REVISITING THE NIGERIAN TAX TREATY NETWORK AND ITS IMPACT ON FOREIGN DIRECT INVESTMENT*

Abstract

A country's tax regime is always a key factor for any business considering moving into new markets. The major reason states sign tax treaties is so as to avoid international double taxation which usually arise as a result of cross-border trade and investment. For a capital importing or developing country like Nigeria, attracting Foreign Direct Investment (FDI) which will facilitate the transfer of technology and drive economic development and growth is good reason for entering into tax treaty negotiations and agreements with capital exporting or developed countries. Since independence, Nigeria has signed several tax treaties which created legally binding obligations between it and other countries. As a country blessed by God with abundant natural resources, Nigeria, ideally, is an investment haven for both local and foreign investors. Unfortunately, the inflow of Foreign Direct Investment (FDI) to the country is abysmally poor and low when compared to its potentials. More so, the Nigerian tax treaty network which is aimed at attracting Foreign Direct Investment (FDI) seems not only unsatisfactory and inadequate but has also constituted a hindrance to the inflow of investments into the country. This article evaluates the Nigerian tax treaty network and its impact on Foreign Direct Investment. The paper finds that many of the extant tax treaties tn Nigeria hae not been ratified and those ratified have not been domesticated as required by the Constitution and suggests that there is need for change in the status quo. It makes some recommendations which if followed could help Nigeria in realizing its objectives in entering into better tax treaty arrangements.

Keywords: "Tax Treaty", "Tax Treaty Network", "Double Taxation", "Foreign Direct Investment".

1. Introduction

Tax is a major source of revenue generation to the government. It is one of the most important activity of governments all over the world d[1] to generate revenue in order to provide basic social

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[1] M More; 'The Taxation- Governance Connection', *Nigerian Taxation*, Vol. 10, Nos. 1,2, (2008), Chartered Institute of Taxation of Nigeria, Lagos

amenities for the citizens. In the *United States case of Nichols Vs Ames*[2], the court emphasized the importance of tax thus:

> Tax is one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as the air he breathes to the natural man. It is not only the power to destroy; it is also the power to keep alive.

Generally, the imposition of tax on any item is chiefly dependent on the movement and place of the commercial transaction or activities. In a world today where there exists wide-spread coordination and integration of national economies and increase in the number of business functioning and operating globally, the need for international tax treaties becomes crucial[3]. Tax treaties or arrangements have the effect of moderating the impact of domestic laws on cross-border transactions as well as providing benefits to the respective countries involved.[4]

Basically, tax treaties are negotiated by countries because of conflicts that usually arise on the taxation of incomes and capitals earned from cross-border trade[5]. Even when there are no conflicts, tax treaties are still very pertinent to avoid double taxation since every country has its own taxing powers free and independent of the other. By entering into tax treaty or double taxation arrangements, capital importing or developing countries provide to the foreign investors the needed security and stability as regards issues pertaining to taxation in addition to the relief from double taxation[6]. For developing countries to remain in their quest for Foreign Direct Investment, it is argued that more attention should be given to tax treaties[7]. This is because it is through tax treaties that their dreams of attracting foreign direct investments can be achieved.

As a Commonwealth country, Nigeria's tax treaty network was focused mainly on Commonwealth countries whereby reliefs were generously granted to taxpayers that had paid or were liable to pay tax in any of the commonwealth countries. However, due to the increasing trend in international business and the widening scope of the country's trading partners beyond the spheres of commonwealth countries, the commonwealth reliefs were soon replaced with income tax treaties. With Nigeria's abundant natural resources, the country is supposed to be an investment haven but it is sadly not. According to the statistics from the International Monetary Fund (IMF) and the World Bank, the ratio of Foreign Direct Investment (FDI) in Nigeria is nothing to write home about considering the country's potentials[8].

[2] *Nichols v Ames U.S.* 509 (1899) P. 515.

[3] M Kobetsky; 'International Taxation of Permanent Establishment, Principles and Policy (Cambridge University Press, 2011) 1.

[4] International Taxation, Faculty of the Chartered Institute of Taxation of Nigeria, Nigerian Tax Treaty Manual, CITN, Lagos (2014), 13.

[5] *Ibid*.

