

**AN APPRAISAL OF TAXATION AND ITS LEGAL EFFECTS  
ON FOREIGN DIRECT INVESTMENT IN NIGERIA**

**BY**

**Musa NDAGI**  
*LL.B (HONS.) ABU, LL.M (ABU), B.L*  
**PhD/LAW/4739/2011/2012**

**JANUARY, 2016**

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**A THESIS SUBMITTED TO THE SCHOOL OF POST  
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REQUIREMENTS FOR THE AWARD OF DOCTOR OF  
PHILOSOPHY (PhD) IN LAW**

**DEPARTMENT OF COMMERCIAL LAW**

**JANUARY, 2016**

## **DECLARATION**

I hereby declare that this thesis is solely the result of my personal efforts.

It has never been presented or published anywhere. All quotations and references are indicated and their sources duly acknowledged.

**NDAGI MUSA**

\_\_\_\_\_  
**Date**

Ahmadu Bello University, Zaria

January, 2016

## CERTIFICATION

This dissertation, entitled: “An appraisal of Taxation and its Legal Effects on Foreign Direct Investment in Nigeria”, meets the requirements for the award of the degree of Doctor of Philosophy, (PhD), from the Department of Commercial Law, Ahmadu Bello University, Zaria, and it is approved for its contribution to knowledge and literary presentation.

\_\_\_\_\_  
Dr. D. C. John  
Chairman, Supervisory  
Committee

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Dr. A. A. Akume  
Member, Supervisory  
Committee

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Dr. I. F. Akande  
Member, Supervisory  
Committee

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Dr. A.R. Agom  
Head, Department of  
Commercial Law

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Prof . K. Bala  
Dean, Post Graduate School

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

## **DEDICATION**

TO ALLAH, THE ALMIGHTY, FOR HIS BLESSINGS.

ALSO TO THE LOVING MEMORIES OF:

MA'AJIN MUHAMMADU DANGI

YAGINNA

YAGIRE

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## **ABSTRACT**

Principles of taxation, especially international taxation, are one of the instruments through which Foreign Direct Investment, (FDI), is usually attracted to a country. These principles are invariably contained in bilateral or multilateral tax treaties signed between the host countries and the investor countries. The issue for consideration is whether tax treaties between Nigeria and other countries have achieved their desired objectives of attracting foreign direct investment and facilitating economic growth and development. Part of the research problems is how to establish a correlation or nexus between the principles of taxation and foreign direct investment into Nigeria. The aims and objectives of this research are therefore to discuss the impact of taxation on the Nigerian economy and to examine the relationship between the principles of international taxation and foreign direct investment. Consequently, both doctrinal and empirical methods of research are employed in this work. Some of the research findings are that tax treaties between Nigeria and other countries do not have adequate provisions to curb harmful practices like thin capitalization, treaty shopping and tax deferrals, among others. The research then makes recommendations on anti-thin capitalization rules, anti-deferral measures and anti-treaty shopping provisions in the tax treaties between Nigeria and other countries.



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# CHAPTER ONE

## 1.1 GENERAL INTRODUCTION/BACKGROUND TO THE STUDY

Generally, countries of the world interact with each other and engage in activities across their borders for social, economic, cultural, religious, political or any other reasons. These transactions sometimes have tax implications in the source state, (that is, where the income is derived), as well as in the state of residence, (that is, where the income earner resides).

Incidentally, there is no tax statute known as International Tax Law, which the use of the term `International Taxation` may seem to suggest. In other words, even though taxation is based only on statutes, (as there is no common law of taxation), there is no statute anywhere in the world regulating international taxation. In fact, according to Yariv Brauner<sup>1</sup>, the idea of a single worldwide tax system that would eliminate all international inefficiencies and assist all the nations in maximizing their relative advantages is not only an illusion but utopian. Brauner however advocates the possibility of worldwide adoption of a single set of international tax rules that would entail a gradual, partial harmonization effort aimed at eventual unification of all international tax rules.

However, there are treaties, which deal mainly with Double Taxation Agreements, (DTAs), that are applicable to the taxation of cross-border or international economic activities.

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<sup>1</sup> Yariv Brauner, "An International Tax Regime in Crystallization", 56 Tax Law Review, 259, (2003), accessed on 6/7/2016

Thus, tax experts refer to international taxation to mean the relevant provisions and agreements of the domestic or municipal tax laws of a country dealing with territorial, (for source), system of taxation and world-wide, (or residence), system of taxation. In other words, international taxation generally refers to the tax treatment of cross-national transactions. Since each nation has its own rules of taxation, and one rule is hardly the same as another, it is possible, or even likely, that income will be taxed more than once, (double taxation), or that it will go untaxed at all by any jurisdiction, (tax evasion). To avoid this, countries of the world have evolved two principal methods of international taxation, namely: territorial (or source system), and residence, (or worldwide), system.

To illustrate this point, a taxpayer, (whether Nigerian or foreigner), may be liable to Nigerian taxation either because he is resident in Nigeria, or because the source of his income is located in Nigeria. A Nigerian resident is liable to tax in his world-wide, or global income, whereas a non-resident will only be liable to tax on his Nigerian source of income.

For example, Roy Rohatgi in his book, "*Basic Principles of International Taxation*"<sup>2</sup> defines international taxation as "the global tax rules that apply to the transactions between two or more countries, (also called states), in the world". The author went on to say that international taxation encompasses all tax issues arising under a country's income tax laws that include some foreign element.

Taxes are not, *per se*, international. As we observed earlier, there is no separate global tax law or statute that governs cross-border transactions. And unlike in the area of criminal law, there is no international tax court, tribunal or even administrative body for the enforcement of international tax issues. All taxes are levied or imposed under

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<sup>2</sup> 2nd Edition, Vol.1, Taxmann Allied Services Ltd, India, 2007, page 1

domestic laws by the federal, state or local governments. However, these taxes have an impact on cross-border transactions. International taxation then governs these domestic tax laws under the principles of customary international law and treaties or conventions<sup>3</sup>.

The sources of international tax law include:

- i. Multilateral international agreements, for example, the Vienna Convention on the law of Treaties, secondary law of international communities of states, mutual agreement procedures for equitable settlement of conflict of legal system;
- ii. Comprehensive bilateral double tax treaties, for example, protocols, exchange of letters and notes, memoranda of understanding, and supplementary administrative agreements;
- iii. Limited bilateral double tax treaties, for example, reciprocal declarations, specific treaties on shipping and airlines, death duties and taxes on gifts;
- iv. Customary international law and general principles of law. Examples of this are the principles of law recognized by civilized nations in their national legal systems, statute law, customary law and judicial decisions, and the practices of international organizations.<sup>4</sup>

Foreign Direct Investment, (FDI), on the other hand, is defined as “investment made to acquire a lasting interest in an enterprise operating in an economic

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<sup>3</sup> ibid

<sup>4</sup> Asif H. Qureshi, “The Principles of International Law of Taxation” (Graham, et al), India, 1994, pages 1-9.



environment other than that of the investor, the investor's purpose being to have an effective voice in the management of the company.

Corporate income tax system may be used by the Nigerian Government as a policy instrument to influence economic behaviour, including foreign direct investment.

Thus, tax incentives can be designed to attract Foreign Direct Investment, (FDI), in the country in order to enhance Nigeria's international competitiveness. That is, Multinational Companies, (MNCs), can take tax incentives into account when making decisions on the location of their companies. Success in this regard will improve Nigeria's economic development by generating increased employment, incomes, higher tax revenues, improved infrastructure and better standards of living.

It is conceded that, generally, the main determinants of foreign investment in any country, particularly in Nigeria are: the market size, (sometimes a function of the Gross Domestic Product, GDP); stable macro-economic policies; a level of human capital that is tolerable by the investors;<sup>5</sup> availability of adequate infrastructure, both physical and human. However, a supportive institutional environment seen in the existence of an effective and equitable legal system is also very crucial to foreign direct investment. Thus, the role of international tax law in providing the necessary legal frame work for FDI cannot be ignored.

FDI can also be attracted through tax incentives for the sole purpose of generating spill-over benefits like knowledge transfer, provision of skills and training to local employees that could be applied elsewhere in the Nigerian economy and

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<sup>5</sup> Ayanwale, A.B., Impact of FDI in Nigerian, [http: www.aereafrika](http://www.aereafrika), 2009, accessed: 5/10/13, 12.34am

generating market demand for labour and other factors of production, (e.g. intermediate inputs), that may not otherwise exist in the country.<sup>6</sup>

Tax incentives for FDI are provided in a variety of ways:

- a. tax holidays, that is exemption from tax for a particular period;
- b. reductions in the statutory corporate income tax rate;
- c. enhanced or accelerated write-offs for capital expenditures;
- d. general or targeted investment tax credits;
- e. reductions in dividend withholding tax rates and for the provision or extension of imputation relief;
- f. reductions in withholding tax rates on interest and royalty income;
- g. permitting or allowing reserves to be off-set against future costs; and
- h. provision of tax deferrals for certain types of corporate transactions.<sup>7</sup>

Almost all countries of the world<sup>8</sup> tax income generated by economic activities that take place within their borders. In addition, many countries also tax incomes of their residents. These are carried out under the source or residence rules in international taxation. The most popular head of tax in this regard, globally, is corporate tax. In the United States of America, (taken as a representative of the developed economies), corporate tax is 35%. In Egypt, it ranges between 32% to 40%, depending on whether the company is engaged in export and industrial operations or not. And in Nigeria, corporate income tax is 30% under the Companies Income Tax and 45% under the Petroleum Profits Tax. The relatively lower rates of corporate income tax in the

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<sup>6</sup> OECD Tax Policy Studies, No.4, 2001, pages 19-20

<sup>7</sup> Ibid, pages 25-35.

<sup>8</sup> Except some of the pure tax havens.

developing economies is deliberate, as it is aimed at attracting more foreign direct investment, FDI.

It is to be noted that most, if not all, the companies involved in oil exploration in Nigeria are foreign MNCs, and a sizeable number of companies that pay tax under CITA are also foreign MNCs.

In addition, those MNCs have contributed immensely to employment generation, skill acquisition, capital flight to Nigeria and improved infrastructure.

International taxation, (as an instrument for the attraction of FDI), is also important to every country of the world in many other ways, because of the great potential it has to generate the much needed revenue, apart from the other uses to which taxation can, generally, be employed to serve.

In providing the necessary legal framework, the Nigerian Government has enacted the following laws that regulate Foreign Direct Investment in the country: the Nigeria Export Processing Zone Act,<sup>9</sup> Investments and Securities Act<sup>10</sup>, Nigerian Investment Promotion Commission Act,<sup>11</sup> Foreign Exchange (Monitoring & Miscellaneous Provisions) Decree No 17 of 1995, the Nigeria Enterprises Promotion (Repeal) Decree No 7 of 1995. The Decree No 7 of 1995 effectively abolished any restrictions in respect of the limits of foreign shareholding in Nigerian companies. By that law, the only enterprises in which foreign participation is prohibited are those involved in:

- a. the production of arms and ammunition and;
- b. the production of, and dealing in, narcotic drugs and psychotropic substances.

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<sup>9</sup> Cap. N109, Laws of the Federation of Nigeria, 2004

<sup>10</sup> Cap. I24, Laws of the Federation of Nigeria, 2004

<sup>11</sup> Cap. N117, Laws of the Federation of Nigeria, 2004

In addition, there are also specific tax statutes that encourage foreign direct investment in Nigeria. These statutes contain provisions granting reliefs, allowances, concessions, and others contain provisions on penalties, forfeitures. Thus, these provisions in the Companies Income Tax Act,<sup>12</sup> the Petroleum Profits Tax Act,<sup>13</sup> Personal Income Tax Act,<sup>14</sup> among others will be discussed in this research.

The research will further look at how these statutes have been able to achieve the aims of revenue generation and Foreign Direct Investment, (FDI), in Nigeria, through the instrument of International Taxation. In addition, the research will discuss whether the various types of Foreign Direct Investment, (FDI), have made any meaningful impact on the Nigerian economy.

The various types of FDI, however, are: wholly foreign owned; joint ventures; special contract arrangements; technology (marketing management, and subcontract co-production and specialization. Each of these types will be discussed, analyzed and its impact on the Nigerian economy studied.

## **1.2 STATEMENT OF THE RESEARCH PROBLEM**

The integration of world capital markets carries important implications for the design and impact of tax policies under international taxation. This integration has given rise to close interactions and commotions, which, in turn, give rise to the need to evolve legal frameworks or machinery to regulate the activities of the major stakeholders.

As stated earlier in the Background to this research, there is no statute on International Taxation. There cannot be because: each country of the world is

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<sup>12</sup> Cap. C21, Laws of the Federation of Nigeria,, 2004

<sup>13</sup> Cap. P21, Laws of the Federation of Nigeria, 2004

<sup>14</sup> Cap. P8, Laws of the Federation of Nigeria, 2004

sovereign and independent and so, one cannot make a law for the other; and (2) each country has its own social, economic, political and cultural peculiarities.

However, since it is necessary to create a conducive environment for Foreign Direct Investment to thrive in every country, because of its obvious advantages, rules have evolved under treaties on international taxation. These rules deal principally with the issues of double taxation and tax evasion or avoidance.

Making of tax treaties involves a lot of dynamics, negotiation and intrigues. During the ministerial conference of the World Trade Organization, (WTO), at Singapore in 1996, the developed countries of the West pressed for a relaxation of entry conditions for investments into the developing countries, so that their home-based MNCs can have greater access and control over the economies of the developing countries.<sup>15</sup>

Thus, developed countries are always under constant pressure from their taxpayers and MNCs to ensure that the level of the tax burden on them in developing countries does not exceed that laid<sup>16</sup> down under their domestic laws. But because of this pressure the developed countries harm the economic interests of developing countries by imposing bilateral tax convention models which curb their legitimate fiscal expectations. This, the developed countries do under the thin guise of facilitating the establishment of an instrument that promotes investment flows to the developing countries.

In addition, developing countries also soon realized that, in signing tax treaties with developed countries, they were, in fact, merely negotiating the right to tax income generated in their own countries, and not income generated or derived world-

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<sup>15</sup> Ugwu J. (in her forward to "Attracting FDI in Nigeria", by Aremu J., Market Link Communications, Lagos, 2005, page 4

<sup>16</sup> Ibid.

wide by MNCs with branches or subsidiaries all over the world. That is, these tax treaties are always lopsided, with emphasis on residence rule, leaving out the source rule.

Most MNCs also engage in some harmful practices like thin capitalization, (that is, excessive loan or debt capital over equity capital), with the sole aim of paying little or no tax in developing countries.

