TAX BITES

MONTHLY FOCUS ON TAX RELATED ISSUES

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15 reasons why October 5th is a day to remember in the Nigerian tax terrain

There are some days that go unnoticed to many; which in the long run turn out to be significant. One that easily comes to mind is 6th August 1991. On that day, Tim Bernes-Lee launched the first ever web browser. For many businesses operating in Nigeria, as well as tax and finance officers based in Nigeria, 5th October 2015 could very well be a day of significance that has gone unnoticed.

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Except 5th October was your birthday, or wedding anniversary, or something along those lines, chances are it was just another Monday when you had to get on with whatever it was you had to do for the week. You woke up, dragged yourself to work (if you're one of those that hate Mondays), got stuck in traffic, worked hard (or pretended to), returned to the traffic, got home, and slept. But I tell you, if you are a tax professional or someone with tax oversight function in any business, you should pay attention. 5th October 2015 wasn't just another day. We are about to see a new set of issues in the Nigerian tax space and the events of that day could very well be the catalyst that will quickly bring those issues to the fore.

There are many events that are remembered long after they have happened. Take 5th of November 1605, when Guy Fawkes was captured under the House of Lords trying to blow up King James I and his parliament. The event created an instant stir and till today is still commemorated in many parts of the world as a Bonfire night.

Then there are days that go unnoticed to many; which in the long run turn out to be significant. 6th August 1991 comes to mind. On that day, Tim Bernes-Lee launched the first ever web browser. For many businesses operating in Nigeria, as well as tax and finance officers based in Nigeria, 5th October 2015 could very well be a day of significance that has gone unnoticed.

On 5th October 2015, the OECD released its final package on the 15 BEPS action plans. In case you are asking; why on earth should I be bothered about the OECD? Isn't that a gang of rich nations? And BEPS? Doesn't it have to do with complicated tax issues that only developed countries understand? Why should I be concerned? This is Naija; all those "Oyinbo" things do not matter here. Well, you couldn't be more wrong.

It has been a while since developing countries felt their interests on tax matters were aligned with those of the developed countries. Developing countries have always felt they do not get the right amount of taxes in their countries because the multinationals that operate there prefer to move all their profits to the other side of the world. In the last few years however, these countries seem to be accepting that the developed countries may not be the real problem and that in fact, neither of them seems to be getting as big a chunk of the pie as they should.

BEPS stands for Base Erosion and Profit Shifting. It is a phrase used to describe complex tax avoidance schemes used by multinationals to minimise their overall tax burden. It is believed that this happens largely because the existing international tax rules are outdated. The OECD's BEPS action plan is an attempt by members of the G20 to revamp the rules to better deal with the complex structures that make profits shifting possible. Because many of these structures are not illegal, tax authorities are not able to counter them under existing tax frameworks. The foundations and fundamental principles guiding the current international tax frameworks were laid as far back as 100 years ago long before the internet was invented.

Today you can buy almost anything online, from books to cars or pay for services from a company based abroad. In the old days these companies would have had to open a shop in Nigeria to service their customers. But in this day and age this is no longer necessary. In the old days the shop in Nigeria would have been liable to tax on the profits they make from selling to Nigerian customers but thanks to the internet, they pay no tax because they do not have a shop in Nigeria and the law will only tax you if you have a "shop" in Nigeria. So what has basically happened is that the way of doing business and making profits has changed but the laws which impose tax on the profits have stayed the same; and the tax authorities are trying to change this. Think about it, it's hard to see any aspect of business or the way we live in general that has not changed in the last 10 years let alone 100 years, yet many of the core principles guiding international taxation have remained unchanged for over a century.

There is a Yoruba adage which says: it is the way that the bird flies that the hunter will throw stones at it. The BEPS package is essentially the OECD trying to change the way that it stones the birds since the bird's flying style (or call it swag if you like) has changed. The interesting thing is that I actually heard this Yoruba adage first from the head of the TP division of the FIRS. I think this nicely captures the FIRS' view on BEPS, Transfer Pricing and Tax as a whole.