[6] E Neumayer ; 'Do Double Tax Treaties Increase Foreign Direct Investment to Developing Countries?' (2007) (Vol. 43 No. 8) *Journal of Development*, 1501. Available at <https//papers.coms2013>Delivery>Accessed 1/5/2020.

[7] *Ibid*

[8] A Adejugbe; 'Foreign Direct Investment in Nigeria: Overcoming Legal and Regulatory Challenges to Foreign Direct Investment in Nigeria. Is the Nigerian Government Doing Enough? (2003). Available at <https://papers.ssm.com/abstract?2013. Accessed 1/5/2020.

The situation may be attributed in part to the promulgation of the Nigerian Enterprises Promotion Decree[9] in 1972 which was aimed at indigenizing most sectors of the economy to ensure that Nigerians assume greater control of certain percentage of enterprises within the economy[10]. It was reported that in 1998, Foreign Direct Investment in the non-oil sector was completely negative as foreigners divested from Nigeria. This paper therefore examines the impact of the Nigerian tax treaty network on the inflow of Foreign Direct Investment.

2 Conceptual Clarification:

2.1 Tax Treaty: Otherwise known as Double Taxation Agreement (DTA) could be defined as an agreement between two or more countries (also known as contracting states or parties) with the aim of ensuring that a resident of one or both of the contracting states does not have to suffer from paying double tax on the same income in both jurisdictions or unduly gain from not paying appropriate taxes in any of the states through tax avoidance or evasion. It is an agreement entered into by sovereign states creating binding tax obligations between them as subjects of International Law.[11]Tax treaty agreement may cover taxes on income and capital only, and may not extend to consumption taxes such as Value Added Tax or sales taxes. It appropriates taxing rights and powers between the contracting parties with a view to preventing double taxation[12]. According to Fabian Barthel, the main role of modern tax treaties is to allocate taxing rights, primarily by shifting rights from capital importing nations to capital exporting nations[13]. Developed and developing countries worldwide use tax treaties as a means to reduce tax impediments to cross-border trade and investment and to mitigate the risk of double taxation[14]. By reducing tax impediments to cross-border trade and investments, foreign investors are most likely to invest in a treaty country because of the impact of the treaty on domestic laws of a source country.

Tax treaties generally determine the amount of tax that a country can apply to a taxpayer's income, their capital, estate, or wealth[15]. To avoid double taxation, tax treaties may follow either the Organization for Economic Co-operation and Development (OECD) or the United Nations (UN) Model Convention. The Organization for Economic Co-operation and Development[16] Tax Convention on Income and on capital is more favourable to capital-exporting countries than capital-importing countries and it requires the source country to give up some or all of its tax on certain categories of income earned by residents of the other treaty country.[17]

[9] Now, Nigerian Enterprises Promotion Act, 1972.
[10] O M Okoye; *Principles of Development Administration*, (Onitsha: Abbot Books Ltd, 2003), p.125.
[11] U O Umozurike; *Introduction to International Law* (Ibadan: Spectrum Books Limited, 2010) p.16.
[12]M Kobesky; International Taxation of Permanent Establishment, Principles and Policy (Cambridge University Press 2011) 1.
[13] B Fabian et al; 'The Relationship between Double Taxation Treaties and Foreign Direct Investment', in M Long et al., (eds); *Tax Treaties: Building Bridges between Law and Economics* (Lagos: IBED, 2010). pp. 3-18.
[14] A Oluseye and F Fatai; 'Improved Double Tax Arrangements in Nigeria: Any Reason for Delay' (2015) Inside Tax (Deloitte).
[15] Organization for Economic Co-Operation and Development (OCED) 'Glossary of Tax Terms: taxation Treaty'. Accessed 1/5/2020.
[16] The OECD Tax Convention on Income and on capital is a group of 36 countries with a drive to promote world trade and economic progress.
[17] Organization for Economic Co-Operation and Development. 'Model Tax Convention on Income and on capital: Condensed Version 2017'. pages 15-18. Accessed 1/5/2020.

The United Nations treaty model which is the second treaty model seeks to increase political and economic cooperation amongst its member countries, gives favourable taxing rights to foreign country of investment and it is more favourable to developing or capital importing countries. Tax treaties provide mechanisms to eliminate double taxation of business and wage income earned by individuals who live or have their main income in one country but (temporarily) work in another country.