In view of the foregoing, this work has formulated the following research questions:

1. Whether the Nigerian tax system, especially its tax incentives regime has provided sufficient legal tools for the encouragement, attraction or stimulation of foreign direct investment into the country;
2. Whether Nigeria has been able to evolve any legal or regulatory framework to plug the usual loopholes in the tax treaties between it and developed countries.
3. Whether there has been any link or nexus between the principles of taxation in Nigeria and foreign direct investment into the country.

### **1.3 AIM AND OBJECTIVES**

Taxes play a role in determining the location of foreign direct investment. Thus, countries use taxation to attract Foreign Direct Investment (FDI), because of its acknowledged advantages as a tool for economic growth and development.

Africa, and Nigeria, in particular, joined the rest of the world in seeking Foreign Direct Investment as shown in the formation of the New Partnership for Africa's Development, (NEPAD), which has the attraction of foreign investment to Africa as a major component.

Consequently, this research, in summary, therefore seeks to achieve the following aim:

1. This work examines the conceptual, practical and legal framework of international taxation in Nigeria and other parts of the world, with a view to comparing how well Nigeria is doing in attracting FDI into the country.

And the objectives are to:

1. Discuss the impact of international taxation on the Nigerian economy, particularly how it has contributed to revenue generation in the country.
- 2.
2. Examine the relationship between the principles of international taxation and foreign direct investment in Nigeria. In this regard, it will be suggested that a new framework be devised to genuinely support the flow of investment to developing countries, particularly Nigeria. This can be in the form of allocating exclusive and unlimited taxation rights, (on both source and global income), to the developing countries. This will take care of the first problem identified in the preceding paragraph.
3. Discuss the relationship between international taxation and international tax planning, and examine how the latter can be effectively achieved through the application of the principles of the former.
- 4.
4. Identify the challenges or problems hindering the full realization of the objectives of international taxation especially in the areas of revenue generation and foreign direct investment, FDI in Nigeria, particularly the loopholes or lacunae in the country's tax treaties, which have sometimes led to outright tax evasion.

5. Proffer other solutions, suggestions, recommendations on how these challenges can be addressed.

#### 1.4 JUSTIFICATION OF THE RESEARCH

The rationale for granting incentives for attracting Foreign Direct Investment, (FDI), is based on the belief that FDI inter alia, generates technological transfers and bridges the gap between the rich and poor nations.

Nigeria is one country with a great demand for foreign goods and services. So it has, through the instrumentality of international taxation, attracted FDI over the years. For example, the FDI net inflow into Nigeria between 2005 and 2014 was valued as follows;

2005	-	₦2,859.2
2006	-	₦709.2
2007	-	₦1,036.6
2008	-	₦1,958.2
2009	-	₦740.8
2010	-	₦2,421.6
2011	-	₦3,151.4
2012	-	₦2,466.9
2013	-	₦5,562.5
2014	-	₦10,258.6 <sup>17</sup>
<b>Total</b>	<b>=</b>	<b>₦31,165.00</b>

(Thirty one trillion, one hundred and sixty-five billion Naira only)

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<sup>17</sup> CBN Annual Statistics Bulletin, vol.25, December, 2014



More importantly however, this work will be most beneficial to those involved in international tax planning. International tax planning is the art of arranging cross-border transactions with the knowledge of international tax principles in order to achieve a tax effective and lawful routing or direction of business activities and capital flows.<sup>14</sup> The planning process follows the money flows in cross-border transactions, as they pass from the host country where they arise to the home country where they eventually end. The prime objective of international tax planning is to receive the after-tax flows of overseas income on investment, lawfully, and at minimal cost and risk.<sup>18</sup>

Thus, this research work will therefore also be of immense benefit to those involved in international tax planning in Nigeria.

There is a paucity of such planners in Nigeria at present. It is therefore hoped that this work will stimulate interest in that area of the law of international taxation.

The work will equally be beneficial to scholars and students of international taxation, just as tax practitioners and administrators will find the work of immense benefit. In addition, the Federal Ministries of Finance and Foreign Affairs, the FIRS and the general public will find this work useful. These, and many more are the justifications for this research.

## **1.5 SCOPE AND LIMITATION OF THE RESEARCH**

Taxation in Nigeria, (as a subject), is the scope of this research work. The work will discuss the effects of international taxation on revenue generation in the country. In addition, this research will also discuss the effects of international taxation on Foreign Direct Investment, (FDI), in Nigeria.

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<sup>18</sup> *ibid*

The scope of this research will also extend to the general principles of international law. The right of a state to legislate and enforce on tax matters, (to the exclusion of another state), is generally referred to as “fiscal jurisdiction”. Now, fiscal jurisdiction is a function of the sovereignty of states. That is, every country has the sovereign right to establish its own tax rules, which govern its domestic and international transactions. However, international law only permits the enforcement by a country of its tax laws within its legislative jurisdiction. As a matter of sovereignty, one state does not normally enforce the tax laws of another state.<sup>19</sup>

Another reason why international law will be part of the scope of this research is that tax treaties are generally governed by the principles laid down under the Vienna Convention on the Law of Treaties, (VCLT). These principles under the treaties are negotiated under international law as legally binding on the contracting parties or states. It is estimated that there are over 2,500 bilateral treaties and protocols that modify or supplement them, in existence today.

The limitation of this work stems from the fact that, due to paucity of funds and time constraints, the writer could not conduct as much empirical research as he wanted. The research was estimated to cost about N5 million and to take as long as two years to conduct on empirical basis alone.

## **1.6 RESEARCH METHODOLOGY**

The methodologies used in this research work are, in the main, doctrinal and empirical in nature.

The doctrinal method of the research, which is mainly theory-based, would enable this writer to consult, refer to, review, study and fill the gaps in the works of

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<sup>19</sup> US V. Harden (1963) CLR 366.

authors, contained in textbooks, journals, and the internet. Consequently, the following materials would be consulted for the research: Primary sources and Secondary sources. For empirical research, the writer would go out in the field to talk to the key players, especially in the area of foreign direct investment in Nigeria.

## 1.7 LITERATURE REVIEW

Quite a lot has been written in the area of Foreign Direct Investment in Nigeria. However, the bulk of these materials are from the economists` point of view. Few legal scholars have written on FDI in Nigeria.

Conversely, there is paucity of Nigerian materials in the area of international tax law. Thus only few authors have written especially on international law of taxation in Nigeria. However, M.T. Abdul-Razaq spared a chapter in his book<sup>20</sup> to this novel area of the law. Works of other writers like M.N. Umemweke, A.J. Easson, J. Tilley, are discussed in the research.

Umemweke, for example, is of the view that: “Western European investors dominate Foreign Investment into Africa capitalizing on their post-colonial ties with [the] countries in the region”<sup>21</sup> But this assertion is not true, having regard to our observations in paragraph 1.3 above. The U.S. and China dominate FDI in Africa in general, and Nigeria, in particular. In any case, most Western Countries themselves are now struggling to keep their heads above water, and are not pre-occupied with matters of FDI.

Ayadi, F.S.<sup>22</sup> is of the view that Nigeria and other developing nations should not “blindly reduce taxes, wages and change regulations so as to attract FDI.” What

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<sup>20</sup> Revenue Law and Practice in Nigeria, Malthouse Press Ltd, Lagos, 2010 Pages 307 to 323

<sup>21</sup> Umemweke, M.N., Tax law and Its Implications for Foreign Investments in Nigeria, NOLIX Education Publications, Enugu, 2006, page 291

<sup>22</sup> <http://iaabd-org./3/72014, 6:04pm>

was the reason that prompted Ayadi to give this piece of advice? Has Nigeria paid any heed to this admonition?

In addition, the view of M.T. Abdul-Razaq that: “International tax is concerned with the tax system as soon as it moves beyond the purely domestic scene. It is concerned with the taxation of non-Nigerian source income accruing to residents and with Nigerian source income accruing to non-residents” will be critically examined and analyzed as a basis for this research.

In his book, “*Basic International Taxation*”<sup>23</sup> Roy Rohatgi posits that:

*The starting point for any study of international taxation is a broad knowledge and understanding of the domestic tax rules in various countries. Domestic tax law governs the tax rate, what is taxable, how the taxable income is computed and the tax compliance rules. It is essential to know the tax rules and how the rules are applied to cross-border transactions in a given country.*

Rohatgi R. is also of the view that international taxation involves the study of tax treaties, and tax treaties involve a negotiated sharing of the tax revenues by two states. In developed countries, with comparable tax systems, the treaty rules usually lead to a balanced sharing of tax revenues. In developing countries, however, these negotiations may be governed by economic and social factors as well as revenue considerations. According to the author, many of the rules in tax treaties involving developing countries are designed to “promote capital, labour and technology flows through fiscal measures, such as tax exemptions and allowances”. The tax due in the home country may be “spared”, (or waived), under a treaty as a special concession for them to retain the tax benefit of these incentives”.

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<sup>23</sup> Op.cit.

Thus, this research is being conducted to, *inter alia*, find those exemptions, allowances and reliefs, and analyze how effective they have been in attracting FD1 in Nigeria.

In the second edition of his book,<sup>24</sup> Rohatgi emphasized the need for international tax planning in international taxation.

He stated that the opportunities for international tax planning are limitless, and they are based on many techniques. The extent of the tax benefit from the planning, he said, is dependent on several factors, and that it “varies with the amount of income earned abroad, the difference between domestic and foreign tax rates and the nature of the income” itself.

On foreign direct investment, FD1, Rohatgi, in the same book,<sup>25</sup> defines FD1 as “investment made to acquire a lasting interest in an enterprise operating in an economic environment other than that of the investor, the investor’s purpose being to have an effective voice in the management of the company”. The author stated that investment can either be portfolio investment, (that is passive investment), or direct investment, (or substantial, active investment). He said that both types of investment require tax planning, though the methods may generally differ.

Umозuvike, U. D., in his book, “*Introduction to International Law*”<sup>26</sup> posits that International transactions, including tax transactions are normally carried out through treaties. And treaties, he said, are called by about thirty different names, including convention, protocol, declaration, charter, covenant, pact, act, statute or agreement. Thus, those terms will be used interchangeably in this work.

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<sup>24</sup> Op.cit

<sup>25</sup> Op.cit.

<sup>26</sup> Spectrum Books Ltd, Ibadan, 1993, page 163

We agree with Ladan, M.T., when he stated in his book, *Materials And Cases On Public International Law*,<sup>27</sup> that the “Vienna Convention on the Law of Treaties, 1969, defines a treaty as an international written agreement concluded between states and governed by International Law”. In making treaties, states can be represented by their heads of states, heads of government, ministers of foreign affairs, or sometimes, heads of diplomatic missions or “representatives accredited by states to an international conference”<sup>28</sup> or organization.

On Sovereignty of States, M.T. Ladan in the book referred to above, quoted Article 14 of the Draft Declaration On The Rights And Duties Of States, prepared by the International Law Commission, (ILC), in 1949, thus:

“Every state has the duty to conduct its relations with other states in accordance with international law and with the principle that sovereignty of each state is subject to the supremacy of international law”.<sup>29</sup>

Flowing from this premise, the author posits that in “bilateral and multilateral relations between states, sovereignty occupies a very important place”, and that without sovereignty, “small states, which are the majority of today’s world would have very little chance of becoming free from outside domination”. This writer cannot agree more with this observation. However, we think that the principle of sovereignty is being observed more in breach than otherwise. The way and manner in which ‘big’ countries of the world throw their weight around and load it over smaller nations, constitutes a threat to the doctrine of sovereignty.

Aremu, J.A., in his book, *“Attracting and Negotiating Foreign Direct Investment with Transitional Corporations in Nigeria,”*<sup>30</sup> highlights the problems that

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<sup>27</sup> ABU Press Ltd, Zaria, 2007 pages 50-51

<sup>28</sup> Ladan, M. T. op.cit

<sup>29</sup> Article 14, Draft Declaration on the Rights and Duties of States, ILC, 1949.

<sup>30</sup> Market Link Communications, Lagos, 2005.

TNCs, or MNCs normally have to contend with in Nigeria, with regards to different tax laws, which disturb and distort their economic activities. Thus, there is the need to fashion out a harmonized and coherent system of our domestic tax laws, if the required FD1 is to be achieved. The author also discussed the theoretical underpinnings of FD1 and the history, impact and types of FD1 in Nigeria. The structure and effects of MNCs are also discussed in the book.

Arogundade, J.A., in his book, *“Nigerian Income Tax & Its International Dimension”*,<sup>31</sup> stated that the “Nigerian Oil Industry (both upstream and downstream) and indeed the oil industry all over the world, is dominated by Multinational Enterprises (MNEs), or Trans-national Enterprises (TNEs)”. The author described these enterprises as “groups of associated companies with huge capital, technology and know-how”. The concept of MNE, the author said, raises the concern of transfer pricing, tax avoidance and other tax abuses. Then, the author observed that the “huge resources and technology they can muster explain the policy of government to attract them with all sorts of incentives”. Elsewhere, the author listed some of these incentives.

However, Arogundade did not provide any empirical evidence on the “huge resources and technology” that the MNEs have brought to Nigeria. The author also failed to state how the FD1 attracted by these MNEs has been as a direct result of the principles of international taxation. What are those provisions in treaties, protocols and conventions that Nigeria has used to attract FD1 into the country?

In chapter 16 of his book,<sup>32</sup> Arogundade discussed, extensively, the concept of transfer pricing under international taxation. He tried to distinguish between transfer pricing and tax planning. The author also provided the necessary legal framework,

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<sup>31</sup> Spectrum Books Ltd., Ibadan, 2<sup>nd</sup> edition, 2010, page 199

<sup>32</sup> *ibid*

especially for transfer pricing, both under our domestic law and under treaties, especially the OECD conventions. He then cited decided cases to illustrate the concept of transfer pricing. Some of the cases cited by the author include *Kodak Ltd V. Clark*,<sup>33</sup> *Irving Vs. Tesco Stores (Holdings) Ltd*,<sup>34</sup> *Pikington V. CIR*<sup>35</sup> and *BN Noble Ltd V. CIR*<sup>36</sup>. The snag here is that all these are foreign cases. No Nigerian case has been cited to illustrate the concept of transfer pricing or tax planning in Nigeria. Yet, Nigerian cases abound. The contribution that this research will therefore make to the existing literature in the area of transfer pricing and tax planning under the international law of taxation is that it will discuss and expound the concepts with illustrations from Nigerian cases. Thus, Nigerian cases like *Aluminum Industries Aktien liesellschaft V. FBIR (Federal Board of Inland Revenue)*,<sup>37</sup> *FBIR V. Joseph Razcallah & Sons Ltd*,<sup>38</sup> *FBIR V. Manila Industrial Security Services Ltd*<sup>39</sup> and *FBIR V. The Nigerian General Insurance Co. Ltd*,<sup>40</sup> will be discussed.

