NEWSLETTER
17 OCTOBER, 2021

REVIEW OF THE STATEMENT ON A TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY.

1. INTRODUCTION

1.1 The 8th of October 2021 saw a significant development in the international tax regime as the international community struck a ground-breaking tax deal for the digital age. This deal characterised as the 'Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy' (the Agreement) has been in the works since 2015 and has now seen 136 countries out of the 140 members of the Organisation for Economic Cooperation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) move towards reforming international tax rules to be suitable for the 21st Century. Interestingly, Nigeria is one of the countries that are yet to join the Agreement.

1.2 The Agreement will ensure that Multinational Enterprises (MNEs) will be subject to a minimum of 15% tax rate from 2023. This will see member countries collect around US$150 Billion as revenue annually.

1.3 This Newsletter will review the Agreement, attempt to explain why Nigeria is yet to join the Agreement and how Nigeria's non-inclusion will affect Nigeria if she does not eventually join the Agreement.

2. The Two-Pillars

Pillar One

2.1 This Pillar (Nexus and Profit Allocation Rules) focuses on MNEs with a global turnover of above 20 Billion Euros and a profitability ratio of above 10%. It will see to a fair distribution of profits among countries with respect to the MNEs. Also, some taxing rights over the MNEs and profit in excess of 10% of revenue will be re-allocated from their home countries to the markets where they have business activities and earn profits on revenue of atleast 1 Million Euros (market jurisdiction) irrespective of whether the MNEs have a physical presence there. For countries with a GDP lower than 40 Billion Euros, the re-allocation will be for profits on revenue of at least 250 Thousand Euros.

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2.2 Further, the MNEs will benefit from dispute prevention and resolution mechanisms, which will avoid double taxation, in a mandatory and binding manner, without delaying the substantive dispute prevention and resolution mechanism.

2.3 The Multilateral Convention (MLC) will require all parties to remove all *Digital Services Taxes* and other relevant similar measures with respect to all companies and to commit not to introduce such measures in the future. No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8th October 2021 and until the earlier of 31st December 2023 or the coming into force of the MLC.

Pillar-Two

2.4 This consists of two interlocking domestic rules vis: (i) an Income Inclusion Rule (IIR), which imposes a top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and (ii) an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR. The two rules are known as together the Global anti-Base Erosion Rules (GloBE rules) or Global Minimum Tax Rules.

2.5 It also consists of a treaty-based rule (the Subject to Tax Rule (STTR)) that allows source jurisdictions to impose limited source taxation on certain related-party payments subject to tax below a minimum rate.

2.6 The minimum rate for this Pillar is 15% and same shall apply to companies with revenue above 750 Million Euros and is estimated to generate around US$150 billion in additional global tax revenues annually.

3. Our thoughts

3.1. As indicated by the Secretary-General of the OECD, Mathias Cormann, the Agreement will make international tax arrangements fairer and work better. We believe that effective implementation of the Agreement will see developed and developing countries benefiting from Cross Border trade and services by MNEs.

3.2. While we would expect that Nigeria by issuing the Companies Income Tax (Significant Economic Presence) Order 2020 to define the meaning of Significant

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Economic Presence in the Finance Act 2020 as taxation of activities of non-resident digital service providing companies such as Amazon, Netflix, Zoom, etc; would readily agree to an Agreement such as the one under review, Nigeria is yet to sign the Agreement.

3.3. It appears that the presence of the *Digital Services Tax* in Nigeria runs against the requirement for the Multilateral Convention with respect to the Agreement, that countries should remove all *Digital Services Taxes* and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. For Nigeria to join the Agreement, that aspect of the Nigerian law will be expunged. This will require a legislative process of amending the relevant laws.

3.4. Further, we believe that Nigeria is yet to join the Agreement because of the complexity, technical issues, tax uncertainties and resource issues for the implementation of the Agreement. These were issues that stalled the process of reaching a consensus with respect to the Pillars in October 2020.

3.5. In addition, the mandatory and binding disputes resolution mechanisms to promote tax certainty puts Nigeria in a disadvantaged position because the judiciary as presently constituted does not give confidence in the effective and timely resolution of treaty-related disputes.

4. Conclusion

4.1. We cannot say whether Nigeria will join the Agreement before it starts to be implemented in 2023. We believe however that when steps are taken to cure the impediments as enumerated above, Nigeria will be in a better position to join the Agreement, otherwise, Nigeria will miss out on the opportunity to boost its revenue through the reformed international tax system.

4.2. While we are hopeful that Nigeria joins this Agreement soon, we shall give an update when she does.

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