification is necessary in order to determine the implications of non-Nigerian e-commerce trader on Nigerian tax.

---

[115] 'Tax Treaty' <http://en.wikipedia.org/wiki/tax-residence> accessed on 03 March, 2011.

[116] See generally Sections 2 and 3 of the Personal Income Tax Act, Cap P8 Laws of the Federation of Nigeria 2004.

Tax Residence in Nigeria for Individuals *vis-a-vis* a Non-Nigerian Electronic Commerce Trader

In respect of individual resident in a particular state in Nigeria, tax of a specified amount as prescribed by law, otherwise known as income tax, is payable for each year of assessment on the total income of every individual or corporate sole or body of individuals deemed to be resident for that year in the relevant state or Federal Capital Territory, Abuja, once an individual person derives his income within or outside Nigeria.[117]

However, despite the fact that a non-Nigerian is resident outside Nigeria but derives income or profit from Nigeria, he is also taxable for an amount payable for each year of assessment on his total income.[118] This shows, therefore, that whether a non-Nigerian electronic commerce trader is resident in Nigeria or not, he is liable to pay tax of an amount to be determined by law payable for each year of assessment on his total income insofar as he derives income or profit from Nigeria.

Tax Residence in Nigeria for Companies *vis-a-vis* a Non-Nigerian Electronic Commerce Trader

In respect of companies, subject to the provisions of the relevant laws, profits of a company are taxable for each year of assessment, if the profits are accruing in, derived from, brought into or received in Nigeria.[119] For a non-Nigeria company e-commerce trader, therefore, it is

---

[117] *Ibid,* Section 2 (b) (10)
[118] Personal Income Tax, Cap P8, Laws of the Federation of Nigeria 2004, Section 2.
[119] Companies Income Tax Act, Cap C21, Laws of the Federation of Nigeria 2004, Section 9.

immaterial whether the company is resident in, within or outside the soil of Nigeria before its profits are taxable. What is material is whether its profits are accruing in, derived from, brought into or received in Nigeria. Where, however, a non-Nigerian company is not resident in Nigeria, the mere fact that it is a beneficial owner of share capital of a Nigerian company does not make such non-Nigerian company subject to Nigerian tax. This is the position of the Supreme Court in *Aluminum Industries v. Inland Revenue Board.*[120]

Problem may still arise where a non-Nigeria e-commerce trader company derives its income from more than one source, that is, from two or more tax jurisdictions. For a non-Nigerian e-commerce company, only profits attributable to its operation within Nigeria are taxable while for a Nigerian Company, the tax is on its global income whether or not the profits have been brought into or received in Nigeria. In resolving this problem, however, it appears that double taxation agreements between tax jurisdictions would go a long way.

It is submitted, therefore, that since Nigeria has entered into Avoidance of Double Taxation Agreements (ADTAs) with many other countries, a non-Nigerian individual or company may be exempted from paying certain tax, if such a similar tax is imposed in his or its country of residence.

[120] (1971) 7 NSCC 6 at 10.

12 Withholding Tax on Electronic Commerce Payments

Meaning of Withholding Tax

The withholding tax system is a form of tax administration which enables tax authorities to recover at source from taxable persons tax from payment made for certain services which such person renders to another. What is deducted by the person who pays for the services is a percentage of this payment. If the amount is deducted, when the taxable person's tax for the year is duly assessed, whatever had been deducted is credited to him in a manner that he does not pay tax twice on the same income accruing from that payment.[121]

Income Arising from Supply of Digitised Goods over the Internet

Where transactions involve the supply of digitised goods over the internet, there are many issues that may arise concerning the characterisation of the income generated. The crucial issue, however, is whether income from such transactions is business profits or royalties?

---

[121] *7up Bottling Company Plc v. L. S. I. R. B. (2000) 3 NWLR (pt 650) 565, 617, Nzeako, JCA.*

The provision of digitised goods such as software or music which can be downloaded would generally be the provision of a right to use a product and in most jurisdictions would give rise to royalties. However, if the same goods were provided in non-digitised form,[122] there would be a supply of goods giving rise to profits.[123]

Lack of Universality in the Procedure for Withholding Tax Deductions

The procedure for withholding tax deductions varies from country to country. But it would seem sensible to have worldwide operations of withholding tax deductions especially in respect of taxation of electronic commerce because of the borderless nature of electronic transactions. And in such a case, it would be sensible to maintain records of the countries from which payments are received. It is, therefore, anticipated that where software sales are web-based and automated, there may be practical problems in maintaining such records.[124]

Applicability of Regulations on Withholding Tax to E-Commerce

For the purpose of withholding tax, the Nigerian Law provides Personal Income Tax [Rates, etc of Tax Deducted at Source (Withholding Tax)] Regulations.[125] Although, there is no specific tax law on e-commerce, it is

---

122 That is where the goods are provided in a physical form such as a CD-ROM.
123 'Taxation of E-Commerce' <http://www.out-law.com/page-7512> accessed on 03 March, 2011.
124 Gringras C., *The Law of the Internet* (2nd Ed. Butterworths LexisNexis, London) 406-407.
125 See Personal Income Tax [Rates, e.t.c. of Tax Deducted at Source (Withholding Tax)] Regulations 1997.

humbly submitted that since various establishments, bodies and institutions now engage in e-transactions, the provisions of the Personal Income Tax [Rates, etc. of Tax Deduction at Source (Withholding Tax)] Regulations would also apply *mutatis mutandis*.

Thus, where e-commerce transactions relate to payments in respect of all aspects of building construction and related activities, all types of contracts and agency arrangements other than sales in the ordinary course of business, consultancy and professional services and commission, such payments shall be subject to deduction of withholding tax and shall attract a rate of five per cent of the payments.[126] And because e-commerce is still a developing phenomenon, its taxation also has not been adequately catered for.

It may, therefore, be difficult to deduct at source rates taxable on e-commerce payments. However, if necessary steps are taken to enforce tax payments and necessary statutory frameworks are put in place, such as enforcing penalty for failure to deduct tax, non-payment of Income Tax or payment of interest for late payment,[127] the difficulty may be alleviated.

---

[126] *Ibid,* Schedule to Regulation 1. In respect of Companies Income Tax, similar provisions are contained in Schedule to Regulation 1 of the Companies Income Tax (Rates, etc of Tax Deducted at Source (Withholding Tax)) Regulations 1997. See also the combined effects of sections 68, 69, 70, 71, 72, 73 and 81 of the Companies Income Tax Act, Cap C21 Laws of the Federation of Nigeria 2004.

[127] Pursuant to Sections 74, 76 and 77 of the Personal Income Tax Act and Sections 82, 85 and 86 of the Companies Income Tax Act.

13 Challenges to the Taxation of Electronic Commerce

The coming of the Internet age has profound implications for tax administration as it does for just about everything else. The exponential growth of electronic commerce poses a daunting challenge to taxing authorities' traditional approaches to both direct and indirect taxation. The spectre of massive amounts of economic activity conducted through electronic commerce by remote service providers engaged in non-traceable transactions from unidentifiable locations has created concerns among fiscal authorities around the globe. Electronic commerce opens up new avenues for the marketing of traditional goods and services directly to consumers. It creates similar opportunities for business-to-business (B2B) transactions involving both digital and non-digital products and services.[128] The challenges facing taxation of electronic commerce shall be addressed under the following headings.