2.2 Tax Treaty Network: Tax treaty network on the other hand, simply put, has to do with countries that have tax treaties with a particular country. a wide-spread network of tax treaties thus contributes to the competitiveness of an economy and brings economic growth and development. The number of tax treaty network a country has helps in attracting Foreign Direct Investments into it.

2.3 Double Taxation: This refers to the imposition of two taxes of a similar character on the same profit during the same period and for the same taxing purpose. It has to do with the levying of tax by two or more jurisdictions on the same income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes)[18]. It involves the taxation of some income or activity twice. Double taxation is the bane of economic development and growth. This informs why states usually come together to form a symbiotic relationship so as to escape the destructive tendencies of double taxation or reduce it to zero decimal.

2.4.1 Foreign Direct Investment: A foreign direct investment is an investment made by a firm or individual in one country into business interests located in another country.[19] It takes place when an investor establishes foreign business assets in a foreign company. The major feature of foreign direct investment is that it establishes either effective control or at least substantial influence over the decision-making of a foreign enterprise. Foreign direct investment is different from portfolio investment which is the purchase of equities by an investor from another country. A perfect example of foreign direct investments in Nigeria is subsidiaries of multi-national companies or corporations.

3 Reasons for Tax Treaties

Nations enter into Double Taxation Arrangements for variety of reasons. For each treaty entered into and for each country, the reasons are likely to be different, depending on the prevailing economic and political situation of the country and its relations with the potential contracting party. Some of the reasons includes:

A. Political Reasons: Countries may enter into tax treaties for instance
   - To foster diplomatic or other relations with the other
   - To strengthen regional diplomatic, economic and trade ties
   - To send a message of readiness and willingness to abide and adopt international tax norms.
   - To comply with international obligations for example under regional agreements.

B. To facilitate outbound investment by residents:
   - By removing completely or reducing tax discrimination on investment on the other country.
   - By completely removing or reducing double taxation on investment in the other country.

[18] en. m, Wikipedia.org/wiki/Double-Taxation. Accessed 8/5/2020

[19] www.investopedia.com/terms/f/d/i Accessed 8/5/2020.

- By providing simplicity and/or certainty with respect to taxation on investment in the other country on outbound investment by residents.
- By reducing drastically excessive source country taxation.

C. To enhance and encourage inbound investment and inbound transfers of technology and skills by residents of the other country by:
- Maintaining benefits of tax concessions and tax holidays provided with respect to inbound investments or transfers.
- Reducing excessive source taxation.
- Completely removing or reducing double taxation on the inbound investment or transfers.
- Developing a closer relationship between tax authorities or officials and business for instance through the mutual agreement procedure.

D. To reduce to the barest minimum cross-border tax avoidance and evasion through:
- Mutual assistance in collection of taxes
- And exchange of information

E. For developing countries, the reason may be the following:
- To attract foreign direct investment.
- To respond to political or other pressure from other countries
- To attract inbound transfers of skills and technology.

3 Historical Development of Nigerian Tax Treaties/Double Taxation

Just like tax legislations, tax treaties are very old in Nigeria. Income Tax Ordinance (CITO) was enacted in Nigeria as far back as 1939. One major shortcoming of the Ordinance was that it left out individuals from the tax net. This resulted to the enactment of the Income Tax Ordinance in 1940 as a substitute.[20]This very enactment brought both individuals and companies into the tax net under a single codification. In 1943 (ie three years later), the 1940 ordinance was replaced by the Income Tax Ordinance, No. 29 of 1943. This latest ordinance took effect from 1st April, 1943. The ordinance covers both the protectorate and as well as the colony. Section 33(1) of the Ordinance states that:

> If the governor in council by order declares that arrangements specified in the order have been made with the Government of any territory outside Nigeria with a view to affording relief from double taxation in relation to tax imposed under the provisions of this ordinance and any tax of a similar character imposed by the laws of that territory, and that is expedient that those arrangements shall have effect, the arrangements shall have effect not withstanding anything in any enactment.

[20] In March 1940, the government issued an Income Tax Ordinance, which mandated that women whose yearly incomes were less than 50 pounds per year would pay a flat rate of 5 pounds, but women who earned 50 pounds or higher would be taxed 3 dollars on each pound.