On Tax Haven, Rohatgi, Roy, in “*Basic International Taxation*”<sup>41</sup>, says it is a country, which is used to avoid tax that would have been payable otherwise in another country. Besides offering a “low or nil tax” system, the author said, a country may be characterized as a tax haven if it also offers certain exemptions, incentives, investment opportunities or other preferential treatment. Does Nigeria have these incentives and exemptions to qualify to be called a tax haven? Which countries can be referred to as tax havens in the global economy? What are their levels of economic and social

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<sup>33</sup> CA, 1903, 4, TC 549

<sup>34</sup> Ch D. 1982; 58 T.C. 1

<sup>35</sup> 1982 T.C. 103, 113

<sup>36</sup> KB 1926; 12 TC 911

<sup>37</sup> (1971) NMLR 339

<sup>38</sup> (1962) All NLR 1

<sup>39</sup> Suit No. FRC/PH/37/75

<sup>40</sup> (1969) 1 All NLR 453

<sup>41</sup> Op. cit. 2<sup>nd</sup> edition



development, compared with Nigeria? This dissertation will study this phenomenon, and proffer solutions for the purpose of increasing FDI in the country.

In his review of the tax incentives regime and FDI in Nigeria, Kanyip, Benedict Bekwaph,<sup>42</sup> discussed the tax policy of the Nigerian Government, expressed through the tax incentives. However, the author and respected jurist failed to establish a direct link or nexus between tax incentives and FDI in Nigeria. In particular, he failed to say even a word on the Free Trade Zones in Nigeria. This is a big lacuna in the article, which this research will fill.

Bimpe Balogun<sup>43</sup> posited that the “...inconsistencies in our tax law do not make it any easier for these companies (sic) decision making process.” However, the author did not give even one example of an inconsistency in our tax laws.

The problem with the Nigerian tax regime is hardly traceable to any inconsistency in the tax statutes. The problem lies in the interpretation and application of these statutes. For example, the Supreme Court, with respect, wrongly interpreted and applied the clear and unambiguous provisions of S.10 of the Petroleum Profits Tax Act,<sup>44</sup> when it held that expenses on scholarship awards were allowable deductions because they were incidental to oil drilling and exploration.<sup>45</sup>

On the other hand, Ahmed Abdullahi analyzed the various types of taxes in Nigeria as they apply to a foreign investor. Then he discussed some of the incentives in the various sectors of the economy. But the author failed to point out the importance of the various tax treaties and the Bilateral Investment Treaties (BITs) signed between

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<sup>42</sup> In “Taxation Issues in Foreign Investment”, Modern Practice Journal of Finance in Investment Law, MPJFIL, Vol.2, No.1, January, 1998, page 107

<sup>43</sup> In “Taxation of Remuneration of Expatriates...” Law & Business Quarterly Journal, Vol.4 No.1, March 1999, page 114

<sup>44</sup> Cap. P.13, Laws of the Federation of Nigeria, 2004

<sup>45</sup> Please see Shell Petroleum V. FBIR (1996) & NWLR (Part 466), 256.

Nigeria and other countries or Multinational Corporations, (MNCs). This work will show that it is the various tax treaties that provide for the elimination of double taxation, just as the BITs guarantee protection against expropriation of property without prompt, reasonable and or adequate compensation.<sup>46</sup>

Lorraine Eden,<sup>47</sup> extensively discussed the sacred principles of equity and neutrality under international taxation of capital. The author elucidated, quite commendably, the two principal methods or systems of international taxation, that is, the source (or territorial) rule and the residence (or world-wide) rule. However, the author fell short of drawing the reader's attention to the problem particularly associated with entering into the treaties between developed and developing countries. And that is that such treaties are almost always lopsided, giving the developing countries the right to tax income generated in their countries alone. This places emphasis on the residence rule, leaving out the source rule. And this has resulted in serious revenue consequences for these developing countries of the world.

D. A. Guobadia<sup>48</sup> analyzed the statutory framework for foreign investment in Nigeria. The author also discussed "other factors" that facilitate foreign investment in Nigeria. The big gap in the discourse however is the failure of the author to start with, or even discuss the ground norm of the country, that is, the 1999 Constitution of Nigeria, as amended. Thus, Ss.16, 43 and 44 of the Constitution will be discussed in

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<sup>46</sup> In "Nigeria's Tax Regime ... As viewed by the Foreign Investor", *Law & Business Quarterly Journal* Vol.4, No.4, December, 1999 page 99

<sup>47</sup> In "Equity and Neutrality in the International Taxation of Capital" *Osgoode Hall Law Journal*, New York University, Ontario, Canada, Vol.26, No.1, 1988, page 367

<sup>48</sup> In "Issues in Facilitating Foreign Investment... in Nigeria", *Finance & Investment Law Journal*, MPJFL, Vol.2, No.4 Oct. 1998, page 38

this work in the context of the encouragement and protection they give to foreign investment in the country.

Udoma Udo Udoma<sup>49</sup> discussed the fiscal incentives available in Nigeria for Gas Ventures. He also discussed the effects of these incentives and the “General Regulatory And Investment Environment.” However, the author left a yawning gap when he failed to discuss an equally important incentive, which is institutional quality. That is, apart from the legal or regulatory regime, Nigeria has to provide solid infrastructure in terms of good roads, stable power, portable water and to also guarantee social, political and economic stability. And Nigeria must also tackle its disturbing security challenges.

Transfer pricing has been a teething problem in international taxation, especially for developing countries. It is any transaction between two closely related firms, which transaction is not at arm’s length price. Transfer pricing is, for instance, when a parent company sells its goods to a subsidiary at a price that is well below the market price. For tax purposes, it means that the parent company will pay less tax than it should have paid. Thus, Schewarz J.C.<sup>50</sup> discussed various techniques used by MNCs to engage in transfer pricing. One of such techniques, according to the author, is the grant of bogus loans by parent companies to their subsidiaries, and refusing to charge interests on such loans. It is our opinion however that the author missed the point. For, in most jurisdictions, bank loans do not attract any tax. So, if the two companies are banks, the parent company does not have to bother about waiver of interest for tax purposes. In any case, even if the companies are not commercial

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<sup>49</sup> In “Incentives for Gas Ventures in Nigeria”, MPJFIL, Vol.2, No.3, July 1998, page 1

<sup>50</sup> In “Trawling for Taxpayers and Transfer Pricing Regulations”, Western Reserve Law Review, 1992, 42, Page 933

banks, interest waivers are still allowed in International Taxation for: (a) subsidiary's start-up period, (b) financial difficulties, (c) trade credits, where interest is included in the price of goods sold. This is part of our contribution in this area.

However, as observed by Trachtman, J.P.,<sup>51</sup> the mutual agreement procedure is clearly, "special procedure outside the domestic law". So, it can be set in motion only in cases where tax has been charged, or is going to be charged, in disregard of the clear provisions of the Convention. However, it is important to note that Article 25 is not entirely satisfactory from the tax payer's point of view. For, competent authorities are required, under the Convention, only to seek a solution; they are not obliged to find one. Thus, if a provision in the Convention is interpreted, and sought to be applied differently by two contracting states, and if the competent authorities are unable to agree on a 'mutual' solution within the framework of a mutual agreement procedure, double taxation is still possible. Now, double taxation is contrary to the spirit and purpose of the Convention itself, as its principal aim is to avoid it. Consequently, Article 25 remains unsatisfactory. The way forward is to have recourse to arbitration or the domestic judicial process.

In summary, this work has identified the following gaps in the existing literature in the area of research, which will be addressed accordingly:

1. The existing literature does not analyze and critically examine the pitfalls in the tax treaties, especially in the areas of making provisions against bad practices like transfer pricing, thin capitalization, .
2. The body of existing literature does not also establish a link, nexus or

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<sup>51</sup> In "Recent Initiatives in International Financial Regulation & Goals of Competiveness, Effectiveness, Consistency and Cooperation", 1991, *Journal of International Law & Business*, 241

connection between tax treaties and FDI in Nigeria, particularly how FDI has been facilitated or encouraged into Nigeria through the instrumentality of its tax treaties.

## **1.8 ORGANIZATIONAL LAYOUT**

This work is divided into six chapters.

Chapter one deals with the General Introduction, Background to the study, Problem of the Research, Aims and Objectives of the Research, Justification, Scope of the Research, Literature Review, Research Methodology. Chapter two deals with the conceptual clarification of key terms and general principles of the law of taxation.

In chapter three of the research, the legal regime of international taxation is generally analyzed. The chapter also discusses taxation of foreign income under specific Nigerian tax statutes.

Chapter four of the research deals with tax incentives and revenue generation in Nigeria.

Chapter five of the work deals with international taxation and foreign direct investment in Nigeria. The meaning, types, advantages and disadvantages of FDI in Nigeria are also discussed in the chapter.

Chapter six of the research deals with summary, findings and recommendations.

## CHAPTER TWO

### CONCEPTUAL CLARIFICATION OF KEY TERMS

#### 2.1 INTRODUCTION

Taxation, particularly international taxation, is a special area of law that has continued to attract the interest of scholars, students, tax practitioners and the general public.

The subject is fairly wide, and a study of its key components can lead to a serious, deep and profound analysis of the different branches of the law of taxation.

International taxation is still evolving. The principles of international taxation do change, though not radically. Because of the evolution and the changes, new terms and phenomena also emerge, requiring proper understanding and analysis.

It is thus imperative to define some of these terms in international taxation. The concept of Foreign Direct Investment also involves some degree of economic interaction between Multi-National Corporations (MNCs) and their host countries.

These interactions sometime give rise to peculiar problems or challenges. The work will discuss how these challenges should be addressed. This chapter will also provide generally acceptable definition of the key terms in international taxation.

##### 2.1.1 Meaning of Taxation

The word “tax” or “taxation”, like many other words in the law of taxation,<sup>1</sup> does not lend itself to an easy, precise definition. Thus, many attempts have been made in text-books, judicial decisions, statutes, to define the word.

For example, the *Oxford Advanced Learner’s Dictionary of Current English*<sup>2</sup> defines tax as money that one has to pay to the government so that it can pay for public services. And it defines taxation as the money that has to be paid as taxes.

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<sup>1</sup> For example, ‘income’ and ‘trade’

The *Osborn's Concise Law Dictionary*<sup>3</sup> does not define the word 'tax'. But it defines taxation as the "... imposition of duties for the raising of revenues". The dictionary then went on to distinguished between direct and indirect taxation.

The *Black's Law Dictionary*,<sup>4</sup> defines tax as a charge by the government on the income of an individual, corporation or trust, as well as the value of an estate or gift. It goes on to add that tax is a "pecuniary burden laid upon individuals or property to support the government, and is a payment exacted by legislative authority".

Is tax necessarily a "duty" as defined by Osborn's dictionary or is it different from it? The tax statutes do not seem to have clarified the situation. In fact, many Nigerian tax statutes do not provide a definition of the word "tax". The few that do provide a definition fail to put a concise and precise meaning to the word.

For example, the *Companies Income Tax Act*<sup>5</sup> defines tax simply as "the tax imposed by this Act". This, no doubt, begs the question. What is tax?

The *Personal Income Tax Act*<sup>6</sup> defines tax as "any income tax imposed in conformity with the provisions of this Act." And in *Section 46 of the VAT Act*,<sup>7</sup> tax is defined as "the VAT imposed and charged under Section 1 of this Act". The *Petroleum Profits Tax Act*<sup>8</sup> simply stated that "Tax means chargeable tax". Judicial decisions have also provided an insight into what tax or taxation means.

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<sup>2</sup> 6<sup>th</sup> edition, Wehmerier S. and Ashby M. eds (Oxford University Press ,London, 2000, page 1227).

<sup>3</sup> 7<sup>th</sup> edition, by Bird R., Sweet & Maxwell, London, 1983, page 318.

<sup>4</sup> 6<sup>th</sup> edition, by Black H.C., West Publishing Co. U.S.A. 1998, page 1457.

<sup>5</sup> Cap. C21, Laws of the Federation of Nigeria, 2004, S.105.

<sup>6</sup> Cap. P8, Laws of the Federation of Nigeria, 2004, S.108.

<sup>7</sup> Cap. V1, Laws of the Federation of Nigeria, 2004.

<sup>8</sup> Cap. P13, Laws of the Federation of Nigeria, 2004, S.2.

However, there is a paucity of Nigerian judicial authorities in this area. That is, Nigerian courts have generally shied away from providing a definition of the word 'tax'. The Supreme Court had an opportunity to define tax in the case of *Shell v. FBIR*.<sup>9</sup> But instead of defining the word, the court simply held that it should be deemed as a debt to the government.

But attempts have been made by judges outside Nigeria to define tax. For example, in *United States v. Butter*,<sup>10</sup> tax was defined thus: "A tax in the general understanding of the term... signifies an exaction for the support of government"

In *Mathews v. Chicory Marketing Board (v)*<sup>11</sup> the Australian court defined tax as a "compulsory exaction of money by a public authority for public purposes, or taxation is raising money for the purpose of government by means of contributions from individual persons."

And in the Canadian case of *Lawson v. Interior Tree Fruit*,<sup>12</sup> it was held that taxes are imposed under the authority of the legislature and that they are levied by a public body for public purposes.

Text-book writers have also proffered various opinions on what tax means. For example, Umenweke, M.N., in his book,<sup>13</sup> stated that the most important thing to note about tax is that; "it is a pecuniary burden laid upon individuals or persons or property to support the government and [it] is a payment exacted by legislative authority".

However, from the various attempts made to put a meaning to the word 'tax' as shown above from dictionaries, opinions of text-book writers, judicial decisions, it is clear that the emphasis of the writers or authors is only on the characteristic of tax as a 'compulsory' contribution towards government activities.

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<sup>9</sup> (2004) FWLR pt. 859 page 46.

<sup>10</sup> 2276, U.S 1, (1936) page 61.

<sup>11</sup> (1938) 60 C.L.R. 263 at page 276.

<sup>12</sup> (1931)SCR 357.

<sup>13</sup> 'Tax Law and Its Implications for Foreign Investments in Nigerian', Nolix Publications, Enugu, 2008 pages 5-6.



### 2.1.2 International Taxation

We briefly discussed international taxation in the preceding chapter of this work.

However, it is worth repeating here that it is a discipline of study and practice that centres on the application of taxes and tax laws in the international community as it relates to individuals, businesses and government agencies that conduct cross-border commerce.<sup>14</sup>

According to Rohatgi,<sup>15</sup> all taxes are levied by federal, state or local governments under their domestic tax laws. However, some of these laws have impacts on cross-border transactions, that is, on international transactions, and they are governed or regulated by laws of international taxation.