Implementation Challenges

An internationally consistent application of the taxation principles to electronic commerce will help to maintain the

[128] Walter Hellerstein, 'Electronic Commerce and the Challenge for Tax Administration<http://unpan1.un.org/intradoc/groups/public/documents/un/unpan001065.pdf>accessed on 12 August, 2011.

fiscal sovereignty of countries; will achieve a fair share of the tax base from electronic commerce among countries and should minimise the risk of double taxation and non-taxation. The implementation of these principles in the electronic commerce environment will raise new challenges for tax authorities. The four main areas where the implementation challenges arise are Consumption Taxes, Tax Treaties, Transfer Pricing and Tax Administration.[129]

- ***Consumption Taxes***

The concept of the place of supply is important in consumption tax systems such as Value Added Tax (VAT) systems and Goods and Services Taxes (GST). In broad terms, the basis for supply rules falls into two categories: those which depend upon identification of a relevant establishment (the supplier in some cases and the customer in others); and those which are based on the place of performance or enjoyment.[130] Since electronic commerce makes much more opaque the links between the place of supply, the place where the enterprise is located and where the service is used or consumed, the Internet raises new compliance issue for consumption tax authorities.[131]

The communications revolution poses challenges for the traditional concepts underlying Value Added Tax systems. Tax administrations and others are concerned with the ways in which supplies of telecommunications services, internet fees, satellite broadcasting and supplies of computer

---

[129] Jeffrey Owens, 'Electronic Commerce Answering the Emerging Taxation Challenges' <http://lobby.la.psu.edu/080-Internet-Sales-Tax/Agency-Activities/ACEC/Challenges.d-c> accessed on 06 August, 2011.

[130] *Ibid.*

[131] *Ibid.*

software and related computer services will be dealt with under Value Added Tax.[132]

Translating the 'place of consumption' principle into a practical measure necessitates work to agree on how that place of consumption should be defined and how related place of taxation rules should operate. There are also a set of questions around the definition, for consumption taxation purposes, of services and intangible property; and the sort of tax collection mechanisms that it is necessary to put in place to ensure that the taxation principles can operate effectively.

Consumption taxes or sales taxes are intended to be borne by consumers and are dependent upon retailers acting as tax collectors. If not properly designed, however, sales taxes may impose an economic burden on business. Sellers bear the cost of determining the applicable tax rate, which may depend on the type of product and the location and type of customer; preparing invoices according to tax rules; collecting tax; filing and remitting tax; and maintaining tax records. If the tax is assessed incorrectly, the seller (or its third- party agent) typically will be held responsible for any shortfall and will not be able to reclaim it from the customer.[133]

Continually, developing technologies are causing governments and suppliers to face many challenges in the collection of consumption taxes with respect to determining the jurisdiction in which tax should apply; verifying the place

---

[132] 'Electronic Commerce: The Challenges to Tax Authorities and Taxpayers'<http://cryptome.info/turku18.htm>accessed on 13 August, 2011.

[133] Richard Jones and Subhajit Basu, 'Taxation of Electronic Commerce: A Developing Problem' 'Taxation of Electronic Commerce: A Developing Problem' (Paper presented at 16th BILETA Annual Conference, 2001) 8. See also http://www.bileta.ac.uk/01papers/rjones.html> accessed on 16 December, 2009.

of consumption; determining the correct tax treatment of bundled products, bad debts and tax credits; retaining data and complying with audit requirements.[134]

- ***Redefining Tax Treaties***

Tax treaties are bilateral and cover income and capital taxes, though there are some examples of multilateral tax treaties and treaties concerning other taxes. The purpose of bilateral tax treaties is typically expressed in their preamble to be 'the avoidance of double taxation and the prevention of fiscal evasion.'[135] Consequently, the Internet will cause tricky problems of interpretation for the negotiators of tax treaties. Can existing concepts such as that of permanent establishment and royalties be adapted to cover activities on the Internet or should tax authorities be undertaking a more fundamental review?

A central element in determining taxation rights in tax treaties is that of business presence employed to establish whether or not a permanent establishment exists. Whether or not the operation of an establishment in a country rises to the volume that makes it a permanent establishment is primarily a question of fact. Does the existence of a web-site or a server in a jurisdiction create a permanent establishment and therefore give that jurisdiction the right to tax the income attributed to that enterprise? Treaty negotiators will have to examine these questions and more generally to see how treaty concepts can be applied to new ways of doing business.[136]

---

134 OECD 'Implementation Issues for Taxation of Electronic Commerce'< www.oecd.org/dataoecd/38/42/5594899.pdf>accessed on 13 July, 2011.

135 'Electronic Commerce: The Challenges to Tax Authorities and Taxpayers' <http://cryptome.info/turku18.htm> accessed on 13 August, 2011.

136 Jeffrey Owens, 'Electronic Commerce Answering the Emerging taxation Challenges' <http://lobby.la.psu.edu/080-Internet-Sales-Tax/Agency-Activities/ACEC/Challenges.doc> accessed on 06 August, 2011.

- ***Implications for Transfer Pricing***

In principle, electronic commerce does not offer new problems and no fundamentally or categorically different dimensions for transfer pricing.[137] It may, however, increase the complexity of transfer pricing analysis. The development of private Intranets within multinational enterprises (MNEs) puts pressure on the traditional application of the arm's length principle,[138] by stimulating the fuller integration of multinational operations, particularly in the provision of services. The OECD's Guidelines on Transfer Pricing specify that a functional analysis may be required to establish comparability but with electronic commerce and the use of private Intranets, it may be difficult to know who is doing what. The deeper integration may also bring benefits of synergies over and above the directly measured contributions of the participants. This raises the difficult question of how such benefits should be divided up between the related enterprises. Clearly, transfer pricing will increase in complexity.[139]It is suggested that prior to enacting any legislation or creating any regulation that will affect e-commerce, government must consider the potential impact that e-commerce will have on the economy.[140]

Examining the totality of existing arena, it will be difficult in terms of determining appropriate transfer pricing to decide which business functions should carry greater weight

---

[137] The prices charged for transactions that take place between the different parts of a multinational enterprise.

[138] That is the principle that transactions between the related enterprises of an MNE should be treated as though they were undertaken between independent enterprises.

[139] Jeffrey Owens, 'Electronic Commerce Answering the Emerging taxation Challenges' <http://lobby.la.psu.edu/080-Internet-Sales-Tax/Agency-Activities/ACEC/Challenges.doc> accessed on 06 August, 2011.

[140] Eugene R. Quinn, 'Tax Implications for Electronic Commerce' (1999) 4 (3) *Journal of Technology Law & Policy.*

particularly given that e-commerce has changed the way of intermediation and distribution of business flows to a significant extent. It is no small wonder, therefore, that taxpayers and tax collectors alike are struggling to determine which business functions are significant and then agree upon a suitable allocation of profits thereto.[141]

Transfer pricing issues, though not created by e-commerce, will become more complex with the Internet. This is because networks make it possible to pool together resources from diverse locations to deliver a service or product to a customer. Pricing of such services is already a difficult task and it will only become more complex with e-commerce. Similarly, attributing incomes to different related concerns involved in producing the finished product would be complex. These issues need to be seriously considered if unhindered growth of e-commerce is to be ensured.[142]

- ***Tax Administration***

Tax authorities will face many difficulties in taxing profits attributable to the software functions of servers. Calculating the income attributable to the server or website would require tax authorities to go through case by case and thousands of lines of computer code. This is not administratively feasible, as tax authorities would somehow have to determine the amount of added value provided through server functions.[143]

---

[141] Dayana M.K., 'E-commerce and Taxation'< http://articles.manupatra.com/PopOpenArticle.aspx?ID=f3c75cea-57c1-4b7e-a881-3c5a339eddc7&txtsearch=> accessed on 15 August, 2011.

[142] 'Enforcement Issues in Electronic Commerce' <http://www.rashminsanghvi.com/chapter3.pdf> accessed on 07 August, 2011.

[143] Annet Wanyana Oguttu and Sebo Tladi, 'The Challenges E-Commerce Poses to the Determination of a Taxable Presence: The "Permanent Establishment" Concept Analyzed from a South African Perspective' (2009) 4 (3) (*Journal of International Commercial Law and Technology*) 221.

To tax an economic activity, the tax authority must be able to identify a taxable event. The factual nature of tax determinations and the difficulties that may arise in telecommunications and electronic commerce environments have been a challenge to tax administrators. For example, whether or not a business has a permanent establishment depends upon the volume of activity in the country; the arm's length principle cannot be applied without a factual analysis of the enterprise's activities and the location of the activities.

In the conventional commercial environment, tax administrations rely on being able to identify the taxpayer, obtain access to verifiable information about the taxation affairs of the taxpayer and have efficient mechanisms to collect the tax due.[144] A business engaged in electronic commerce on the Internet may be identifiable only by its domain name.[145] Yet the correspondence between a domain name and the location of where the activity is being undertaken is tenuous.