Ten years ago, it was hard to imagine a conversation with the FIRS where current international tax issues would come up. Back then, it was hard to think the FIRS would bring up issues such as BEPS, Controlled Foreign Corporation (CFC) Rules, Transfer Pricing, Treaty Abuse etc in a regular conversation. But this is happening now. And all of this has happened in a short space of roughly two years thanks to their involvement in the BEPS project. Yes the BEPS project is an initiative of the so called "rich countries". But African tax authorities including the FIRS have monitored the developments very closely and are set to begin implementing a number of the recommendations which they consider to be very relevant. The African Tax Administrator's Forum (ATAF) is providing support to its members. The OECD and other multilateral organisations are also supporting African countries. All of this means that the release of the BEPS package on 5 October is set to change the practice of taxation in Africa and indeed in Nigeria.

The BEPS action plans consist of 15 actions targeted at 3 broad objectives: introducing coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in the existing international standards, and improving transparency as well as certainty. I will explain all of this in a bit.

While growing up, one of my younger neighbours was often left behind in school after every other student had gone home. The reason was: his Dad would often think his Mom would be picking him up from school, while his Mom would assume his Dad was picking him up. While this lack of coherence between parents can be a sorry state of affairs for a child, it could be a very welcome arrangement if the child in the analogy is the profit from a business and the lack of coherence is coming from two taxing authorities who somehow manage not to tax the profits even though they both intended to. The OECD believes lack of coherence between countries particularly when their domestic tax laws treat the same transactions differently has led to instances where, like the child that is somehow forgotten by both parents, the profits from transactions are ignored by both tax authorities. The OECD believes that this type of double non-taxation happens on a significant scale and has tried to curtail this through several of the BEPS action plans. In particular Action 2 (Hybrid Mismatch), Action 3 (CFC Rules), Action 4 (Interest Deductions), Action 5 (Harmful Tax Practices) attempt to address BEPS issues arising from a lack of coherence in the international tax rules adopted by different countries.

I once paid what I considered to be a tidy sum for a shirt. You can imagine my annoyance when I found out a friend of mine had paid almost half of the price for exactly the same shirt from the same supplier on the same day I made my purchase. Obviously if I had this information beforehand I would never have accepted the expensive offer. Many tax authorities feel the same way. They believe they are settling for less than they should and can never tell for sure if the profits that are being reported by subsidiaries of multinationals in their countries are adequate because they do not know what profits are being reported by the other foreign related parties who deal with these subsidiaries and make profits from the transactions. The action plans on transparency seek to ensure that tax authorities have access to information from the "other side of the transaction" to allow them make reasonable assessments of BEPS activities. These include Action 11 (Measuring and Monitoring BEPS), Action 12 (Disclosure of Aggressive Tax Planning) and Action 13 (TP documentation and CbyC Reporting).

You may have heard the story of a supposedly "Under 17" football player who was rated very highly due to his performance at a youth tournament. He got a good deal from a top football club as a result. The club believed it was a worthy investment since he was still young and had a lot of energy and many more years of good football ahead of him. They were wrong. 3 years later and his career was over. It seemed the age that had been declared "in the contract" was different from his real age (substance). The contractual age and not the substantial age had determined the price. Tax authorities believe the contractual information on intercompany transactions do not always reflect the actual substance of the transactions. Because of this, many intercompany transactions are priced incorrectly, leading to base erosion. In order to counter this, the OECD has several action plans which seek to ensure that pricing will follow substance rather than contractual arrangements. These include Action 6 (Treaty Abuse) and Action 7 (Artificial Avoidance of PE). There are also Actions 8 to 10 (Aligning Transfer Pricing Outcome with Value Creation) which primarily deal with changes to the OECD TP guidelines.

A number of the action plans deal with other issues which may not fall neatly under any of the three broad categories discussed above. They include Action 1 (Digital Business), Action 14 (Dispute resolution) and Action 15 (Multilateral instruments).

October 5th has come and gone and it is only a matter of time before we start to see the impact. Whereas not all the issues being addressed by the action plans are an urgent concern for the FIRS, there are many of them that have tickled the taxman's interest.

As a taxpayer, there is nothing wrong with arranging your affairs in a way that helps to minimise your costs (including tax). After all, you are in business to make profits. It is not illegal and arguably you have a right to do so. You however need to make sure that you are playing within the rules. You also need to be alert to changes in the rules and changes in the attitude of the rule-makers so you are not caught unawares. BEPS is changing the rules and the attitude of governments globally and in Nigeria.

When I heard the hunter and the bird adage from the FIRS, one of the proverbs in Chinua Achebe's things fall apart immediately came to mind. "Eneke the bird says that since men have learned to shoot without missing, he has learned to fly without perching". The FIRS is training to shoot without missing. What are you doing about it?

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