The sources of international taxation are treaties and the principles of customary international law. Tax treaties may be bilateral or multi-lateral, and their principal objectives are not only to maximize revenue, but to also: a) avoid double taxation, b) prevent fiscal evasion, and c) facilitate exchange of information on tax matters. On the other hand, the principles of customary international law that deal with tax issues try to resolve tax conflicts that may arise during cross-border transactions. However, besides the treaties, there are no overriding international laws of taxation that are enforceable on taxing states.

The key objectives of international taxation are to:

- i) achieve economic efficiency;
- ii) achieve National Wealth Maximization,
- iii) balance capital export and import neutrality, and
- iv) achieve tax equity.<sup>16</sup>

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<sup>14</sup> Rohatgi, *ibid*, page 1

<sup>15</sup> *ibid*

<sup>16</sup> Srinivas CA, "Introduction to International Taxation", Taxman Ltd, Bangalore, Karnataka, India, 2006 page 5

The systems or methods of levying international taxation are principally, two: the source method or the residence method. Since each nation has its own tax rules and the rules of one nation are rarely perfectly meshed with those of another, it is possible that income will be taxed more than once (that is double taxation), or that it will go untaxed at all by any jurisdiction, (that is tax evasion). To prevent this, countries employ different systems or methods of taxation under international tax law. Principally, two systems or methods of taxation have evolved for direct taxes such as personal and corporate income taxes: the territorial (or source) system of taxation and the worldwide (or residence) system. Under a pure source system, all income earned in a country is taxed by that country, regardless of whether the earner is deemed to be foreign. A pure residence system taxes income regardless of where it was earned as long as the earner is deemed to be a resident of the country.<sup>17</sup>

An analogy made here to the familiar distinction between Gross Domestic Product, (GDP), and Gross National Product, (GNP), may be helpful. GDP includes all income produced domestically, whether by domestic or foreign nationals, and is analogous to income taxed under the source method. GNP, on the other hand, includes all income produced by nationals, whether at home or abroad, and is analogous to income taxed under the residence method.

As long as those receiving income are classified by all countries in the same mutually exclusive way as residents or non-residents, and all countries use the same method of taxation, there will be no problem of double taxation. Double taxation problems arise because countries have different residency rules and tax systems.<sup>18</sup> For example, some countries use a territorial (or source) system when defining income while others use a residence (or worldwide) basis for determining what income is taxable. Further,

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<sup>17</sup> Timothy J. Goodspeed, et al "International Taxation", Hunter College, CUNY Graduate Centre, page 257

<sup>18</sup> Timothy J. Goodspeed, op. cit, page 258

no country uses the pure form of either of these two methods. All countries claim the right to tax all income generated within their borders. And that is not unexpected or unreasonable. However, most nations also try to tax at least some of the foreign income of their residents. These attempts to tax the foreign income of residents result in a mixed source and residence basis for taxation, and the consequence is double taxation.<sup>19</sup> This is where tax treaties play a pivotal role, for they do not only try to prevent double taxation, but they also allocate and balance taxing rights between the contracting states.

### 2.1.3 Tax Treaty

A treaty is an agreement that creates binding obligations between subjects of International Law.<sup>20</sup> Treaties are the instruments for conducting international relations. A party to a treaty is usually a country, popularly called “State”. A treaty is also known as convention, protocol, accord, arrangement, pact, charter or covenant.<sup>21</sup> The Vienna Convention on the Law of Treaties, (VCLT),<sup>22</sup> in Article 1(a) defines a treaty to mean “an international agreement concluded between states in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation”. It defines a party, (in paragraph ‘g’), to mean “a state, which has consented to be bound by the treaty, and for which the treaty is in force”.

The first contemporary bilateral tax treaty on income and property was signed between Prussia and Austro-Hungary in 1899. After the First World War, the League

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<sup>19</sup> Timothy J. Goodspeed, *op. cit.*, page 259

<sup>20</sup> Umozurike U.O. “Introduction to International Law”, 3<sup>rd</sup> edition. Spectrum Books Limited, Ibadan, 2006, page 16

<sup>21</sup> *Ibid.*

<sup>22</sup> Adopted on 22/5/1969, and entered into force on 27/1/1980

of Nations took the initiative to evolve an internationally acceptable tax treaty. The model tax treaties we have today have their genesis from these efforts.

According to Sol Picciotto<sup>23</sup>, taxation of business profits or income “originates essentially from the early part of the 20<sup>th</sup> Century”, because state revenue needs were becoming increasingly significant, what with the growth in military and welfare spending. Thus, the author said, most industrial capitalist countries moved from reliance on a multiplicity of specific duties, like custom duties, to direct taxes on income. Tax treaties, the use of which spread after 1945, did not, according to Picciotto, directly tackle the issue of allocation of tax base of internationally-organized business among the various jurisdictions involved. Instead, they allocated rights to tax specific income flows. This, he said, was intended to ensure equality of taxation between investment at home and abroad.

The roots of the arrangements for the international co-ordinations of taxation lie in the work done in the interwar period, mainly through the League of Nations. This produced the model bilateral tax treaty, which was an innovative method of co-ordinating the jurisdiction of states to tax international business. Furthermore, the model treaties drafted by the Fiscal Committee of the League of Nations embodied some of the basic principles and key terms which are still in use today.

Following from this effort, the Financial Committee of the League began the process of producing a Model Bilateral Tax Treaty by commissioning a study by four prominent economists, (Professors Bruins, Einaudi and Seligman, and Sir Joshua Stamp), whose report of 1923 was something of a compromise. The report, *inter alia*, emphasized the principle of ‘ability to pay, and thereby favoured taxation by a country of residence. The report also accepted that agreement on the allocation of

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<sup>23</sup> “International Business Taxation: A study in the Internationalization of Business Regulations” C.U.P. 2013, assessed on 8/7/2016, 4:15 am

jurisdiction to tax could not be reached on the basis of any simple general principle alone. So, it identified four possible methods of reconciling the different national approaches: foreign tax credit, source country taxing right, division of taxing rights between source and residence countries and taxing right according to economic allegiance.<sup>24</sup>

In furtherance to the above efforts of evolving a model bilateral tax treaty, the League of Nations, in 1928, also set up a Fiscal Committee to continue the work of the Technical Experts. The aim work of this Fiscal Committee consisted of continuing the effort to develop principles for the allocation of tax jurisdiction between states, as may be contained in the bilateral treaties.

The result of these efforts is that, between 1920 and 1939, about 60 general treaties were concluded for the avoidance of double taxation of income and property. These treaties were mostly entirely bilateral in nature.

The rules under the Vienna Convention on the Law of Treaties, (VCLT), apply to all international treaties, including tax treaties. One of such rules is Article 26, which provides that “Every treaty in force is binding upon the parties to it and must be performed by them in good faith.”

Nigeria is one of the 100 countries that has ratified the VCLT. Some of the other countries that have ratified the Vienna Convention, that is VCLT, include Austria, Australia, Canada, Denmark, Germany, Greece, Italy, Japan, the Netherlands, New Zealand, Spain, Sweden and the UK. About 50 other countries are signatories to it

Under the Vienna Convention, several countries sign tax treaties with each other. Most of these tax treaties are based on a model, the OECD, (Organization for Economic Cooperation and Development), Model.

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<sup>24</sup> Ibid.

The primary purpose of a tax treaty is to allocate taxing rights. These taxing rights seek to achieve two principal objectives:

- (i) to avoid double taxation; and
- (ii) to prevent fiscal evasion.

That is, a citizen of any of the contracting parties should not be subjected to double taxation, neither should the laws allow him to escape or evade taxation. Other objectives of a tax treaty include:

- i. prevention of tax discrimination of nationals;
- ii. ascertainment of permanent establishments and enterprises;
- iii. resolution of tax disputes due to differences in the interpretation or application of a tax treaty;
- iv. authority to provide exchange of information on tax matters to ensure compliance;
- v. provision of mutual assistance in the administration or collection of taxes.

Most tax treaties or agreements, as stated earlier, are based on the OECD model on tax conventions. Since the end of the last century, developed countries have signed bilateral agreements amongst themselves, the principal aims of which are to prevent international double taxation. However, from the latter part of the century, emphasis has shifted to bilateral agreements between developed and developing nations of the world. The objectives of these later conventions are not materially different from those set out above, that is, to prevent double taxation; to facilitate free movement of capital across borders; and to prevent fiscal evasion.

However, developing countries soon realized that they were being short-changed, as the bilateral agreements do not pay sufficient attention to their legitimate fiscal interests. For example, they realized that the flow of investments and income between

the two types of countries is almost always markedly one directional. That is, developing countries later realized that, in signing an agreement with developed countries, what, in fact, was being negotiated was the right to tax income generated in their jurisdiction by investments of developed countries.

The OECD itself came into force on 30<sup>th</sup> September, 1961, pursuant to Article 1 of the Convention signed in Paris, France, on 14<sup>th</sup> December, 1960. It is a unique forum where governments of member states work together to address the economic, social and environmental challenges of the world, and to help one another to confront emerging problems of corporate governance. The OECD has the following broad objectives:

- i. to achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- ii. to contribute to sound economic expansion in member as well as non-member countries in the process of economic development; and
- iii. to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

Nigeria is not a member of OECD. Some of the current members are: Belgium, Canada, Norway, Portugal, Spain, Japan, Mexico, Finland, U.S.A., U.K., Turkey, Sweden, South Korea and the Czech Republic.<sup>25</sup>

In 1971, the member countries of the OECD set up a Committee on Fiscal Affairs to work on all aspects of the taxation policy of the Organization. Specifically, the Committee on Fiscal Affairs was mandated to investigate “the methods by which taxation can be used to promote improved allocation and use of economic resources,

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<sup>25</sup> OECD Tax Policy Studies No. 4, 2001, Paris, page 1

both domestically and internationally, and for proposing ways of increasing the effectiveness of taxation as a policy instrument for achieving Government objectives, but excluding work on the use of fiscal policy for demand management purposes”<sup>26</sup>

Consequently, the Committee has investigated and worked on the following areas, and its findings or recommendations form the basis for entering into tax treaties between member countries of the OECD:

- a. Double Taxation Treaties;
- b. Taxation and International Capital Flows;
- c. Tax Avoidance and Evasion;
- d. Taxation of Multinational Enterprises;
- e. Tax Analysis and Social and Economic Policy;
- f. Co-operation within OECD and with other international fora, e.g. ECOSOC, (Economic and Social Council), IMF, (International Monetary Fund), and CEC, (Commission of the European Communities).

Nigerian tax laws<sup>27</sup> contain guide-lines on how tax treaties between Nigeria and other countries shall provide for such matters as double taxation, computation of tax, reliefs.

Nigeria has signed tax treaties with many countries like Romania, Canada, Belgium and France.

The tax treaty between Nigeria and Romania, for example, is dated 21<sup>st</sup> July, 1992, but came into force on 1<sup>st</sup> January, 1993. It is principally on the avoidance of double taxation. It covers all persons who are residents of one or both of the contracting states. It also covers such heads of tax in Romania as tax on income derived by

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<sup>26</sup> OECD Committee on Fiscal Affairs, (Activities 1971-1990 and Current Work Programme). 1990, France, page 17.

<sup>27</sup> For example, SS. 61, 62 of Petroleum Profits Tax Act, Cap. P13, Laws of the Federation of Nigeria, 2004



individuals and corporate bodies; tax on profits of foreign representation and companies with participation of foreign capital; tax on income derived from agricultural activities. In Nigeria, the heads of tax covered by the treaty are: personal income tax; the companies income tax; the petroleum profits tax; and the capital gains tax. The treaty also defines such knotty terms in international taxation like “fiscal residence”, “permanent establishment”, , and provides for how income from immovable property, business profits, shipping and air transport, associated enterprises, dividends, interest and royalties shall be computed and taxed.

The tax treaty between Nigeria and other countries like Canada, Belgium and France contain similar provisions.<sup>28</sup>

The tax treaties between Nigeria and these other countries, in addition to the foregoing objectives, generally provide for the following:

- a. The elimination of double taxation through the grant of credit for taxes paid by a Nigerian company in the other country, and also through the acceptance in an investor’s country of taxes paid by the investor in Nigeria as a set off against the taxes to be paid;
- b. The protection of the tax incentive legislation of the government which could otherwise be modified by the tax measures of the other country;
- c. The creation of a stable tax regime which a prospective investor can rely on for business planning and transaction;
- d. The grant of the concession of treaty-rates for investment income, which should be lower than domestic rates;

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<sup>28</sup> Other Countries with which Nigeria has entered into tax treaties include: The United Kingdom, The Netherlands, Pakistan, Italy (limited to shipping and air transportation), The Czech Republic, Poland, Philippines, South Africa, China, Mauritius and Bulgaria.

- e. The provision for exchange of vital information between the contracting states on tax matters and on the activities of taxpayers resident in each of the states.<sup>29</sup>

An offshoot or by-product of a tax treaty is treaty shopping. Treaty shopping is the routing of income arising in one country to a person in another country, through an intermediary country, to obtain an unintended tax advantage of tax treaties.<sup>30</sup>

Abdulrazaq defined it as a practice where a resident of a state, which is not a party to the treaty, establishes an entity within a state which is a party to the treaty in order to take advantages of its provisions.<sup>31</sup> That is, treaty shopping occurs when a taxpayer residing in a non-contracting, third country takes advantage of the benefits of a treaty that would not normally be available to him. The aim, principally, is to reduce taxes payable on income. Treaty shopping can also help to: (a) reduce withholding taxes, (b) avoid or defer remittances of taxable income to the home country, (c) avoid or defer capital gains tax on the sale of investments abroad,<sup>32</sup>

An example of a tax treaty is the OECD Model Convention on Income and Capital (OECD MC). The Convention consists of 31 Articles under seven chapters.

#### **2.1.4 Double Taxation**

Investment in other countries would be seriously impeded if there is a danger that income derived from this investment would be taxed both in the country where the money was invested and in the country of residence of the investor. It is therefore important for the harmonious development of international economic relations that the basic rules for taxing income and capital should follow an agreed standard pattern and should be as clear and precise as possible.

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<sup>29</sup> Dike, M.A.C. International Taxation, CITN Tax Practice Series No: 17, 2003, page 10.

<sup>30</sup> Rohatgi, op. cit, vol. II, page 165

<sup>31</sup> Abdulrazaq, op. cit.