As Small and Medium Enterprises (SMEs) engage in more activities in international electronic commerce, lack of identifiability may become more problematical. Furthermore, there are cases where the Internet domain name can imply a relationship to a well-known business without any such relationship existing, giving rise to trademark-type disputes.[146]

---

144 Jeffrey Owens, 'Electronic Commerce Answering the Emerging taxation Challenges' <http://lobby.la.psu.edu/080-Internet-Sales-Tax/Agency-Activities/ACEC/Challenges.doc> accessed on 06 August, 2011.

145 For example www.businessname.com.

146 Jeffrey Owens, 'Electronic Commerce Answering the Emerging Taxation Challenges' <http://lobby.la.psu.edu/080-Internet-Sales-Tax/Agency-Activities/ACEC/Challenges.doc> accessed on 06 August, 2011.

Without accurate identification of taxpayers, it is difficult for the tax administrators to levy taxes. Even if they can identify the taxpayer but not its physical location in the world, this will give rise to jurisdictional disputes between tax authorities, with all the attendant risks of double taxation. Responsible businesses engaged in electronic commerce recognise that there are sound commercial reasons for them to work with government to ensure adequate identification.

Measures such as the registration of business names, mailing addresses and telephone and facsimile numbers on their Internet sites have been promoted by business as one way to foster consumer confidence in electronic commerce. Such measures will also address some of the challenges faced by tax authorities in identifying taxpayers. Tax authorities may also face difficulties in physically collecting tax in the virtual world.[147]

A very large part of tax revenue is collected by intermediaries. Employers are responsible for the collection of wage tax; businesses for consumption taxes; financial institutions for taxes on interest and royalties. In some cases, electronic commerce may remove these intermediaries[148] so that tax authorities will be required to collect small amounts from a large number of taxpayers. This may place an unacceptably high compliance cost on taxpayers and high administrative costs on tax authorities.[149]

The tax administrators should encourage business practices that identify businesses engaged in e-commerce

---

147 *Ibid.*

148 When, for example, a producer deals directly with the consumer rather than via a retailer

149 Jeffrey Owens, 'Electronic Commerce Answering the Emerging Taxation Challenges' <http://lobby.la.psu.edu/080-Internet-Sales-Tax/Agency-Activities/ACEC/Challenges.doc> accessed on 06 August, 2011.

and examine mechanisms to facilitate tracing of inadequately identified web sites and other electronic places of business.[150]

Enforcement Challenges

The effect of the Internet on enforcement of tax laws has raised fears of governments being unable to meet legitimate demands of their citizens for public service. The advent of e-commerce will demand a high level of preparedness from the tax administrators, to address the many enforcement challenges likely to be posed by this fast emerging way of doing business.

In this regard, identity and location of parties; anonymity of transactions and accounts; dis-intermediation; transfer pricing issues; online delivery and net cash; easy access to tax havens and low tax jurisdictions; identification of taxing jurisdiction; new evasion opportunities; recovery of tax; exchange of information and taxpayer service opportunities are the enforcement challenges of taxation of e-commerce.[151]

One of the significant perceived threats associated with the advent of the Internet is anonymity offered by the Internet. The customer does not know where the server is located and the server cannot identify where the customer is located. With e-commerce and use of private intranets, it may be difficult to know who is doing what and without accurate identification, it may be difficult to tax a taxpayer.[152]

---

[150] OECD, 'Tax Administration Aspects of Electronic Commerce: Responding to the Challenges and Opportunities' (Report from the Forum on Strategic Management to the OECD Committee on Fiscal Affairs February 2001) <http://www.oecd.org/dataoecd/46/u4/1923272.pdf>accessed on 23 July, 2011.

[151] 'Enforcement Issues in Electronic Commerce' <http://www.rashminsanghvi.com/chapter3.pdf> accessed on 07 August, 2011.

[152] *Ibid.*

There may be double taxation or problems in determining tax jurisdiction. Transfer pricing problems, existing even at present, are expected to become much more complicated with the Internet. The Internet also encourages disintermediation. This takes away third party source of information as also recovery of taxes as these have to be collected directly from a large number of taxpayers. It is also feared that with the Internet, mobility of enterprises increases. Enterprises can move to low tax jurisdictions. Tax havens become more easily accessible even for small enterprises with a consequent adverse effect on tax revenues.

To some, 'the Internet has no physical presence location and it is difficult to monitor and prevent transmission of information or electronic cash.' Electronic delivery creates the problem of detection, ownership determination and taxation. With the increase in bandwidth, the volumes of transactions involving online delivery will accelerate. Buying online enables consumer to evade indirect taxes. Transactions involving digitised delivery are difficult to monitor or tax as no audit trail is left. When the payment is also through electronic cash, detection and monitoring will be impossible.

It was noted that large volumes of business are not done between strangers. Sound commercial considerations make it necessary that the parties to the transactions of substantial size not only know each other but are also satisfied with the credentials of the other party. Even in Business to Customer (B2C) commerce, both sides have to have some checks in place. Usually, these would consist of reputation of the retailer and prepayment by consumers.

Also, in majority of the e-commerce transactions, the mode of delivery and payment remain traditional. The real challenge for enforcement arises only where delivery and

payment are through the Internet or any other network. The delivery in digitised form creates complications for tax administrations in enforcement of law. But total anonymity exists only where both payment and delivery are in digitised form involving e-cash. Once the technical problems of delivery and payment are sorted out, online commerce will grow exponentially. It is, therefore, necessary that tax administrators have adequate responses in place to meet the real challenges before they come. It is also necessary that tax administrators seize the opportunity offered by the Internet to improve taxpayer services.[153]

- ***Identity and Location of Parties***

The anonymity available to parties to an e-commerce transaction, as also the scope of concealing the transaction through the use of encryption and maintaining books on a server located in another tax jurisdiction are among the most serious concerns in an e-commerce situation. Even the fact that the domain name may indicate a link to some well-known business without there being any such link is a concern. But, in reality, the address given for registration with network service providers and the mode of payment of access charges will leave an audit trail.

The fact that hackers into the systems of some of the big enterprises were quickly traced indicates that technically, tracing the correct identity and locations of the Internet users is possible. With the available technology and co-operation between different tax jurisdictions, it is possible to trace the correct identity and location. The need for ensuring smooth and unhindered growth of e-commerce also requires some safeguards to prevent

[153] 'Enforcement Issues in Electronic Commerce' <http://www.rashminsanghvi.com/chapter3.pdf> accessed on 07 August, 2011.

frauds. Proper systems would, therefore, have to be put in place by responsible business organisations themselves. These will help in enforcement of tax laws.

Existing tax systems tend to determine tax consequences based on where the taxpayer is physically located. The e-commerce model enables businesses to operate with very few physical locations. An online vendor can easily sell to customers throughout the world from a single physical location.[154]

It is, therefore, recommended that the tax administrators should get together with the business organisations in putting proper systems in place for identification of the Internet and other network users. Systems, which would minimise tax compliance risk, should be put in place by the governments and other enforcement agencies to devise uniform or compatible systems for restricting the anonymity of the Internet and other network users and preventing illegal activities which would otherwise be encouraged by the anonymity offered. A common approach is required so as not to put unreasonable compliance burden on the intermediaries, like network service providers and banks.

The tax systems affecting e-commerce should be designed in consultation with the intermediaries, who will have to bear the compliance burden. Similarly, special cells within the tax administration may be created with expertise to tackle problems like tracing of identity and location of the parties relating to taxation of e-commerce. The systems to be devised will have to specify circumstances under which identification will be ordered, the level of officers who will exercise this authority, the penalties for non-

---

154 *Ibid.*

compliance and the period for retention of records by those required to comply.[155]

- ***Anonymity of Transactions***

Systems providing for anonymity revocation under specific circumstances need to be put in place. Such systems would require mandatory disclosure of transactions and encryption code by the party and the disclosure of transactions by the intermediaries like network service providers. The systems should also provide for disclosure of digital signature by appointed certifying authorities and specify the level of officers who will have necessary authority and penalties for non-compliance.