The above provision of the 1943 Income Tax Ordinance.[21] As at 1948 and 1958, Nigeria it should be noted, operated federal and unitary systems of government though at different periods, of which the constitutions of those times did not require adoption and transformation of tax treaties or the domestication of same before they are enforceable in Nigeria. Why this happened was because Nigeria was not yet a sovereign State at that material time. Nigeria also lacked the very essence of statehood as it were at that period. The era, represented the formative years of the Nigerian tax system as the country's economy was not extensively global as it is today. In 1958 when the Income Tax Ordinance of 1943 was consolidated and amended as CAP 85, again the section 35(1) of the consolidated Ordinance provided for Double Taxation Arrangements and it remained in existence until 1961 when the companies Income Tax Act was enacted. Section 39(1) of the Companies Income Tax Act retains the provision for Double Taxation Arrangements in tenor and spirit with the 1943 Ordinance. Currently however, the Double Taxation Arrangement is provided for in section 45(1) of Companies Income Tax Act.[22]

4 The Nature and Legal Status of Nigerian Tax Treaties

Nigeria today is practicing a constitutional democracy known amongst other things for its doctrine of separation of powers. This presupposes that there is a division of power amongst the three arms of government in Nigeria namely, the Executive, the Legislature and the Judiciary. Each of these arms of government has specific functions of which it is expected that non should encroach on the function of the other. The legislature, according to section 4 of the constitution,[23]is saddled with the responsibility of making laws for the federation. The constitution, however, made it mandatory that for a treaty to become enforceable in Nigeria, it must be enacted into law by the National Assembly.[24] The purport of this is that every treaty between Nigeria and other countries must be domesticated in Nigeria before it can be enforceable. In other words, a substantive requirement that validates the application of treaty provisions to individuals is the transformation of the treaty into domestic law.[25]

The Supreme Court of Nigeria in the popular case of *Abacha v Fawehinm*[26] reiterated this position of law when the apex court held that an international treaty entered into by Nigeria will not be binding until enacted into law (domesticated) by the National Assembly. Although section 45 of the Company Income Tax Act, 2007 provides that the Minister of Finance (MOF) may by order give effect to any Double Taxation Treaty between Nigeria and another country, the common knowledge is that the Constitution takes precedence over all other laws. Therefore, it has always been the practice that treaties will not become effective until they are domesticated or enacted into law by the National Assembly as required by the Constitution. An international treaty has no force of law and its provisions are not justiciable in the Nigerian courts until it is domesticated or enacted into law by the National Assembly.

[21] which was later codified as CAP 92, Laws of the Federation of Nigeria, 1948 formed the basis of signing some Double Taxation Arrangements by Nigeria during the colonial era
See fourth schedule to CAP 22, Laws of Federation of Nigeria, LFN, 1961 for the list of all the Double Taxation Arrangements by Nigeria during colonial period.
[22] Companies Income Tax Act, CAP 121, Laws of the Federation of Nigeria, 2004.
[23] Constitution of the Federal Republic of Nigeria 1999 (as amended)
[24] Section 12, Constitution of the Federal Republic of Nigeria 1999 (as amended)
[25] U O Umozurike, *Introduction to International Law*; (Ibadan: Spectrum Books Limited, 2010) p. 30.
[26] *Abacha* vs *Fawehinmi* (1999 – 2000) 5 ALLNLR

A treaty ranks at par with other domestic laws though not superior to the constitution once it is enacted into law.[27] An inquiry into the National Assembly of Nigeria and the Ministry of Justice has revealed that most (if not all) of the Nigerian tax treaties are in breach of the constitutional requirements for domestication of international treaties. The inquiry revealed that the nature of the Nigerian tax treaties is that some are ratified but not domesticated or enacted into law as required by the constitution by the National Assembly and as such, they are not justiciable or enforceable. What then is the need of a tax treaty that is ratified but not enacted into Nigerian law by the National Assembly as required by the constitution? Is it in the best interest of the country to ratify a treaty without domesticating it? Can a treaty in this state attract foreign direct investment into the country? Ratification, albeit synonymous with adoption or enactment, are not actually one and the same.