<sup>32</sup> Rohatgi, op. cit, page 8

Each country of the world exercises its own taxing rights under its domestic tax law. So, where a taxpayer is subject to taxation on cross-border transactions in more than one jurisdiction, he generally ends up with a higher tax liability than he would incur on similar transactions carried out wholly at home. He may therefore be liable to double, (or even multiple), taxation as a result of conflicting taxing rights of different countries.

Double taxation therefore occurs when the same taxable item is taxed more than once, and it is generally regarded as an impediment to international trade and investment. Therefore, an objective of international tax is that it should be avoided. Many countries provide unilateral reliefs to avoid or minimize double taxation under their domestic tax laws, for example, tax exemption, tax holiday, tax credit or an expense deduction for foreign taxes paid. However the problem of double taxation in international law is now addressed principally through tax treaties, known as Double Taxation Avoidance Agreements, (DTA As). As stated in the preceding paragraph, these tax treaties are governed by the principles laid down under the Vienna Convention on the Law of Treaties. (VCLT)

There are, today, more than 2,500 such bilateral treaties and protocols that modify or supplement them, in existence.<sup>33</sup> Nearly all of them follow the internationally accepted format prescribed either by the Committee on Fiscal Affairs of the Organization for Economic Co-operation and Development (OECD Model) or the version recommended by the ECOSOC Committee of Experts on International Co-operation on Tax matters. These model conventions contain standard Articles with detailed commentaries to assist both in the bilateral negotiation and in their subsequent application and interpretation.

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<sup>33</sup> Rohatgi, op. cit, page 3

In international taxation, there are two types of double taxation: economic and juridical. **Economic double taxation** arises when the same economic transaction, item, or income is taxed in two or more states during the same period but in the hands of different tax payers. Examples of economic double taxation are income in the hands of husband and wife, partnership and partners, company and shareholders, parent company and subsidiary. The same tax object is taxed on legally different but economically, similar or connected subjects in two jurisdictions or states. A further example of economic double taxation is where a company pays tax on its profits, and its shareholders are taxed separately on the dividends paid out of the taxed profits. This economic double taxation may be avoided or mitigated by giving relief to the company when it distributes its profits or by giving relief to the shareholders by means of an imputation tax credit or a credit for underlying taxes already paid by the company.

**Juridical double taxation** is when two or more states levy their respective taxes on the same entity or person for the same income and for identical periods. Thus, it deals with the same tax object and the same tax subject. It is an imposition of comparable taxes by two or more states on the same taxpayer in respect of the same subject matter, and for identical periods. This arises where income is taxed both in the source country and in the country of residence of the recipient of such income.

Juridical double taxation is the result of a conflict between two tax systems. It occurs due to the overlapping claims of tax jurisdictions on interrelated economic activities. The competing powers of fiscal sovereignty lead to double, (or even multiple), taxation in two or more jurisdictions. Alternatively, these competing rights may, by mutual agreement, lead to double tax exemption, that is, non-taxation.<sup>34</sup>

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<sup>34</sup> Ibid, pages 15-16

International tax law, and this research in particular, is primarily concerned with juridical double taxation, that is, double taxation based on jurisdictions or states.

Although the domestic tax systems in most countries provide for unilateral relief, juridical double taxation conflicts are largely resolved through tax treaties negotiated under the principles of international tax law accepted by sovereign states. Through their distributive rules that avoid double taxation and relief methods when it does arise, they ensure a fair distribution of global tax revenues among nations, (international equity). They also attempt to achieve global tax neutrality where tax issues do not affect economic choices of taxpayers on international transactions.<sup>35</sup>

Thus, a country may apply the following international tax principles in its domestic tax laws:

- a. **The residence rule.** Under this principle, unlimited taxation rights are granted to the country of residence of a taxpayer, due to his `personal attachment`. The country of residence, (or nationality), may impose its taxes on the worldwide income of individuals or corporations due to the protection and other services it offers to the tax subject.
- b. **The source rule.** Here limited taxation rights are granted to the country of source due to the `economic attachment` of persons. The country of source reserves the right to tax the income that is derived from the economic activities within its territory.

However, in spite of these broad principles, international juridical double taxation may arise in three cases:

- i. where each of two states, under its domestic taxation law, treats the same person as having his residence within its territory;

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<sup>35</sup> Ibid.

- ii. where each of two states imposes tax on the same income or capital, (limited tax liability in both states). For example, where a permanent establishment in one state derives income from immovable property in another state, and neither state is the state of residence of the owner of the permanent establishment; and
- iii. where a person, who has his residence in one state, derives income from or owns capital in another state and both states impose tax on that income or capital.<sup>36</sup>

In these situations, it is the opinion of this writer that Articles 23 (A) and 23 (B) of the Draft Convention for the Avoidance of Double Taxation with Respect to Taxes on Income And Capital<sup>37</sup> provide that the conflict in (i) above may be resolved in accordance with Article 4 of the convention, that is, by determining the fiscal domicile of the person. The conflict in (ii) above can be resolved only by mutual agreement of the contracting parties, as the convention is confined to residents of either of the contracting parties only. The conflict in (iii) above may be resolved by renunciation, (or forbearance), of taxing rights by either of the states, that is, either the residence state or the state of source of the income and capital. In other words, in the case where the state of source renounces its right to tax, the income or capital in question “shall be taxable only” in the other state. But where the state of source does not renounce its right to tax, the state of residence must give relief to tax. In either case, double taxation is avoided.

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<sup>36</sup> Rohatgi, op.cit

<sup>37</sup> OECD Model Tax Convention, 1963

### 2.1.5 International Tax Planning

“Anyone may arrange his affairs so that his taxes shall be as low as possible. He is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one’s taxes. Over and over again the courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands.”<sup>38</sup>

Arranging one’s affairs in such a way that they attract minimum tax is what tax planning is all about.

Tax planning may be domestic or international. Domestic tax planning is concerned primarily with the national rules of tax deductions, allowances, reliefs and exemptions. It is also concerned with the different tax rates levied on various sources of income in a single jurisdiction. International tax planning on the other hand examines the interrelationship of two or more tax systems, the impact of juridical and economic double taxation, and the tax compliance rules in more than one country. It also involves additional considerations such as tax incentives and exemptions for foreign income, availability of foreign tax credits, use of tax treaties and anti-avoidance measures.<sup>39</sup>

Tax planning, (whether domestic or international), may be either defensive or offensive. A defensive tax planning attempts to avoid double or multiple taxation on the same income and taxpayer. Offensive tax planning, on the other hand, deals with techniques or strategies that lawfully optimize the after tax income and capital flows of a transaction as it travels from the overseas source state, (“host country”), to the residence state, (“home country”), of the taxpayer. These plans consider the transaction costs, the management structure, business risks, as well as the relevant anti-avoidance measures.

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<sup>38</sup> Hand J. In *Gregory v. Helvering* (1935) 89f2d 809 (US).

<sup>39</sup> Rohatgi, R., *Basic Int’l Taxation*, Vol. II, Taxmann Publisher Ltd. India, 2007, page 1.

International tax planning is the art of arranging cross-border transactions with the knowledge of international tax principles to achieve a tax effective and lawful routing of business activities and capital flows.<sup>40</sup> The primary objective of international tax planning is to minimize or defer global taxes lawfully to meet the desired business and other objectives of such transactions; that is, to receive the after-tax flows of overseas income lawfully at minimal cost and risk. The technique does not only look at legal tax-saving opportunities, but also at tax risks such as double taxation and prospects of counteracting or violating tax legislation.<sup>41</sup>

The need for international tax planning cannot be over-emphasized. Tax is not usually a primary or overriding factor in the decision of investors to engage in overseas business activities, or even to invest abroad. Such decisions are usually primarily influenced by such factors as business viability, availability of resources, market accessibility and potentiality, availability of infrastructure, skilled and low cost workforce, political and economic stability. However, once the initial decision has been made, tax often becomes an important business consideration.<sup>42</sup> A survey conducted by the Ruding Committee in the UK revealed that almost half the multinationals in the European Union considered the tax rate on business profit as a decisive factor in choosing the country to locate their operations.<sup>43</sup> Availability of tax treaties and qualitative tax administrators are other tax related issues that influenced decisions of multinational corporations to locate their business in particular countries. Many techniques have been evolved in international tax planning. Some of these techniques or strategies are: exemption from tax, deferral of tax payment and credit or exemption for foreign taxes paid, among others.

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<sup>40</sup> Ibid

<sup>41</sup> Hinnekens, C., *International Tax Planning and Electronic Commerce*, Taxmann Prints Ltd, India, 2004, page 16

<sup>42</sup> Rohatgi, op. cit

<sup>43</sup> Omo Ruding Committee Report (independent experts on Company Taxation), Luxembourg, 1992.



Consequently, an international tax planner is usually guided by a ‘check-list’ of those matters that would assist him in proper planning and advice for his client. The check-list includes the following steps: analysis of existing database, design of tax planning options and evaluation the plan.

In Nigeria a foreign company is allowed to invest in any business, except:

- a. production of arms and ammunition;
- b. production of and dealing in narcotic drugs and psychotropic substances; and
- c. production of military and paramilitary wears and accoutrement, including those of the Police, Customs, Immigration and Prison Services.<sup>44</sup>

In addition, the NIPC (Nigeria Investment Promotion Commission), Act, gives the following reliefs or incentives for foreign investment:

- i. A guarantee of unconditional transferability of funds, in freely convertible currency, of all dividends or profits, (net of taxes), attributable to the investment;
- ii. Transferability of payments in respect of loan servicing where a foreign loan has been obtained; and
- iii. The remittance of proceeds, (net of taxes), and other obligations in the event of a sale or liquidation of the enterprise or any interest attributable to the investment.<sup>45</sup>

Foreign companies shall also not be arbitrarily acquired or nationalized without a fair and adequate compensation in convertible currency<sup>46</sup>

Similar provisions are also contained in the Foreign Exchange (Monitoring And Miscellaneous Provisions) Act,<sup>47</sup> guaranteeing an unconditional transferability of funds through an Authorized Dealer in freely convertible currency.

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<sup>44</sup> Sections 18 and 32 of NIPC Act, op. cit.

<sup>45</sup> Section 24, *ibid*

<sup>46</sup> Section 26 (2)

<sup>47</sup> Cap. F 34, Laws of the Federation of Nigeria, 2004

Furthermore, in Nigeria, Export Processing Zones have been designated as physical areas set aside by government to encourage foreign investment in the production of goods for export. The Nigeria Export Processing Zones Act<sup>48</sup> provides incentives for foreign investors by granting a total exemption from all federal, state and local government taxes, levies and rates.<sup>49</sup> In addition, the Act allows any approved enterprise to import into a zone, free of customs duty, any capital goods, consumer goods and raw materials, components or articles intended to be used for the purpose of, and in connection with, an approved activity, including any article for the construction, alteration, reconstruction, extension or repair of premises in a zone or for equipping such premises.<sup>50</sup> Other incentives granted under the Act include non applicability of legislative provisions on taxes, levies, duties; non requirement of import or export licences; allowing up to 100% foreign ownership of business in the zones and allowing foreign companies operating in the zones to employ foreign managers and qualified personnel.

It is thus clear that Nigeria has sufficient tax incentives to attract the interest of any international tax planner. But is there a direct relationship between these incentives and Foreign Direct Investment (FDI), in Nigeria?

## **2.1.6 Domicile**

### **A. Meaning of Domicile**

Domicile is not necessarily synonymous with residence, especially in international taxation. Residence is only a feature of domicile. A person may be resident in a place even if he is not ordinarily resident there. For, people are domiciled where they have

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<sup>48</sup> Cap. N107, Laws of the Federation of Nigeria, 2004

<sup>49</sup> Ibid, Section 8

<sup>50</sup> Ibid, Section 12

or are deemed by law to have their permanent home.<sup>51</sup> Thus, people must, by law, have a domicile, but may not have more than one.<sup>52</sup>

Determination of residence which is necessary mostly in domestic taxation, and which has to do with assessment of tax, is guided by five factors: (i) the period of the taxpayer's physical presence in a particular country in the year under question, (ii) whether or not he was present in that country in the previous year of assessment, (iii) the regularity or otherwise of his visits in successive years, (iv) the reason for those visits, and (v) whether or not there is a place for his domestic use in the country.<sup>53</sup>

Detailed rules have further been provided in the Personal Income Tax Act<sup>54</sup> for the determination of residence of a taxpayer.

Domicile, on the other hand, is difficult to define, as each country seems to define it according to its peculiar circumstances. The concept of domicile under the common law, for example, differs from the term as used in civil law countries where it usually refers to the place of permanent residence or home.

However, the word "domicile" has been defined in the UK as "a place [that] is properly the domicile of a person [and] in which his habitation is fixed without any present intention of moving therefrom."<sup>55</sup> Thus, the term "domicile" signifies a permanent home or place where a person is a permanent resident with the intention of remaining there for an indefinite period "unless and until something, (which is unexpected or the happening of which is uncertain), shall occur to induce him to adopt some other permanent home."<sup>56</sup>

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<sup>51</sup> Whisker v. Hume (1858) 7 HL 124

<sup>52</sup> Abdul-Razaq, M.T. op. cit; page 315

<sup>53</sup> Ibid

<sup>54</sup> Cap. P8, Laws of the Federation of Nigeria, 2004

<sup>55</sup> Craignish v. Craignish (1892) 2. Ch. 180

<sup>56</sup> Sykes, E.I., et al, Australian Private International Law, (The Law Book Company Ltd), 1987 pages 314-315

Once established, the domicile can continue even if the person is away for a long period, as long as the intention remains of returning to the domicile as a permanent residence.<sup>57</sup>

Under the common law therefore, two elements are necessary for the existence of domicile: (a) a residence of a particular kind, and (b) an intention of a particular kind. The person must not only reside in the country where he takes up residence, but he must also intend to stay there permanently. And, again, everyone must have a domicile, and a person can be domiciled only in one place at any time.

## **B. Types of Domicile**

There are, broadly, three types of domicile:

**i. Domicile of origin.** This is the domicile which the law attributes to every individual at birth. Thus, if a child is legitimate, his domicile is that of the father at the date of the child's birth. If, on the other hand, the child is illegitimate, or posthumous, his domicile is that of the mother.<sup>58</sup> The domicile of a foundling is in the country where he was found.

This domicile of a child acquired through the father is not dependent on the father's nationality, the country where he was born or the country of his residence.

The domicile of origin stays with the person until abandoned by him for a domicile of choice.

**ii. Domicile of choice.** This is the domicile, which people acquire by leaving or abandoning their domicile of origin, and taking up residence in another country with the intention of making it their permanent home.<sup>59</sup> However, until there is both the

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<sup>57</sup> Jeffrey R. J., *The impact of State Sovereignty on Global Trade and Int'l Taxation* (Kluwer Law Int'l), 1999 pages 50-51

<sup>58</sup> *Udny v. Udny* (1869) LR 1 SC & Div. 441, 457.