Other enforcement agencies responsible for tackling crimes, including financial crimes,[156] terrorism and drug trafficking, would also need to have similar access to information. With liberalisation of rules relating to currency convertibility, the Central Bank of Nigeria will need to monitor fund flows. Even the audit agencies will require access to information. It is advisable that all concerned agencies are involved in devising the above systems so that individual endeavours in this regard do not place unreasonable compliance burden on network service providers. It is also necessary that the providers of information are involved in this exercise. This will ensure that systems do not place impractical demands on network service providers.

---

[155] *Ibid.*

[156] Such as the Economic and Financial Crimes Commission (EFCC) established under the Economic and Financial Crimes Commission Act, Cap E1 LFN 2004 and the Independent Corrupt Practices and Other Related Offences Commission (ICPC) established under the Corrupt Practices and Other Related Offences Act No. 2 of 2000 (now embodied in Cap C31 LFN 2004).

E-commerce also makes monitoring of transactions necessary by the tax authorities. This is because considering the easy possibility of evasion and also the difficulty in realising tax dues from virtual firms, investigation of past transactions may cause serious loss of revenues once digitised delivery and payment mechanics become common. Since enforcement agencies concerned with illegal activities will also have to monitor transactions on the networks, it will be appropriate for the tax authorities to put in place a system of surveillance of such transactions in consultation with these agencies.

Generally, disclosure of total commerce undertaken through networks may suffice. However, the system should be decided in consultation with the relevant institutes such as Chartered Institute of Taxation of Nigeria and Institute of Chartered Accountants of Nigeria and business organisations.

- ***Disintermediation***

Another important issue for tax administrators is the process of disintermediation and the increase in cross-border trade, which are central features of both the new economy and e-commerce, as they greatly reduce the way that certain taxes are collected. This is because the activities of information reporting and withholding of taxes by traditional intermediaries and withholding agents, such as brokers and financial institutions, are gradually being removed as a traditional taxing point and force tax administrators to collect taxes from a greater number of unsophisticated taxpayers and in smaller amounts.[157] The fear that e-commerce will

[157] Jinyan Li and Jonathan See, 'Electronic Commerce and International Taxation'< http://osgoode.yorku.ca/osgmedia.nsf/0/04CFE186956B8C33852571CE0058C4B7/$FILE/ISUMA-Vol-3-no-1-Spr-02.pdf >accessed on13 August, 2011.

lead to disintermediation is justified. The seller and buyer can get in touch directly without intermediaries. The wholesaler and retailer will be eliminated due to the capability of even small enterprises to access customers anywhere in the world at a nominal cost.[158] Disintermediation is expected to create problem in getting third party information and in recovery of taxes. Network service providers will be the new intermediaries together with the controller and certifying authorities appointed under the tax laws. Systems requiring network service providers to furnish information will have to be put in place. Once that is done, third party information would be available including information relating to assets.

- ***Online Delivery and E-Cash***

The real problems for enforcement in an e-commerce situation arise in transactions involving online delivery and payment. Even though, the volume of online commerce is only a fraction of the total e-commerce, it is important enough to be specifically included in the definition of e-commerce to include electronically marketed products like travel and ticketing services, software, entertainment, banking, insurance and brokerage services, legal services, real estate services, health care, education and government services. In these transactions, where the supplier is from a foreign tax jurisdiction, it becomes difficult to charge or collect direct as well as indirect taxes. Withholding of tax through a large number of small consumers for direct tax purposes or realising indirect taxes from them is administratively impossible. Normal audit trail in the form of documents

[158] For instance, an artist instead of going through a recording company, wholesaler and retailer, before reaching the consumer as required in traditional commerce, will go directly to consumer online or through the recording company.

like purchase vouchers, transportation documents and intermediaries, such as wholesalers or retailers would be missing in such transactions. The development of e-cash[159] also referred to as 'net cash' or 'digital cash' is an even more serious challenge for the tax administrations.

Another consideration is that the anonymity revocation does not motivate crimes more serious than those it protects against. E-cash is intended to emulate the perceived anonymity of regular cash transactions for protection of user privacy and prevention of the compilation of personal data. But it can also facilitate frauds and criminal acts, such as money laundering, anonymous blackmailing and illegal purchases. The attempt is, therefore, to develop 'anonymity controlled e-cash' with either 'owner tracing'[160] or 'coin tracing'[161] models. Although, the development of e-cash is not likely to be significant in near future, there is a need for monitoring the developments in areas of e-cash on a regular basis in co-operation with other enforcement agencies.[162]

- ***Use of Tax Havens***

The next issue is the effect of easy accessibility of tax havens and low tax jurisdictions in an e-commerce situation. Mobility of capital results in its 'free' riding at the cost of less mobile labour. E-commerce makes low tax jurisdictions accessible to more people who wish to evade tax. This creates distortion inasmuch as the individuals continue to use the services provided by high tax countries without paying

---

[159] In its simplest form, e-cash system consists of three parties (a bank, a user and a shop) and four main procedures (account establishment, withdrawal, payment, deposit).

[160] This model is useful for tracing legal and regulatory requirements of large money exchanges.

[161] This second model's main purpose is to track fraud and other criminal activities in a manner similar to tracking based on serial numbers on the notes.

[162] 'Enforcement Issues in Electronic Commerce' <http://www.rashminsanghvi.com/chapter3.pdf> accessed on 07 August, 2011.

their taxes. Also, the affluent are more mobile and therefore more likely to take advantage of tax havens. Tax havens are typically used for tax evasion and money laundering.

Within OECD, a study is being undertaken on what are called 'harmful tax practices'. Thus, OECD has already initiated action against what are termed 'harmful tax practices'. These cover jurisdictions, which levy differential tax on foreign enterprises as compared to its citizens or place restriction on information exchange. There is also a race among some of the developing countries for lowering tax rates. It is feared that a stage may be reached when the countries are unable to even raise the revenues required for providing public services as a result of operations being located in tax havens.

Notwithstanding the potential that tax havens possess in respect of drain on revenues, it is to be noted that tax havens have been in existence for a long time and is not a phenomenon created by the Internet. However, it is pertinent to note that tax rates are not the sole reason for choosing a location and that people generally do not like to move to another country. The remedy lies in constantly monitoring the developments, cooperating with international action against harmful tax practices, introducing legal provisions for controlled foreign corporations at appropriate time and modifying Double Taxation Agreements which are found to cause serious erosion in country's tax base. Regular monitoring of relevant data and action to modify DTAs wherever these cause serious erosion of tax base should be made and international co-operation in the form of information exchange to curb harmful tax practices should be fully supported.[163]

---

[163] *Ibid.*

- ***Identification of Taxing Jurisdiction***

The place of execution of contract and the place where title to the goods or services passes are important in determining where the income accrues or can be deemed to accrue and, therefore, taxed. In e-commerce, with offer and acceptance on the networks, the place where the contract is executed will not be known under laws and rules applicable to traditional commerce. Similarly, where delivery is of digitised goods or services, the place where title to the goods or services passes is difficult to determine. Determination of the jurisdiction where a particular e-commerce transaction is taxable, therefore, becomes complex. This, however, is a legal issue. The remedy lies in clarifying the position under the domestic laws. The law is, therefore, in place for determination of place of execution of contract or place of passing of title in digitised goods or services provided through networks.[164]

- ***New Evasion Opportunities***

The implications of e-commerce for tax systems are wide-ranging. From the perspective of tax administrator, the new communications technologies such as the internet and computers open up possibilities to improve the administration of tax systems but also open up new avenues for tax evasion and avoidance.[165]

Currently, foreign exchange remittances in respect of export realisation are subject to scrutiny and detection when the physical goods are exported. No such scrutiny is possible in case of export of software or other digitised