5 Nigerian Tax Treaty Network and Its Impact on Inflow of Foreign Direct Investment

The major highlights of the National Tax Policy of the Federal Government of Nigeria is that Nigeria shall continue to pursue and expand its frontiers on international tax treaties, as well as respect its obligations in the contract so as to encourage among other things the inflow of foreign direct investment[28]. The country currently has twenty-two (22). Double Taxation Treaties with other countries. Out of these treaties, only fifteen (15) have been ratified. These include the treaties with the following countries: The United Kingdom, the Netherlands, Canada, South Africa, China, Philippines, Pakistan, Romania, Belgium, France, Mauritius, South Korea, Sweden, Slovakia, and Italy.

The treaties that are yet to be ratified include those with the following countries: Kenya, Poland, Singapore, Qatar, Spain, UAE, Cameroon and Ghana. Except the treaty with Italy which covers Air and Shipping agreements only, all the other treaties are comprehensive. Although there is an increase in the inflow of foreign direct investment into Nigeria since signing the tax treaties, the volume is abysmally poor when compared to the potentials of the country. Earnings from crude oil sale as it were have made Nigeria not to pay adequate attention to policies that can increase internally generated revenue such as taxation and as well promote the inflow of foreign direct investments to supplement domestic investment. Foreign Direct Investment (FDI) is crucial for Nigerian economy because it engenders the transfer of technology and improvement in productivity, which ultimately would result in the alleviation of widespread poverty in the country by increasing per capital income and improving the overall standard of living[29]. Apart from supplementing domestic investments, foreign direct investment stimulates domestic competition and employment generation[30].

It is therefore an established fact that economic development in the developing countries including Nigeria can be linked to the level of foreign direct investment (FDI) inflow. The present state of Nigerian economy suggests that either there are not enough tax treaty negotiations that would attract substantial inflow of foreign direct investments or that the one

[27] *Ibid*
[28] Chapter 5 of the Nigerian National Tax Policy, 2016
[29] DBJ, 'Foreign Direct Investment in Nigeria', (2012), *Dartmouth Business Journal* <dartmouthbusinessjournal.com>foreign
[30] F O Koya, 'Foreign Direct Investment and Economic Growth: A Case of Nigeria', (2017), <m.covenentuniversity.edu.ng>profile. Accessed 5/5/2020.

already negotiated are not beneficial to the country. In supporting this position, Omoigui-Okauru[31] in analyzing the Nigerian tax treaty network on March, 2012 states that:

> The narrow treaty belies the extent of foreign direct investments into and out of Nigeria. Our current tax treaty network is not only inadequate and unsatisfactory, but may be viewed as an impediment to the inflow of investment into Nigeria and expansion by Nigerian companies to the other treaty jurisdictions.

The Nigeria tax treaty network has not really impacted positively on inflow of Foreign Direct Investment and this seriously calls for a change in the *status quo*.

6 Conclusion and Recommendations

As stated earlier in this paper, the major reason countries enter into tax treaty agreements is so as to avoid international double taxation which always result from cross-border trades and investments. However, most countries especially developing countries go into tax treaty negotiations because they want to attract foreign direct investment which will engender economic growth and development in their countries.

Nigeria has entered into many tax treaty agreements with many countries but it seems that those international tax treaty agreements have not really attracted the much desired foreign direct investments into the country considering Nigeria's potentials.

Therefore, to attract much foreign direct investment as the country would want, it is recommended that it needs to enlarge its tax treaty network, targeting the developed (capital exporting) countries. There is a need to expand the Nigeria tax treaty network as the number of effective double taxation treaty generally reflect the volume of favourable cross-border trade negotiations that the country has entered into.

The country needs to enter into more tax treaties like other countries. For example, the United Kingdom has one hundred and thirty-one tax treaties, Canada has ninety-two, United States has seventy, and Malaysia has sixty-eight. Focus, however, should be on beneficial tax treaties not just the number. Nigeria should ensure that any tax treaty it enters into is beneficial and provides maximum value for the country. Tax experts should be involved in the tax treaty negotiations always.

More so, the tax treaties that the country entered into already should not just be ratified but should be enacted or domesticated in line with the requirement in section 12 of the 1999 constitution of Nigeria (as amended). This if done, will make the treaties enforceable and effective in Nigeria.

[31] Mrs Ifueko Omoigui-Okauru, the Executive Chairman of Federal Inland Revenue Service.