<sup>59</sup> Abdul-Razaq, M.T., *op.cit*

intention to change domicile and also to establish a permanent home in the new country, the domicile of origin remains. Thus, a domicile of choice is acquired by the combination of residence and an intention to establish a permanent or indefinite home elsewhere. The domicile of choice continues until the former domicile is resumed or another one acquired.

A person can give up his domicile of choice by not residing there and not intending to reside there permanently or indefinitely. Since a person cannot be without a domicile nor have more than one domicile, he then either acquires a new domicile of choice, or he reverts to the domicile of origin.

**iii. Domicile of dependency.** A domicile of a dependent person follows the domicile of the person on whom he is legally dependent. For example, an adopted child takes up the domicile of the adopting parents, while the domicile of the wife is that of her husband.<sup>60</sup> In the United Kingdom, a wife acquired the husband's domicile if married before 1<sup>st</sup> January, 1974. If married after that date, her domicile status is dependent on her origin or choice.<sup>61</sup>

Thus, domicile is the most long-lasting form of attachment between the individual and the state. Determination of domicile is important, because under the tax law, certain countries do not tax non-domiciled persons on their worldwide income except on remittance basis. An example of such a country is the United Kingdom. Another tax implication of domicile is the determination of the country that has the right to tax the income of the taxpayer, which right is dependent on his domicile.

Furthermore, the concept of domicile also has various functions and it is important in the following three cases:

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<sup>60</sup> Rohatgi R., op. cit, pages 221 -222

<sup>61</sup> Ibid

- a. in determining a convention's field of application with respect to physical and legal persons;
- b. in solving cases where double taxation arises as a consequence of a conflict between domicile and source;
- c. in solving cases where double taxation arises in consequence of a dispute over which country a taxpayer is domiciled in.

### **2.1.7 Permanent Establishment**

#### **A. Meaning of Permanent Establishment**

A Permanent Establishment, (PE), is a fixed place of business, which generally gives rise to tax liability in a particular jurisdiction.<sup>62</sup> The tax system in many countries imposes tax only where an enterprise maintains a Permanent Establishment, (PE) in the country.

With the globalization of world economies, the concept of Permanent Establishment has gained significant magnitude in the world due to its direct impact on the revenue generated by a country.

But what is Permanent Establishment, (PE)? It is a measuring tool to determine the right of a country to tax the profits of an enterprise which has a presence in another country, and it is generally used in cross-border transactions on taxability of the income generated across borders.<sup>63</sup>

The concept of Permanent Establishment, (PE), is therefore central to the jurisdiction of a source country to tax the profits from foreign trade carried on by a non-resident company within its jurisdiction. The rule is that there is a threshold beyond which a

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<sup>62</sup> Arogundade, J. A. "Nigerian Income Tax & Its International Dimension", Spectrum Books Ltd, Ibadan, 2010, page 438.

<sup>63</sup> Ibid.

state of source can only tax the income of a non-resident company from sources located within that state.<sup>64</sup> That threshold is the PE. What the country of source is entitled to tax is the income attributable to that PE. In other words, where an enterprise carries on business in the other country through a PE located in that other country, such a company is liable to tax on the income attributable to that PE.<sup>65</sup>

The underlying principle, according to Arogundade,<sup>66</sup> is that a resident company of one country must have a sufficient presence in another country to be liable to tax in respect of its profits from business operations in the other country. Where no such presence exists, or where the presence is not sufficient, that other country from which the income is being derived has no authority to tax the income that the company may derive from its jurisdiction. The implication of the rule therefore, is that it is not every income that a non-resident company makes from another country that is liable to tax in that other country. The country of source cannot tax such income unless the company has a PE in the country and the income is attributable to that PE. For example, if a UK resident company carries on business in Nigeria, Nigeria has no authority to tax the profits from that business unless Nigeria is able to ascertain that the company has a PE in the country. The rationale is to allow for a free flow of international trade and commerce.

Article 5 (2) of the Draft Convention For the Avoidance of Double Taxation with Respect To Taxes on Income And Capital defines the term “Permanent Establishment” to include the following:

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<sup>64</sup> Arogundade, J. A., *Nigerian Income Tax & Its International Dimension*, Spectrum Books Ltd, Ibadan, 2010, page 438

<sup>65</sup> Ibid.

<sup>66</sup> Ibid.

- a. a place of management;
- b. a branch;
- c. an office;
- d. a factory;
- e. a workshop;
- f. a mine, quarry or other place of extraction of natural resources;
- g. a building site or construction or assembly project which exists for more than twelve months.

In paragraph (3), the Article provides that the term “permanent establishment” shall not be deemed to include:

- a. the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- b. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- c. the maintenance of stock of goods or merchandises belonging to the enterprise solely for the purpose of processing by another enterprise;
- d. the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting, (not evaluating or editing), information for the enterprise;
- e. the maintenance of a fixed place of business solely for any other activity of a preparatory or auxiliary nature for the enterprise;
- f. the maintenance of a fixed place of business solely for any combination of activities in (a) to (e) above, provided it results in an overall business activity of a preparatory or auxiliary nature.



Preparatory or auxiliary activities are services that are “so remote from the actual realization of profits that it is difficult to allocate any it to the fixed place of business in question.”<sup>67</sup> Examples include support services such as advertising, supply of information, scientific research, servicing of patents.

Furthermore, the Article provides that an enterprise of a contracting state shall not be deemed to have a permanent establishment in the other contracting state merely because it carries on business in that other state through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.<sup>68</sup> Article 5 (7) of the Convention deems an independent agent acting in the ordinary course of his business as an agency of PE if his activities are devoted wholly or almost wholly on behalf of an enterprise, unless the transactions are conducted on an arm’s length basis. A transaction conducted on an arm’s length basis is one under which independent parties would agree to pay a particular price in the same or similar circumstances.

However, as we stated in the preceding chapter of this work, the definition of the term “permanent establishment” failed to take cognizance of an important element in international tax law, and that is, “production”. In other words, the definition of the term should have included any activity with a ‘productive character’, which is any activity that is able to contribute to business growth and development. Production here should not be confused with manufacturing, for an enterprise may be involved in the provision of services only, and thereby still be productive, even though it does not necessarily manufacture goods.

Another defect in the definition of the term ‘permanent establishment’ under the convention is the absence of the element of “profitability.” Profit is the main target of

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<sup>67</sup> OECD Commentary Article 5 (23).

<sup>68</sup> *ibid*, Article 5 (6)

taxation, including international taxation. Thus an enterprise that does not earn profits should not attract the taxman's hammer.

**B. Nigerian decided cases on Permanent Establishment (PE)**

As Arogundade observed,<sup>69</sup> (and we agree with him), there are few decided cases in Nigeria on the issue of liability to Nigerian tax by a non-resident company on the basis of PE. The few that there are were decided prior to the 1993 amendment of Section 18(2) of the Companies Income Tax Act.<sup>70</sup> The Section provides:

“The profits of a company other than a Nigerian company from any trade or business shall be deemed to be derived from Nigeria to the extent to which such profits are not attributable to any part of the operations of the company carried on outside Nigeria”.

Thus, in *Offshore International S.A.V. FBIR*,<sup>71</sup> the plaintiff, a resident of Panama, got well drilling and completion contracts from some Nigerian companies. For the purpose of executing the contracts, it formed a wholly-owned Nigerian subsidiary called International Drilling Co. (Nig) Ltd ‘IDC’ to which it sub-contracted the Nigerian operations. The plaintiff company was assessed to tax on the basis that the profit from the contract was a profit derived from an activity in Nigeria. It appealed against the assessment on the principal grounds that:

- i. it was a foreign company, incorporated in Panama;
- ii. it was not resident in Nigeria, being ordinarily resident in Houston, Texas;
- iii. it had no office or place of business in Nigeria.

The court found that IDC was a wholly-owned subsidiary of the plaintiff and that it carried out the drilling operations on behalf of the plaintiff. The court then held thus:

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<sup>69</sup> op. cit, page 458

<sup>70</sup> op. cit

<sup>71</sup> 1 NTC 384

*...if the plaintiffs enter into agreement to take up drilling contracts in respect of oil wells to be drilled in Nigeria, and they undertake to do it by or through a person, (IDC), who is their son, as it were, and they guarantee to supply the wherewithal required by that person, (IDC), for the execution of the said oil drilling operations in Nigeria, and the said operations are in fact being executed, it will be in vain for them, (the plaintiffs), to say that they have no trade or business in Nigeria.*

In *F.L. Smith & Co. Ltd V. FBIR*<sup>72</sup>, the issue was the interpretation to be placed on Article 3 (2) of the Nigeria/U.K Colonial Double Taxation Agreement, as it applied to the plaintiff company. The Article provides that the profit of a UK enterprise shall not be taxed in Nigeria unless it engages in trade or business in the country through a permanent establishment. Even then tax is to be imposed only on those profits attributable to the activities of the permanent establishment.

The plaintiff company signed an agreement with the Nigeria Cement Company, Nkalagu, to act as a consultant for the rehabilitation of the factory after the Nigerian Civil War, (1967-1970). The Nigerian company was to provide office and residential accommodation for the engineers of the UK company. The prayer of the plaintiff company was to be exempted from tax on the profit from its consultancy fees, on the ground that it did not operate in Nigeria through a branch or a permanent establishment. The Board of Appeal Commissioners decided that the plaintiff company was liable to tax because the phrase ‘permanent establishment’ was not synonymous with ‘everlasting’, but that the term ‘permanent establishment’ implies “indefinitely continuous”.

In addition, the Appeal Commissioners found that there was evidence before them that the plaintiff company “had a continuity of operations over a period which is ..... established as indefinite.” It accordingly dismissed the appeal.

Thus, the concept of ‘permanent establishment’, has been expounded and applied by the courts in Nigeria, sometimes to the benefit of the revenue authorities, and at other

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<sup>72</sup>Unreported (1976) APP. Comm. 228

times to their detriment. A more pragmatic approach is needed, especially on the part of the judiciary. This is because, the judiciary, in *Reiss & Co. Nig Ltd V. FBIR*<sup>73</sup>, allowed a foreign company to use its subsidiary as a smoke screen for evading tax in Nigeria. And as Ayua said, this would have adverse impact on the government share of revenue from international investment income arising within Nigeria.<sup>74</sup>

### **C. Transfer Pricing**

Closely related to the problems arising from the operations of permanent establishments is the issue of transfer pricing. Transfer pricing in international tax law is an economic term, which refers to the valuation process for transactions between related entities.<sup>75</sup> It is “the amount charged by one segment of an organization for a product or service that it supplies to another segment of the same organization”.<sup>76</sup> Improper transfer pricing methods lead to unjustified profit transfers between countries. For example, artificially deflated or inflated prices on transactions would reduce or increase the taxable profits of associated companies in other countries. Such practices are considered as unacceptable tax avoidance.

Each country wants to attract multinational corporations to its country. But it also wants to ensure that its legitimate rights over the tax receipts due from their activities in its tax jurisdiction are protected. Therefore, national tax authorities may question the transfer pricing on international transactions, if they lead to an unacceptable loss of tax revenue that they believe is due to them and not to another country.

Paragraph 3 of the Preface of the 1979 OECD Report on Transfer Pricing and Multinational Enterprises provides that the term “transfer pricing” is neutral, that is,

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<sup>73</sup> Supra

<sup>74</sup> Ayua. I.A., op. cit, page 58

<sup>75</sup> Rohatgi R., op. cit, vol. II. page 239.

<sup>76</sup> Horngren C.T. et al, Introduction to Management Accounting (Prentice Hall International Inc. 1996) page 142

that "...the consideration of transfer pricing problems should not be confused with the consideration of problems of tax fraud or tax avoidance, even though transfer pricing policies may be used for such purposes".

However, Ayua<sup>77</sup> has observed that:

The multinational or transnational corporations adopt transfer prices which are not arm's length prices in order to minimize tax. This can be done, for example, either by selling goods to a subsidiary in a tax haven at less than arm's length prices, or by a parent company overpricing its exports to foreign subsidiaries so that by inflating the cost of imports of the final product or raw materials, a corporation can increase the margin of profit which of course will be concealed for tax purposes. This leads to artificially lower profits and therefore lower tax collections in the taxing country.

This practice, the author further observed, can adversely affect economic development generally, and in particular, domestic capital formation and tax revenues of a developing country like Nigeria.

The case of *Reiss & Co. (Nig) Ltd V. FBIR*<sup>78</sup>, illustrates this point clearly. For, in that case, the then Federal Revenue Court refused to disregard the legal entity of the Nigerian subsidiary company for the purpose of taxing the profits of its expatriate parent company, Reiss & Co., Amsterdam, which profits were wholly derived in Nigeria. Even though the court found that there is "evidence before [it] that Reiss & Co., (Amsterdam), still has a controlling shareholding of 55% of the shares of the appellant company", and that the whole transaction raised a considerable dark cloud of suspicion regarding the genuineness of the activities between the two companies, it, surprisingly, still held that: "The separate legal entity of the appellants and Reiss & Co. (Amsterdam) cannot be denied: *Salmon V. Salmon & Co.* Respondent cannot impugn the legal situation successfully without adducing sufficient evidence to the contrary"

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<sup>77</sup> Ayua, I.A., op. cit, page 253

<sup>78</sup> (1977) 3 FRCR 251

Thus, it is not enough that there is a permanent establishment (PE) in a country. Identifying a permanent establishment is one thing. Unraveling the intrigues, intricacies and devices for tax avoidance by permanent establishments through their principal companies is quite another. The tax implications of these practices for a developing country like Nigeria can be severe, if not outrightly disastrous.

## **2.1.8 Tax Haven**

### **A. Meaning of Tax Haven**

AbdulRazaq, M.T. posits that a tax haven is “a place with a favourable tax climate”.<sup>79</sup> The author also stated that one country’s tax incentives cause another country to brand it as a tax haven. He then gave examples of tax haven as the Bahamas, the Turks and Caicos Islands, the Cayman Island.

Rohatgi, on the other hand, says a tax haven is a “country, which is used to avoid tax that would be payable otherwise in another country.”<sup>80</sup> The author went further to observe that besides the traditional low or nil tax jurisdictions, a high-tax country may be characterized as a tax haven if it offers certain exemptions, incentives, investment opportunities or other preferential treatment.