---

[164] *Ibid.*
[165] *Ibid.*

products. Inflated price can be shown to facilitate transfer of funds through illegal channels and their inflow as remittance in foreign exchange with direct and indirect tax subsidies. The problem is serious and if not tackled could erode the tax base significantly by providing easy mechanism for laundering untaxed income, which in turn could have a criminal nexus. The remedy lies in technically upgrading the appraisal system by the Customs and Excise Department and selective investigation of such inflows. International co-operation in information exchange is also necessary to implement this initiative. The long-term remedy lies in withdrawal of favourable tax treatment for export incomes. Improved valuation methods and selective verification of source of funds are also recommended. International cooperation in information exchange should also be supported.[166]

- ***Recovery of Taxes***

The capacity of tax administrations to realise taxes from virtual companies is also a matter of concern among nations. The assets may be hidden and kept in other tax jurisdictions. Certain enterprises do not have any assets from which taxes may be recovered as the funds are misappropriated and kept in fictitious accounts or in accounts with fictitious names or in names of persons having no financial resources of their own. The growth of e-commerce may make the problem more acute as such opportunities may become available even to small enterprises. The existing mechanism of tracing source of funds and greater access to information

[166] Enforcement Issues in Electronic Commerce <http://www.rashminsanghvi.com/chapter3.pdf> accessed on 07 August, 2011.

from other tax jurisdictions, including information from banks, is the only way to tackle this problem. This again focuses on the importance of international co-operation in information exchange and amending DTAs specifically to provide for mutual assistance in recovery of taxes. Measures for more efficient exchange of information and mutual assistance in recovery of tax dues need to be introduced in DTAs and International cooperation in this area should be actively supported.[167]

- ***Exchange of Information***

The need for international cooperation in not only in evolving new concepts but also in assisting administering laws emerges as a key aspect in e-commerce situation. Unless such cooperation is forthcoming, e-commerce will cause a serious erosion of tax base. To ensure such co-operation, it will be necessary to create separate units within each tax jurisdiction entirely for information exchange. Broad consensus on the type of information to be exchanged and compatibility in laws relating to banking secrecy would assist in preventing erosion of tax base. The Nigerian government needs to associate itself with international initiatives in this area.

- ***Taxpayer Service Opportunities***

Making people go on-line is not always simple and the same may require incentives to be given for transacting online. With computerisation, it is possible as well as necessary that the Internet should be used to improve taxpayer services. Already, Government websites exist. Facility of online filing of returns should be extended to taxpayers and deductors

---

[167] *Ibid.*

of tax at source. This can be implemented through creation of separate cells to handle these cases. Redressal of grievances online should be started immediately. The 'Taxation Framework Conditions' of the OECD specify three areas for improving taxpayer service opportunities:

- improving communication facilities and access to information;
- minimising compliance costs by simplifying registration and filing requirements and acceptance of electronic material; and
- enhancing voluntary tax compliance through electronic assessment and collection and easier, quicker and more secure ways of paying taxes and securing refunds.[168]

While the challenges are imminent, the opportunities offered by the new technologies are only just emerging. Tax administrations will be able to improve their operations by using new communications facilities.[169]

Feasibility Challenges

The lack of compatibility between the current international tax regime and the features of e-commerce raises feasibility challenges in applying the current regime. It is not clear that the current regime could be applied to e-commerce. The premises of the two are different, the perspectives are different and the concepts are different. There are five main feasibility challenges, which are outlined below.

---

[168] *Ibid.*
[169] *Ibid.*

- ***Income-Classification Rules***

The information-technology revolution generated endless new products, services and methods of doing business that do not reflect the classic categories of transactions. A wide range of intangible products and services are being traded with these new methods. In the age of e-commerce, for example, a book can be bought in a striking number of ways.[170] One can also receive online updates of the book. These possibilities make it difficult to classify the transaction in the classical categories of 'trade income' or 'services income'. The standard categories anticipated products, services and businesses that predate e-commerce; but the current age is different. E-commerce cannot be easily classified according to the old transactional categories.[171]

- ***Source Rules***

The current source rules face an initial problem in applying to e-commerce because the rules are strongly territorially based, whereas e-commerce is not. The current source rules are rooted in two premises:

- that territorial borders separate countries and define their legal jurisdiction; and
- that each income is produced in a territory of a single country.

Accordingly, source rules are designed to identify the territorial country of the income according to economic

---

[170] For example, it is possible to subscribe to a database that includes the book or to download an electronic version of the book to the customer's desktop.

[171] Rifat Azam, 'E-Commerce Taxation and Cyberspace Law: The Integrative Adaptation Model', (2007) 12 (5) *Virginia Journal of Law & Technology,* University of Virginia. See also <http:www.vjolt.net/vol12/issue3/v12i3_al-azam.pdf>accessed on 09 July, 2011.

allegiance between the income and the country. In this process, source rules rely on and use physical concepts of territory and place. But all this is weakened in non-territorial e-commerce. The global character of e-commerce gives very limited, if any, meaning to territorial borders between countries. Similarly, the virtual nature of e-commerce gives very limited, if any, meaning to the location of e-commerce income in territorial place. Therefore, the very basic justifications and concepts behind the source rules are challenged by e-commerce. This challenge is both theoretical and conceptual, touching the roots of source rules. Coping with this challenge necessitates more intervention and change in the current law.[172]

- ***Permanent Establishment***

The contemporary international tax system developed to allocate taxing jurisdiction over buyers and sellers of tangible, physical goods. Accordingly, the current system is based on the actual geographic location of these buyers and sellers. The Organisation for Economic Co-operation and Development (OECD) has incorporated and consistently reaffirmed these physical presence principles in its Model Tax Convention on Income and on Capital (OECD Convention), the predominant world-wide model for bi- and multi-lateral tax treaties.[173] The challenges of applying the permanent establishment principle to e-commerce have gained special attention in the debate on e-commerce taxation and have been discussed extensively.

---

[172] *Ibid.*

[173] Benjamin Hoffart, 'Permanent Establishment in the Digital Age: Improving and Stimulating Debate through an Access to Markets Proxy Approach' 6 (1) N*orthwestern Journal of Technology and Intellectual Property*< http://www.law.northwestern.edu/journals/njtip/v6/n1/6/>accessed >17 July, 2011.

E-commerce enterprises can sell their products or services worldwide with very limited physical presence in any particular consumer's country. They can operate without agents because they can directly, easily and cheaply contact customers worldwide.

Another issue is the question of what constitutes a permanent establishment with regard to electronic commerce. A web site does not have a physical presence and, therefore, cannot be designated as a permanent establishment. Even if the business maintains its own server within a taxing jurisdiction, the storage, display or delivery of goods on the internet has been compared to similar mail-order activities, which are not considered a permanent establishment.

Further, a corporation conducting business on the internet can separate its ordering, delivery and payment functions by delegating them to ancillary sites throughout the world. This fragmentation results in the corporation circumventing the definition of permanent establishment under most tax treaties and thereby being exempted from taxation on income.[174] Therefore, the premises of the permanent establishment rule – that is, to conduct business in a country, you need a presence there – does not apply to ecommerce. The concept of 'fixed place' is meaningless in e-commerce business because it can be located anywhere and can conduct business everywhere.

---

[174] Kathryn Pedwell, 'Taxation of Electronic Commerce: An Assessment of the Opportunities and Challenges Facing Taxpayers and Tax Authorities' (2002) 1(2) *Journal of E-Business*.

Residency

E-commerce taxation challenges are not limited to source-based taxation. Residence-based taxation also faces challenges. The main challenge is to determine the residency of e-commerce corporations. These corporations usually lack fixed physical facilities. Their Web sites are usually their main storefronts and their employees are highly mobile. The physical presence of the corporation in a 'central place of management and control' is limited and the mobility of the corporation is very high. Therefore, it is not easy to determine the 'central place of management and control' of such a corporation in order to determine its residency under traditional definitions. In addition, it is easy to abuse the traditional definitions and locate an e-commerce corporation in a low tax jurisdiction to reduce or even to escape taxation all together.

E-commerce challenges residence taxation by making it easier for corporations to decide where they want to be located for tax purposes. The residence of corporations is generally determined by the place of incorporation test or 'the place of management and control' test. The 'place of incorporation' test is subject to taxpayer manipulation because e-commerce can be conducted anywhere, as it is inexpensive to establish a company in a tax haven. Therefore, the test of place of incorporation basically allows taxpayers to decide whether or not they want to pay tax on the basis of residence or source of income.[175]

---

[175] Jinyan Li and Jonathan See, 'Electronic Commerce and International Taxation' < http://

The legal authority to levy tax, also called jurisdiction, resides with national government and is based on the concepts of residence and source. Residence-based taxation implies that a country can tax its residents on worldwide income, whether the source of that income is domestic or foreign. Source-based taxation infers that countries levy taxes on any income earned within its borders, without regard to whether a resident or a non-resident of the country earns it. Thus, the same economic activity may be taxed twice, once by the country where the income is earned and again by the country in which the taxpayer is deemed a resident.[176]

- ***Enforcement***

The enforcement of the current international tax regime on e-commerce faces many difficulties. The global character of e-commerce makes it difficult for any one country to monitor and tax e-commerce income. International cooperation is needed to handle e-commerce taxation but such cooperation is not easy, given the conflicting interests of different countries. In addition, the virtual nature of e-commerce makes it difficult to monitor and control e-commerce transactions even if countries are cooperating. The limited physical presence of the transaction and the limited physical assets of an e-commerce corporation outside the Internet make it difficult to reveal the business's transactions and income, which in turn makes it difficult to enforce the business's tax duties even if such duties were

---

[176] Kathryn Pedwell, 'Taxation of Electronic Commerce: An Assessment of the Opportunities and Challenges Facing Taxpayers and Tax Authorities' (2002) 1 (2) *Journal of E-Business* 2. See also < http://www.egov.ufsc.br/portal/sites/default/files/anexos/20479-20480-1-PB.pdf>accessed 15 August, 2011.

clearly determined. Furthermore, the anonymity of e-commerce makes it hard for tax authorities to discover the existence of e-commerce transactions, the parties to the transactions and the details of the transactions. Since tax authorities often lack such basic information, they often cannot levy taxes on e-commerce transactions.[177]

Normative Challenges

While the feasibility challenges address whether or not the current international tax regime is able to tax e-commerce income, the normative challenges address whether or not it is the appropriate regime for taxing e-commerce income. The regime is based on several policy considerations, each of which is challenged by e-commerce. The challenge is to tax e-commerce taxpayers and non-e-commerce taxpayers equally, since they are equal according to the leading principle of ability to pay. The current regime tries to allocate tax jurisdiction according to the economic allegiance principle in order to achieve fair distribution of the international tax pie among the countries involved. But the logic of the current economic allegiances and the premise behind the contribution of each country to the production of the income are not applicable to e-commerce today. For example, the logic of giving the source country priority in taxing active income, while the residence country has priority to tax passive income, cannot simply be applied to e-commerce income. Finally, it should be considered whether applying the current international tax regime to e-commerce income achieves economic efficiency, a concern that has warranted

[177] Rifat Azam, 'E-Commerce Taxation and Cyberspace Law: The Integrative Adaptation Model.'

considerable discussion in the literature and has played a central role in designing the current international tax regime. The challenge is to ensure these efficiencies in taxing e-commerce income.[178]

Acceptability Challenges

International consensus is a must in any international tax regime. Such consensus was reached after a lengthy series of negotiations in the 1920s, when the current international tax regime was designed. But a lot has changed since that consensus. E-commerce upsets the consensus of the 1920s because countries have varying and contradictory views on taxing international e-commerce income. The challenge is to renew or rebuild the international consensus concerning taxing international e-commerce income.[179] Business should be prepared for the introduction of new legislation aimed specifically at compelling businesses to collect and remit consumer-based taxes from customers, even when those customers reside outside the jurisdiction in which the business is situated.[180]

---

[178] *Ibid.*

[179] *Ibid.*

[180] Kathryn Pedwell, 'Taxation of Electronic Commerce: An Assessment of the Opportunities and Challenges Facing Taxpayers and Tax Authorities (2003)1(2) *Journal of E-Business* 3. See also <http://www.egov.ufsc.br/portal/sites/default/files/anexos/20479-20480-1-PB.pdf>accessed 15 August, 2011.

14 Conclusion

The Nigerian tax regime covers a wide range of taxes payable by taxable persons. The three tiers of government have their respective legislative competence to make laws relating to taxation. The Nigerian tax laws, however, did not envisage the changing face of taxable items and services as they relate to electronic commerce and transactions. Virtually all aspects of human endeavour are now concerned with electronic activities. There are e-government, e-banking, e-waste and 'e-everything.' It can, therefore, be said that taxation of e-commerce can best be described as a transition area, with state and international organisations yet to find concrete basis for giving a full thrust go at taxation of e-commerce transactions purely on a principle-approach basis rather than an *ad-hoc* one meant simply to disallow loss of revenues.

The phenomenon is not a mere national issue; it is global in nature. Taxing physical transaction may pose little or no problem as the items and persons to be taxed are easily identifiable. The borderless nature of e-commerce with its relatively recent development poses a major problem to taxation and tax regime. The tax authorities and collectors find difficulties in the administration and collection of tax. Therefore, identifying the problems associated with taxation

of e-commerce is only a step towards tackling the problems. A sure way is to have separate legal and regulatory frameworks for the taxation of electronic commerce or, as an alternative suggestion, to amend the existing tax laws to reflect taxation of electronic commerce.

Technological developments have resulted in an online environment that is ostensibly borderless in nature and with these developments, businesses require minimal or no physical presence to conduct commercial activities. The decrease in communications costs eliminates the barrier that distance used to represent for many businesses. As a result, corporations have many opportunities to locate their businesses anywhere in the world. These features raise difficulties for countries that tax corporate income on the basis of corporate residence and the source of income.

E-commerce challenges residence taxation by making it easier for corporations to decide where they want to be located for tax purposes. The residence of corporations is generally determined by the place of incorporation test or 'the place of management and control' test. The 'place of incorporation' test is subject to taxpayer manipulation because e-commerce can be conducted anywhere, as it is inexpensive to establish a company in a tax haven. Therefore, the test of place of incorporation basically allows taxpayers to decide whether they want to pay tax on the basis of residence or source of income.[181]

It is now axiomatic that a paradigm shift is occurring in the way business is conducted in the present economy. Tax policy is a major factor in the growth and development

---

[181] Jinyan Li and Jonathan See, 'Electronic Commerce and International Taxation' <http://osgoode.yorku.ca/osgmedia.nsf/0/04CFE186956B8C33852571CE0058C4B7/$FILE/ISUMA-Vol-3-no-1-Spr-02.pdf.>accessed on 13 August, 2011.

of any economy. However, with the recent global emergence of e-commerce, serious global challenges to tax policy and tax administration are inevitable. If new taxes are imposed and regulations increased, the benefits and potential of e-commerce may be curtailed. The area of taxing virtual economy is ambiguous, confusing and unsettled.[182]

The present tax regime did not envisage the sudden and exponential developments in Information and Communications Technology (ICT). The tax authorities, whose administrative powers are largely restricted to their local jurisdictions, are now faced with the challenges of the borderless world. While it is, of course, expedient for the Nigerian government to decide on the necessary public expenditure and to decide how to raise required revenue through the appropriate tax policies, it is necessary as well to keep in close contact with the global best tax practices that will address tax implications of electronic commerce which the present tax regime did not envisage. While amendment of the current tax laws and policies are inevitable, the various challenges of taxation of e-commerce must be put into consideration.

It has been shown that the world is changing, yet tax systems have been slow to change in the same direction. This can hinder economic progress, lead to a loss in tax revenue and frustrate taxpayers. The government should raise awareness and promote Nigerian Information Technology capabilities and competencies in the international market.

---

[182] Jac K. Shim, *et al*, *The International Handbook of Electronic Commerce*, (The Glenlake Publishing Company Ltd, USA 2000) 235.

Taxation of electronic commerce has been a serious debate both nationally and in the international environment. Dearth of direct legislation on e-commerce and its virtual nature have made it difficult for the government to establish the real and acceptable mechanism of taxing e-commerce.