However, Richard Gordon<sup>81</sup> is of the view that there is no single, clear objective test that identifies a tax haven. Instead, he said, there are characteristics of a tax haven. He said some of these characteristic are:

- a. Low or nil tax on all or certain types of income and capital, as compared to the country of residence;
- b. Bank and commercial secrecy;

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<sup>79</sup> Op.cit, page 316

<sup>80</sup> Op.cit, page 333

<sup>81</sup> his 1981 US Treasury Report, pages 27-34

- c. The lack of exchange controls or a dual currency control system for residents and non-residents;
- d. Offshore banking facilities;
- e. Excellent communication facilities, physical transportation (sea and air), and telecommunications (post, telephone, fax, telex, cable);
- f. Opportunities for multilateral tax planning;
- g. Political and economic stability;
- h. Favourable disposition to foreign capital;
- i. Availability of professional advisors;
- j. Geographical location and good climate;

In fact, according to an OECD definition, the concept of tax haven is a relative one, as any country may be a tax haven to some extent.<sup>82</sup> For, there are many instances where a high-tax country may provide opportunities or devise policies to attract economic activities of certain types or in certain locations. So, the OECD Committee on Fiscal Affairs was of the view that it may not serve a useful purpose to attempt to provide a single definition of the term.

Yet, in 1998, the same OECD released a report on “Harmful Tax Competition”,<sup>83</sup> in which it provided a definition that tax havens were primarily jurisdictions that imposed no or nominal effective tax and provided opportunities to non-resident taxpayers to escape their home taxes or to indulge in illegal activities. The report stated that tax havens prevented an effective exchange of tax information under their laws and lacked transparency in their operations. It said tax havens attract investments

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<sup>82</sup> OECD Committee on Fiscal Affairs; Tax Havens Report, 1987, paragraph 27.1

<sup>83</sup> Committee Fiscal Affairs: Harmful Tax Competition COECD (1998), pages 23-24

or transactions that are purely tax-driven with insufficient activity or economic substance.

Consequently, any country that provides a tax benefit for cross-border transactions or activities can be regarded as a tax haven. This will include both pure tax havens and many of the economically developed countries. This is because many of the developed countries have tax beneficial regimes for investment and business activities that attract non-residents from other jurisdictions, and so, can be described as tax havens for those activities. Many of them also permit the use of their treaties to provide benefits as treaty havens. So, every country, developed or developing, may be a tax haven to some degree, and at least for some purposes.

However, no one country has all the indices or indicators to qualify it as a sole tax haven. Tax incentives, benefits, vary from country to country, according to its level of development or peculiar social, economic and political needs. So, various examples of tax havens have been listed below, against the type of incentive each country provides to investors.

We have already highlighted some Nigerian tax incentives, allowances and reliefs in the preceding paragraphs of this work.<sup>84</sup> Some of these incentives and allowances include the permission allowed a foreign enterprise to engage in any business in Nigeria except those stated in sections 18 and 32 of the NIPC Act; the provisions granting total exemption from all taxes for a company that establishes business in an Export Processing Zone; the provision that guarantees an unconditional transferability of funds through an Authorized Dealer in freely convertible currency; and the provision against arbitrary acquisition or nationalization of a foreign company without a fair and adequate compensation in convertible currency.

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<sup>84</sup> See particularly Paragraph 2.1.5 (Tax Planning).



All these provisions qualify Nigeria to be referred to as a tax haven.

Views on the desirability or otherwise of tax havens are deeply divided. Those in favour of tax havens have listed the following advantages:

- a.** That they play a significant role in international finance and trade by helping to minimize tax liabilities in a competitive global economy. They argue that tax havens help in reducing the effective marginal tax rate on capital and provide incentives for saving and investment.
- b.** That tax havens permit only tax avoidance and not tax evasion. Tax evasion is a crime, while tax avoidance is not. Avoidance simply means paying less tax than the government intended the taxpayer to pay, without breaking the law. Tax evasion is the deliberate refusal to pay tax at all.
- c.** Tax havens help to cut the size of government and improve efficiency. Since no or minimal tax is levied, the government in tax havens is saved from the usual administrative costs and personnel in the implementation of tax laws or collection of taxes themselves.

Conversely however, tax havens have sharp critics, who think that:

- a.** they are usually used for illegal tax evasion schemes by residents. These schemes, they argue, are encouraged by the high level of confidentiality, secrecy. The major problems with tax havens today relate to lack of transparency and lack of exchange of information on tax matters. This is because they have few or no tax treaties.
- b.** Tax havens attract only investments or transactions that are purely tax-driven without economic substance.

- c. Many tax havens have weak regulatory framework or business infrastructure, thereby encouraging such unhealthy practices like transfer pricing and thin capitalization.

## **2.2 SUMMARY**

In conclusion, a country has a choice between being a tax haven, and thereby encouraging foreign investment into its territory, (without much revenue from taxation), or being a high-tax country. The latter may, in the short term, lead to high revenue from taxation. But it may also cause capital flight and little foreign direct investment in the economy of the country. Nigeria needs more foreign presence in the country because of the economic benefits that can be derived therefrom. Revenue derived from taxation of foreign enterprises can be channeled to improve our infrastructure, education, agriculture and law and order.

## **CHAPTER THREE**

### **3.1 ANALYSIS OF THE LEGAL REGIME ON INTERNATIONAL TAXATION IN NIGERIA**

### **3.2 INTRODUCTION**

International taxation, as we discussed earlier on,<sup>1</sup> is the study of tax on a person or business that is subject to the tax laws of different countries. It has to do with the international aspects of an individual country's tax laws. Governments usually limit the territorial scope of their income taxation, or they provide for reliefs to taxation relating to extra-territorial income.

The desire to raise revenue and the need to avoid double taxation of taxpayers are the principal aims of international taxation. Countries of the world have long realized that: (1) it is imperative not to kill the goose that lays the golden egg, and (2) it is unfair to tax a person or business activity more than once in respect of the same economic transaction.

Since these economic transactions that generate the taxable incomes are carried out across borders, countries (or States) have also realized the need to reach mutual "agreements" or "arrangements" to address the problem of double or multiple taxation, while retaining their rights to raise revenue from these activities. This gave rise to tax treaties.

Thus, rules of international taxation are derived from tax treaties, as there is no law or statute anywhere in the world called international taxation.

Nigeria made rules, and in fact enacted laws, based on the principles contained in the tax treaties that it has signed with other countries of the world. Under this paragraph, we shall be concerned with Nigeria's international tax regime. This consists of the provisions contained in the tax treaties it has signed with other

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<sup>1</sup> Chapter One, paragraph 1.0

Countries, and the rules, provisions or laws made pursuant to or derived from these tax treaties.

Furthermore, the increasing number and variety of business transactions undertaken by companies in today's global economy create both challenges and opportunities. Whether a company already operates in multiple jurisdictions or seeks to expand globally, access to accurate and timely information on taxation and other business conditions is critical.

### **3.3 Tax Treaties in Nigeria**

Under the colonial era, a tax treaty in Nigeria was called an "Arrangement". In fact, that was the characterization of all tax treaties under the British colonial regime<sup>2</sup>. After independence, most countries jettisoned that terminology and adopted "convention" for their tax treaties. Nigeria, however, retained the term "Arrangement" in all her tax treaties with other countries of the world. The preference for a particular terminology is however, only a matter of choice.

An agreement, (that is tax treaty), is usually negotiated by technocrats. After the initialing on the conclusion of negotiations of the draft agreement, it is presented to the Federal Executive Council for approval. The Minister of Finance, (as the competent authority under the agreement), or the Nigerian Ambassador/ High Commissioner in the other country then signs the agreement. Thereafter, it is given to the National Assembly for ratification. After ratification, Nigeria has to notify the other country through diplomatic channels that it has completed the internal

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<sup>2</sup> Arogundade, op. cit. page 503

procedures required to bring the agreement into effect. Instruments of ratification are then exchanged between the treaty partners for the agreement to come into force<sup>3</sup>.

The agreement is then incorporated into Nigerian tax laws, and published in an official gazette before it can have effect in Nigeria. The gazette usually contains the purposes of the agreement, some of which are:

- i. To afford relief from double taxation;
- ii. Exchange of information necessary for carrying out the domestic laws of both countries; and
- iii. The prevention of fiscal evasion with respect to taxes covered under the agreement.

Nigeria has signed tax treaties with many countries of the world.<sup>4</sup> Generally, payments of dividends, royalties, interest and fees to these countries are subject to 7.5% tax.

Tax treaties between Nigeria and other countries, as observed in the preceding paragraph, has avoidance of double taxation as their main purpose. The tax treaties are based on models, templates, patterns or standards. There are the Nigerian models, the OECD models and the UN (United Nations) models of tax treaties.<sup>5</sup>

The Nigerian tax treaty model, for example, takes care of the peculiarities of Nigerian tax laws and commercial realities, which may, in some instances, be at variance with the other two types of models mentioned above.

Thus, the key areas of a Nigerian tax treaty model are:

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<sup>3</sup> Arogundade, op. cit., page 505

<sup>4</sup> For example: Belgium, Canada, the Czech Republic, France, Netherlands, Pakistan, Romania, Slovakia and the United Kingdom.

<sup>5</sup> Arogundade, op. cit, page 519

i. **Preamble and Title**

The agreement is on income and capital gains (as opposed to capital), and the purpose includes, not just the avoidance of double taxation, but also the prevention of fiscal evasion.

ii. **Taxes Covered**

In Nigeria, the taxes to be covered are:

- a. The Personal Income Tax;
- b. The Companies Income Tax;
- c. The Petroleum Profits Tax; and
- d. The Capital Gains Tax.

The OECD tax treaty model is the one used for the negotiation of tax treaties between the OECD member countries, which are mainly from the developed, capital exporting, advanced economies of the world. Tax treaties, generally, borrow substantially from the texts and provisions of OECD tax models, for certainty of interpretations and the applications of their provisions. Thus, even the Nigerian tax treaties substantially reflect the texts of the OECD models. This is because most of the trading partners with which Nigeria enters into tax treaties are members of the OECD.

However, the OECD tax treaty model cannot be totally adopted by any country, developed or developing. This is because, the model, for example focuses mainly on residence, rather than the source rules, as a basis of the right to tax any given item of income. In other words, a taxpayer, (under the OECD model), cannot be liable to Nigerian tax if he is not ordinarily resident in the country, even if the source of his income is in Nigeria. This does not only go against the grain of international taxation itself but it would also adversely affect the economic prosperity of a developing country like Nigeria.

The UN tax treaty model is usually the specimen, standard or example for the negotiation of tax treaties between the developed and the developing countries of the world. The model consists of principles and guidelines formulated by the Ad Hoc Group of Experts for the Bilateral Negotiation of tax treaties between the developed and the developing countries.

The main differences between the OECD and the UN models are in the areas of emphasis on residence by the former, the determination of PE (and attribution of profits to them), adoption of a time threshold of twelve months for a PE in the OECD model and six in the UN model. Another major difference between the two models is that the OECD model makes a general provision for the allowance of all “expenses which are incurred for the purposes of the permanent establishment,” whereas the UN model allows only expenses “toward reimbursement of actual expenses,” and categorically disallows interest on inter-group loans, except in the case of banks.

Tax treaties in Nigeria are supreme. That is, they are superior to, and override the domestic tax laws, once they enter into force. Thus, section 38(1) of the Personal Income Tax Act<sup>6</sup> provides that “the arrangements, [or tax treaties], shall have effect notwithstanding anything in any enactment”. Sections 45(1) of the Companies Income Tax Act<sup>7</sup> and 61 (1) of the Petroleum Profits Tax Act<sup>8</sup> contain similar provisions on the supremacy and dominance of tax treaties over domestic tax laws once the former come into force.

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<sup>6</sup> Cap. P8, Laws of the Federation of Nigeria, 2004

<sup>7</sup> Cap C21, Laws of the Federation of Nigeria, 2004

<sup>8</sup> Cap. P13, Laws of the Federation of Nigeria, 2004

### **3.4 The Free Trade Zones and Nigerian International Tax Regime**

Another important area of international tax regime in Nigeria is the Free Trade Zones. Free Trade Zones or Export Processing Zones (EPZ) are clearly delineated and fenced industrial estates within Nigeria's customs and trade regime. They were set up for manufacturing concerns, producing mainly for the export market.

The objectives pursued by Nigeria and other countries that use free trade zones have remained constant. They include: development of disadvantaged regions, generating income and employment, attracting investment, (especially foreign direct investment), and promoting technology transfer. These objectives are usually pursued through free zones by providing a series of incentives to companies and firms operating in those zones.<sup>9</sup>

The first export processing zone in Nigeria is the Calabar Free Trade Zone, (CFTZ), established in 1989. There are two types of free trade zones: specialized, (especially the oil and gas sector), and the general purpose trade/export zone. These two types of free trade zones are managed by two bodies. These are the Oil and Gas Export Free Zone Authority (OGEFZA) established under the Oil & Gas Export Free Zone Act<sup>10</sup> and the Nigeria Export Processing Zones Authority, (NEPZA), also established under the Nigeria Export Processing Zones Act, respectively.<sup>11</sup>

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<sup>9</sup> Raul. T. A. "Free Zones and the WTO Agreement on Subsidies and Countervailing Measures" (2007),

Global Trade & Customs Journal, Vol. 1,2, Issue 5, Page 217

<sup>10</sup> Cap. 05, Laws of the Federation of Nigeria, 2004, S.2

<sup>11</sup> Cap. 107, Laws of the Federation of Nigeria, 2004, S.2



### 3.4.1 The Legal Framework on FTZs

The applicable laws on Free Trade Zones in Nigeria are:

1. The Nigeria Export Processing Zones Act, (NEPZA)<sup>12</sup>
2. The Oil and Gas Export Free Zones Act, (OGEFZA)
3. The Companies Income Tax Act (CITA)
4. The Value Added Tax Act (VATA); and
5. The Federal Inland Revenue Service (Establishment) Act (FIRSEA), 2007.

In addition, there are the following Regulations on Free Trade Zones in Nigeria:

- a. Investment Procedures, (Regulations And Operational Guidelines for Free Trade Zones in Nigeria), 2004; and
- b. Oil and Gas Export Free Trade Zone Regulations (2003).

The priority areas of development for companies operating in Free Trade Zones are the:

- i. Metallurgical/Engineering sector;
- ii. Agricultural (Forest-based/agro-allied) sector;
- iii. Chemical/Petrochemical sector; and
- iv. Construction sector.

Free Trade Zones have, since 1989, (when the Calabar Free Trade Zone was first established), been established all over Nigeria. Thus, in addition to Calabar, there are Free Trade Zones in Onne, (Rivers State), Kano, (Kano State), Maigatari (Jigawa State), Banki, (Borno State), Lekki, (Lagos State), Tinapa Free Zone (Cross River State), Olokola Free Zone, (Ondo & Ogun States), Snake Island Integrated, (Lagos

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<sup>12</sup> Ibid.