As at the time tax laws were being made, e-commerce was never envisaged and therefore taxation of e-commerce is not within the framework of tax laws. Taxing e-commerce, therefore, would require a separate legal and regulatory framework; otherwise, amendment of the existing tax laws to accommodate taxation of virtual business would be of urgent necessity and because of the virtual nature of e-commerce, it would be difficult to enforce tax evasion and non-compliance with tax laws as e-commerce transactions are conducted without the contracting parties necessarily knowing each other.

It is, therefore, difficult for tax collectors to know who to tax, what to tax and when to tax. Therefore, mechanisms should be put in place by the government for the identification of taxpayers on the internet, what to tax and when to tax. This should, of course, be backed with laws to enforce compliance. If necessary machineries and statutory framework such as enforcing penalty of non-payment or if payment of interest for late payment are put in place to enforce tax payments, some of the challenges facing taxation of e-commerce would be alleviated. Monitoring and enforcement agency could be structured within the regulatory institution or otherwise, such responsibility could be devolved on existing law enforcement agencies.

There have been serious debates at the international level on taxation of electronic commerce. The OECD and

EU have severally considered the tax implications of e-commerce and several guidelines and reports have been handed down in this regard. Conventions, workshops and seminars based on these international models have also been organised. It is, therefore, recommended that in promulgating laws and formulating policies for taxation of e-commerce, regard should be had to the international models and treaties. The models and treaties can be adopted or adapted through the appropriate legislative process since they do not have the force of law in Nigeria until they are domesticated.[183]

The current Double Taxation Agreements are unclear on whether websites or host server is a permanent establishment that is subjected to tax. There is, therefore, a need for the government to re-negotiate DTAs to reflect and make the taxation status of electronic commerce certain.

There is need for specialists, practitioners and courts, specialising in taxation of e-commerce if justice must be done in the event of disputes. In order to have just and effective adjudication on taxation of e-commerce disputes, the intricacies and technical nature of information technology and the internet must be put into consideration. Practitioners and courts must, therefore, be specialists in the field of information technology and the internet.

---

[183] By Section 12 (1) of the Constitution of the Federal Republic of Nigeria 1999 (as amended), no treaty between the Federation and any other country shall have the force of law except to the extent to which such treaty has been enacted into law by the National Assembly. See also the Supreme Court cases of *The Registered Trustees of National Association of Health Practitioners of Nigeria v Medical and Health Workers Union of Nigeria & Others* (2008) 1 S.C. (Pt III) 1 at 36-37; *General Sanni Abacha & 3 Others v Chief Gani Fawehinmi* (2000) 4 S.C. (Pt II) 1 at 20-22.

Bibliography

Articles in Journals

Azam, R. (2007). E-Commerce Taxation and Cyberspace Law: The Integrative Adaptation Model. University of Virginia *Journal of Law and Technology* 12 (5).

Charlet, A. & Buydens, S. (2011). The OECD's Draft Guidelines on Neutrality for Value Added Taxes. *Tax Notes International* 61(6).

Hoffart, B. (2007). Permanent Establishment in the Digital Age: Improving and Stimulating Debate through an Access to Markets Proxy Approach. *North Western Journal of Technology and Intellectual Property* 6 (1).

Oguttu, A. W. & Ladi, S. T. (2009). The Challenges E-commerce Poses to the Determination of a Taxation Presence: The "Permanent Establishment" Concept Analysed from a South African Perspective. *Journal of International Commercial Law and Technology* 4 (3).

Pedwell, K. (2002). Taxation of Electronic Commerce: An Assessment of the Opportunities and Challenges Facing Taxpayers and tax Authorities. *International Academy Journal of E-Business* 1 (2).

Quinn, E. R. (1999). Tax Implications for Electronic Commerce over the Internet. *Journal of Technology Law & Policy* 4(3).

Articles on the Internet

Assimekopoulos, N. A.; Kotsimpos, G. K. & Riggas, A. N. International E-Taxation of E-commerce Using Systemic Analysis. <http://www.afscet.asso.fr/resSystemica/Crete02/Assimakopoulos,Kotsimpos,Riggas.pdf> accessed on 23 July, 2011.

Dayana, M. K. E-commerce and Taxation. <http://articles.manupatra.com/PopOpenArticle.aspx?1d=f3c75Cea-57Cl-4b7e-9881-3c5a339eddc7&txtsearch=> accessed on 10 July, 2011.

Double Taxation. <http://en.wikipedia.org/wiki/Double-Taxation> accessed on 03 March, 2011.

Electronic Commerce and the Challenges for Tax Administration. <http://unpan1.un.org/intradoc/groups/public/documents/unpan001065.pdf> accessed on 23 July, 2011.

Electronic Commerce: The Challenges to Tax Authorities and Taxpayers. <http://cryptome.info/turku18.htm> accessed on 13 August, 2011.

Enforcement Issues in Electronic Commerce. http://www.rashminsanghvi.com/Chapter3.pdf> accessed on 07 August, 2011.

Franchise Tax. <http://en.wikipedia.org/wiki/Franchise-tax> accessed on 15 July, 2011.

Gellerstein, W. Electronic Commerce and the Challenges for TaxAdministration. <http://inpan/.un.org/intradoc/public/documents/un/unpad001065.pdf> accessed on 12 August, 2011.

Implementation of the Ottawa Taxation Framework Conditions. <http://www.oecd.org/dataoecd/45/19/20499630> accessed on 22 July, 2011.

Internet Taxation- All about it and How it works. <http://e-commerce-journal.com/articles/internet-taxation-all-about-them> accessed on 30 July, 2010.

Internet Taxation: Issues and Legislation.<http://wikileaks.org/wiki/CRS-RL33261> accessed on 27 July 2010.

Internet Taxation. <https://gsbapps.Stanford.edu/Cases/documnets/P36.Pdf> accessed on 10 July, 2011.

Introduction of a BIT TAX? <http://morlin.obs.coe.int/iris/1996/9/articles6.en.html> accessed on 17 June, 2011.

Li, J. & See, J. Electronic Commerce and International Taxation.< http://osgoode.yorku.ca/osgmedia.nsf/0/04CFE186956B8C33852571CE0058C4B7/$FILE/ISUMA-Vol-3-no-1-Spr-02.pdf >accessed on13 August, 2011.

Nellen, A. E-commerce: To Tax or Not to Tax? That is the Question. Or is it? <http://www.cob.sjsu-edu/facstaff/nellen-a> accessed on 24 July, 2011.

Nellen, A. Overview to E-commerce Taxation Issues. <http://www.cob.sjsu.edu/facstaff/nellen-a> accessed on 24 July, 2011.

Nellen, A. Internet Usage or Bit Tax? <http://21stcenturytaxation.blogspot.com/2010/03/internet-wage-or-bit-tax.html> accessed on 14 July, 2011.

Overview of E-commerce in Nigeria from the Economist Intelligence Unit. <http://www.ebusinessforum.com/index.asp?layout=rich-tory&docid=8403&title=Overview+of+e+commerce+in+Nigeria&Channelid=31> accessed on 28 January, 2011.

Owens, J. Electronic Commerce Answering the Emerging Taxation Challenges. <http://lobby.la.psu.edu/080-Internet-Sales-Tax/Agency-Activities/ACEC/Challenges.d.c> accessed on 06 August, 2011.

Permanent Establishment. <http://en.wikipedia.org/wiki/permanent-establishment> accessed on 24 July, 2011.

Permanent Establishment. <http://umling.tripod.com/id17.html> accessed on 23 July, 2011.

Swindells C. & Henderson K. Legal Regulation of Electronic Commerce. <http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/1998-3/swindells#a2> accessed on 28 July, 2010.

Tax Residence. <http://en.wikipedia.org/wiki/Tax-residence> accessed on 03 March, 2011.

Tax Treaty. <http://en.wikipedia.org/wiki/tax-residence> accessed on 03 March, 2011.

Tax Treaty. <http://en.wikipedia.org/wiki/tax-treaty> accessed on 03 March, 2011.

Taxation of E-Commerce: Traversing the Principles Route. <http://legalperspectives.blogspot.com/2008/02/taxation-of-e-commerce-traversing.html> accessed on 10 July, 2011.

Taxation of E-commerce. <http://ww.out-law.com/page-7512> accessed on 03 March, 2011.

Taxation of E-commerce. <http:www.packet-on.com/docsp1/Taxation%20of%20e-commerce%20.pdf> accessed on 09 July, 2011.

Vat on E-Commerce. <http://www.expantax.nl/vate-commerce.htm> accessed on 03 March, 2011.

Vat on Electronic Services. <http://ec.europa.eu/taxation-customs/taxation/Vat/traders/e-commerce/index-en.htm> accessed on 22 July, 2011.

Books

Basu, S. (2007). *Global Perspectives on E-commerce Taxation Law.* England: Ashgate Publishing Limited.

Doemberg, R. L. & Hinnekens, L. (1999). *Electronic Commerce and International Taxation.* Khuwer Law International.

Gringras, C. (2008). *The Law of Internet* (2nd ed). London: Butterworths LexisNexis.

Shim, J. K. *et al* (2000). *The International Handbook of Electronic Commerce.* USA: The Glenlake Publishing Company Ltd.

Smith, G. J. H. (2007). *Internet Law and Regulation* (4th ed). London: Sweet and Maxwell.

Chapter in Book

Fergusson, M. (2000). 'An Internet Business Framework for Government Agencies' in Syed Mahbubur Rahman & Mahesh S. Raisinghani (eds), *Electronic Commerce: Opportunity and Challenges*. USA: Idea Group Publishing.

Papers Presented at Conferences, Workshops and Seminars

Hellerstein, W. (2002). 'Electronic Commerce and the Challenge for Tax Administration'. Paper Presented at Seminar on Revenue Implications of E-Commerce for Development Geneva, Switzerland. <www.wto.org/english/tratop-e/devel-e/sem05-e/hellerstein.doc> accessed on 19 August 2010 <http://un pan1.un.org/intadoc/grooups/public/documents/un/unpan001065.pdf> accessed on 19 August, 2010.

Jones, R. & Basu, S. (2001). 'Taxation of Electronic Commerce: A Developing Problems'. Paper Presented at the 16th BILETA Annual Conference, University of Edinburg, Scotland.

Nellen, A. (2001). 'E-Commerce: To Tax or Not to Tax? That is the Question... Or Not'. Paper Presented at Computer and Technology Conference, Software, Networks and E-Commerce, Berkeley Centre for Law & Technology and the University of Texas School of Law, San Francisco, California.

Reports and Official Documents

Organisation for Economic Cooperation and Development, 'Tax Administration Aspect of Electronic Commerce: Responding to the Challenges and Opportunities' (Report from the Forum on Strategic Management to the OECD Committee on Fiscal Affairs, February 2001).Organisation for Economic Cooperation and Development, 'Taxation and Electronic Commerce Implementation of the Ottawa Taxation Framework Conditions.'

'Personal Income Tax [Rates etc of Tax Deduction at Source (Withholding Tax)] Regulations' (Nigeria 1997).

Reports and Official Documents on the Internet

Avoidance of Double Taxation Agreements (DTAs) between Nigeria and Other Countries www.firs.gov.ng/DETAILED_COPIES_OF_THE_PUBLISHED_DATA_BETWEEN_NIGERIA_AND_OTHER_COUNTRIES.doc accessed on 30 September, 2010.

Organisation for Economic Cooperation and Development, 'Electronic Commerce: Taxation Framework Conditions' (Report Presented to the OECD Ministerial Conference on 'A Borderless World: Realising the Potential of Electronic Commerce' by the Committee on Fiscal Affairs on 8 October 1998 <http://www.oecd.org/dataoecd/46/3/1923256.pdf> accessed on 12 June, 2011.

Organisation for Economic Cooperation and Development, 'Implementation Issues for Taxation of Electronic Commerce' <http://www.oecd.org/dataoecd/38/42/5594899.pdf> accessed on 13 July, 2011.Organisation for Economic Cooperation and Development, 'Implementation Issues for Electronic Commerce' <www.oecd.org/dataoecd/38/42/5594899.pdf> accessed on 20 July, 2011.

'New European E-commerce VAT Rules' <http://www.fdcpa.com/VAT.rules.htm> accessed on 03 March, 2011.

Long Essay

Oduntan Olugbemi Adebayo, 'Taxation of Electronic Commerce: Prospect and Challenges for Nigeria' (LL.B Long Essay, University of Lagos, Nigeria 2010).

Index

A

acceptability challenges 98
anonymity of 83
assets 19
avoidance of double taxation agreements 65

B

bandwidth 12
bit tax 9
business customers 36
business functions 14
business to customer (B2C) 80
business-to-business (B2B) 71

C

certainty 4
challenges 71, 79
Christopher Cox 54
compromise Bill 55
consumption taxes 72
convenience of payment 11
council directive 48, 49
cyber-transactions 20

D

digitised goods 67
disintermediation 14, 84, 85
double taxation 25
double taxation agreement(s) 26, 27, 87, 103

E

e-cash 85, 86
e-commerce 1, 3, 17, 18, 35, 41, 84, 91, 92, 93, 98, 100
challenges 95
enterprises 94
payments 69
taxation 93
taxpayers 97
transactions 59, 60, 69
e-mail tax 12
economic activity 15
co-operation 41
growth 11
effectiveness 5
efficiency 4, 11
electronic commerce 1, 2, 35, 39, 51, 57, 59, 71
commerce trader 61, 64
services 36
encrypted information 14
enforcement 96
enforcement challenges 79
equity 11
European Commission 50
Union 50
Union Value Added Tax systems 23
Union's Approach 46
evasion opportunities 88
exchange of information 90

F

fairness 5
feasibility challenges 91
fixed place 94
flexibility 5, 15
fragmentation of 15
franchise tax 12

G

global communications systems 13
global electronic commerce 42
Goods and Services Taxes (GST) 72

Gross Domestic Products (GDPs) 5
guidelines 41

H

harmful tax practices 87
high tax jurisdictions 22

I

identity 81
immovable property 30
implementation challenges 71
implications of 35
income-classification rules 92
integration of 14
Internet 19, 67
Access Tax 7
age 71
Service Provider (ISP) 7
Tax Fairness Coalition 56
Tax Freedom Act (ITFA) 54

L

Location 17, 81
low-tax 22

M

marketing techniques 18
model tax convention 93
multinational enterprises (MNEs) 75

N

nature of 18
neutrality 3, 11
Nigerian law 35
Nigerian Tax 61
no-tax jurisdictions 22
non-e-commerce taxpayers 97
non-Nigerian 64
normative challenges 97

O

OECD Model 34
old rules 19
on-line merchants 54
online delivery 85
Organisation for Economic Co-operation and Development 3, 13, 41, 47, 93

P

permanent establishment 23, 24, 93
establishment rule 94
Personal Income Tax 68, 69
Act 27, 61
physical goods 36
private consumers 36
intranets 75
products 18

R

recovery of taxes 89
regulations on 68
remote workforce 19
residence 63
-based taxation 22
residency 95

S

Senator Ron Wyden 54
simplicity 4, 10
Small and Medium Enterprises (SMEs) 77
source rules 92
-based taxation 21

T

tax administration 71, 76
administrators 82, 84
havens 86
law 2, 4
residence 63, 64

systems 17, 82
treaties 74
-exempt organization(s) 19, 20
taxation 3
taxation framework conditions 3
issues 3
of 1
of e-commerce 42
of electronic commerce 46, 52
right 74
systems 5
taxing jurisdiction 88
taxpayer 3
service 90
Technical Assistance Groups (TAGs) 44
telecommunications tax 8
transactions 20, 83
transfer pricing 75

U

United Kingdom's Tax Policy 51
United States' Approach 52
unrelated business taxable income (UBTI) 20

V

Value Added Tax (VAT) 9, 35,60
Value Added Tax Act 59
value added tax systems 72
vendors 3

W

withholding tax 67, 68