State), Imo Guangdong Free Zone (Imo State), Abuja Technological Village, (Abuja FCT), and several others.

### **3.4.2 The Benefits of FTZS**

The establishment of the Free Trade Zones has brought tremendous financial benefits to Nigeria.

1. For example, the Calabar Free Trade Zone alone generated N282 million for the Federal Government as customs duties between January and November, 2003.
2. Total, (private sector), investments in Free Trade Zones in Nigeria reached \$220 million in 2004.
3. The Federal Government has invested about \$500 million into the Zones, which since inception, has provided jobs for over 4,700 persons.
4. Seventy companies have registered to do business in the Calabar Free Trade Zone, with 15 being fully operational, manufacturing and exporting diverse products, while another 15 are about to start operations<sup>13</sup>

### **3.4.3 The Incentives**

The benefits enumerated above have been possible largely because of the incentives granted to companies operating in Free Trade Zones. Some of these incentives are:

- a. Exemption from payment of all Federal, State and Local government taxes, levies and rates;
- b. Repatriation of foreign capital invested in EPZs at any time, with capital appreciation on the investment;

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<sup>13</sup> Elebiju A./[http://waw.nepza. or5./reg. Zones](http://waw.nepza.or5./reg.Zones), accessed on 17/5/2013, 6.54pm

- c. Exemption from payment of import or export licence;
- d. Rent-free land during construction of factory space;
- e. Availability of services like ware-housing, standard pre-built factories, transportation, sanitation and canteen;
- f. Unrestricted remittance of profits and dividend earned by investors in the zone;
- g. 100% foreign ownership of enterprises in the EPZ, except as prohibited by ss.17 and 31 of the NIPC Act, (that is, prohibition of production of arms, ammunition, drugs, military/paramilitary wears, ), and
- h. Sale of up to 25% production is permitted in the domestic market.<sup>14</sup>

### **3.5 International Taxation and Revenue Generation In Nigeria**

The principal purposes of international taxation, as stated earlier,<sup>15</sup> are to prevent double taxation and fiscal evasion. However, a less noted but equally important practical role of international taxation is that it helps in determining taxing rights on international transactions and activities. This latter role is a key motivating factor for Nigeria's conclusion of tax treaties and the provision of other legal framework for international taxation in the country. Nigeria, through its legal regime on international taxation, seeks to present itself to the international community as an acceptable partner in trade, and a good destination for foreign investment.

But what are the benefits from these efforts? The foremost investment agency in Nigeria is the Nigeria Investment Promotion Commission, (NIPC), established in

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<sup>14</sup> Elebiju A., *ibid.*

<sup>15</sup> Chapter One of this thesis

1995 under the NIPC Act.<sup>16</sup> Even though the Commission collaborates with other agencies of the Federal Government,<sup>17</sup> it is saddled with the sole responsibility of promoting, monitoring, registering and generally assisting foreign investors in Nigeria.

Between January and December, 2005, the NIPC issued Business Permits/Expatriate Quotas to about 41 wholly foreign or joint venture companies to do business in Nigeria. This attracted an investment equity of about ₦1.036 billion (one billion and thirty-six million Naira only) into the country and generated about 10,000 jobs.

Between January and December, 2006 the number of Expatriate Quotas granted to foreign companies increased to 71. This attracted a capital importation of a whopping \$620,047,429 (six hundred and twenty million, and forty seven thousand, four hundred and twenty nine US dollars).<sup>18</sup>

Foreign companies from Italy, India, Britain, Belgium, the US, France and Canada, are involved in these transactions or investments. Their areas of interest varied from agro-allied activities to manufacturing, transportation, oil and gas, construction, telecommunications, engineering.<sup>19</sup>

Furthermore, between 2002 and 2005, the NIPC granted pioneer status to 68 companies, out of which 36 are wholly foreign or joint venture companies. These 36 companies were expected to generate 10,666 jobs for Nigerians of different categories.<sup>20</sup> The equity participation of these companies is, again, a whopping ₦1.115 billion (one billion, one hundred and fifteen million Naira only).

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<sup>16</sup> Op. cit.

<sup>17</sup> For example, CAC, NIPC, NEPZA .

<sup>18</sup> Dept. of Investors Relations, NIPC Abuja, 20/7/2011.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid

The companies invested in the following sectors of the Nigerian economy: communications, chemicals/petrochemicals, manufacturing, agriculture/agro-allied, solid minerals, pharmaceuticals, oil and gas and services .

### **3.6 The Legal Framework on the Taxation of Foreign Income in Nigeria**

As discussed earlier<sup>21</sup>, the Nigeria tax system asserts two distinct claims as the bases of tax jurisdiction:

1. It taxes income arising in Nigeria no matter to whom it belongs, that is the source system of taxation and;
2. It taxes residents in Nigeria no matter where their income arises, (that is the residence or world-wide system of taxation).

In general, therefore, tax is charged upon foreign income when it arises. However, in certain instances, tax is only charged upon so much of the income as is remitted to Nigeria and received by the taxpayer.

Consequently, the practice of States taxing all income arising in the State, no matter to whom it belongs, and all income of residents, no matter where it arises, must necessarily involve the double taxation of 'foreign income'. This is likely to happen in the State where the income arises, and again, in the State where the person entitled to such income resides.

To mitigate or totally avoid this effect, reliefs have been provided in various Nigerian tax statutes.

Some of these reliefs are contained in the bilateral tax treaties Nigeria has signed with other countries, which treaties were domesticated and have become part of the Nigerian law.

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<sup>21</sup> Chapter 1, paragraph 1.0 of this Thesis

The provisions of the law on these reliefs will now be discussed as they appear in the Nigerian tax statutes.

### **3.6.1 The Companies Income Tax Act**

The Companies Income Tax Act<sup>22</sup>, (CITA), in S.11 provides that a foreign company is any company or corporation established by or under any law in force in any territory or country outside Nigeria.

In levying tax on the income of a company, S.9(1) of the Act provides “that tax, for each year of assessment, shall be payable on the profit of any company”, (foreign or local), accruing in, derived from, brought into or received in Nigeria, in respect of any trade, business, rent, premium, dividends, interests, annuities, fees, dues or any amount deemed to be income or profit with respect to pension or provident fund.

Thus, all types of income or profit, from whatever source, earned by a company, foreign or local, is taxable under this provision.

However, this provision is subject to S.23 of the CITA, which lists the profits that are exempted from tax. Such profits include those of companies that are statutory or registered friendly societies, co-operative societies, companies engaged in ecclesiastical, charitable or educational activities, trade unions, dividends received from investments in wholly export-oriented businesses, profits of companies established within export processing or free trade zones, .

S.9(1) of CITA is also subject to the provisions of SS.24, 25 and 26 of the Act, which permit allowable deductions under some circumstances.

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<sup>22</sup> Cap. C21, Laws of the Federation of Nigeria, 2004

The profits of a Nigerian company shall, under S.13(1) of CITA, be deemed to accrue in Nigeria wherever they have arisen and whether or not they have been brought into or received in Nigeria.

For a foreign company however, S.13(2) provides that its profits from any trade or business shall be deemed to be derived from Nigeria if:

- a. the company has a fixed base in Nigeria, and the it is attributable to that base;
- b. it habitually operates a trade or business in Nigeria through an authorized agent.

One important provision in this regard is S.22 of CITA, which gives power to the Federal Inland Revenue Service, (FIRS), to disregard “artificial or fictitious” transactions. These are transactions, not at arms length, between too closely related persons or between two persons one of whom has total control over the other. The aim of such transactions is to reduce tax rates otherwise payable. In such circumstances, the FIRS is given the power to assess such persons or companies to the appropriate rate of tax.

S. 29 of the Act provides for the various methods or bases for the assessment of profits of a company, (local or foreign). Such profits are ascertained under the principles provided for in SS.31 and 32 of the Act. S.31, for example, provides that the total profit of any company for any year of assessment shall be the amount of its total assessable profits from all sources.

It is instructive to note that the principles of international taxation are being applied here. In other words, profits of a company are taxable under the territorial, (or source), system of taxation, or under the world-wide, (or residence), system of taxation.

Thus, a Nigerian or foreign company may be liable to Nigeria tax under this principle either because it is resident in Nigeria or because the source of its income is located in Nigeria. A Nigerian resident is liable to tax on his world-wide or global income, where as a non-resident will only be liable to tax on his Nigerian source of income.

Where, however, after all assessments and deductions, the company's earnings result in no taxable profit or the tax payable is less than the minimum tax, the company shall still pay a tax of:

- a. 0.5% of gross profit; or
- b. 0.5% of net assets; or
- c. 0.25% of its paid up capital; or
- d. 0.25% of its turn over for the year, whichever is higher.

SS.34 and 39 of CITA provide for allowable deductions for companies engaged in the areas of rural business, export processing or free trade zones, mining of solid minerals and gas utilization.

CITA, in S.45, provides for double taxation arrangements. It states that double taxation agreements between Nigeria and any other country shall supersede the provisions of the Act. And S.46 provides for the various methods of calculating reliefs to be allowed for double taxation. The section provides, inter alia, that where "foreign tax" has been paid in any country with which Nigeria has a double taxation agreement, such tax shall be allowed "as a credit" (or a set off), against tax payable in Nigeria. The section also provides for details on when a claim for credit shall be made and the total credit allowed.

Consequent upon these provisions, Nigeria entered into Double Taxation Agreements, (DTAs), on companies' income tax with countries like the Kingdom of Belgium, the



French Republic, Canada, Romania and the Kingdom of Netherlands. Most of these agreements have similar provisions, terms and conditions.

For example, in the agreement between Nigeria and the Kingdom of Belgium, titled “Double Taxation Relief ..... Order, 1997”, which was deemed to have come into force on 1<sup>st</sup> January, 1990, provisions were made on how to afford “relief from double taxation” in relation to corporate tax, among others. The agreement also contains provisions on exchange of information necessary for carrying out the domestic laws of Nigeria and the laws of the Kingdom of Belgium concerning taxes covered by the arrangement, including provisions on the prevention of fiscal evasion with respect to those taxes.

Under Article 1 of the treaty, it is provided that the agreement shall apply to persons who are residents of one or both of the Contracting States, and “person”, under Article 3, means an individual, a company or any other body of persons.

An interesting aspect of this treaty is how the knotty issue of the term “resident” has been resolved. Who is a resident of a particular State? How does international taxation determine the status of a tax payer who is a resident of both Contracting States?

Under Article 4(1) of the Agreement between Nigeria and Belgium, the term resident of a Contracting State means any person who, under the laws of the State, is liable to tax therein by reason of his domicile, residence, place of management or incorporation or any other criterion of a similar nature.

But what of a situation where a tax payer satisfies the criteria of being a resident of both Contracting States as laid down in paragraph 1 of Article 4 above?

In that case, paragraph 2 provides that his status shall be determined as follows:-

- a. He shall be deemed to be a resident of the State in which he has a permanent home available to him, and if he has a permanent home available to him 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, his `centre of vital interests;
- b. If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
- c. If he has an habitual abode in both States or in neither of them, he shall be deemed to be resident of the State of which he is a national; and
- d. If he is a national of both States, or of neither of them, the competent authorities of the Contracting State shall settle the question by mutual agreement.

But what happens if the competent authorities of the Contracting States are unable to resolve the issue? In the unlikely event of such a situation, it is suggested that recourse be had to the model UN or OECD conventions on Double Taxation to find out how the issue was resolved. Where that also turns out to be unhelpful, then the mechanisms for resolution of international tax disputes may be explored.

Article 5 of the treaty between Nigeria and Belgium defines the term “permanent establishment” and provides a list of establishments or places that may be included in the definition of that term. Such places include a place of management, a branch, an office, a factory, a workshop or an installation. Under paragraph 3, the places or establishments that should not be deemed as permanent establishments are also listed. They include facilities used solely for the purpose of storage, display or delivery of

goods; maintenance of a stock of goods or merchandise solely for the purpose of storage, display, delivery or processing.

It is observed that the treaty between Nigeria and Belgium on Double Taxation has failed to make provision for two important elements in the definition of term `permanent establishment`. Firstly, the definition failed to include those places or activities that have a productive character, that is, those activities that contribute to business growth and development as opposed to manufacturing. Secondly, why is the element of profitability absent from the definition or description of the term permanent establishment? Taxes are levied mainly on profits or income. So any place or activity from which profit or income is derived should be taxed, and should, therefore, qualify as a permanent establishment under international taxation.

The Double Taxation Agreement between Nigeria and Belgium also provides for other sundry matters like the assessment and taxation of dividends, interests, royalties and capital gains.

### **3.6.2 The Petroleum Profits Tax Act**

The Petroleum Profits Tax Act,<sup>23</sup> defines a “foreign company” under S.18(3) as a company incorporated outside Nigeria before 18<sup>th</sup> November 1968, and having on that date an established place of business in Nigeria.

The reason for the threshold of 18<sup>th</sup> November 1968 is that after the repealed Companies Act, was enacted in 1968, all companies doing business in Nigeria were expected to register under the Act. Subsequently, they all became Nigerian

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<sup>23</sup> Cap. P8, Laws of the Federation of Nigeria, 2004

companies. A foreign company therefore will be one as defined under S. 11 of CITA<sup>24</sup>, that is, one incorporated outside Nigeria, but doing business in Nigeria.

Under S.25 of the Petroleum Profits Tax Act (hereinafter also referred to as PPTA), a company that is not resident in Nigeria, (otherwise called a “non-resident company”), shall be assessed to tax directly or in the name of its manager or any other person who is an employee of the company and is resident in Nigeria.

Under S.61(1) of PPTA, if the Minister [of Finance] declares that a tax imposed under the Act qualifies for relief under a double taxation agreement between Nigeria and any other country, then that agreement or treaty, “shall have effect, notwithstanding anything in any enactment”.

The PPTA also provides<sup>25</sup> that where “foreign tax” has been paid in any territory with which Nigeria has a double taxation agreement, “credit” or relief shall be granted in Nigeria in respect of that income. And where the amount of the credit has also been paid in Nigeria, it may be repaid to that company or carried forward against the tax chargeable upon it for the next accounting period.

The credit for an accounting period shall not exceed:

- (a) The amount of the foreign tax payable on the income; or
- (b) The amount of the difference between the tax chargeable under the PPTA (before allowance of credit under the treaty having effect under S.61 of the Act), and the tax which would be so chargeable if the income were excluded in computing profits, whatever is less of the two amounts.<sup>26</sup>

The Act also provides that, without prejudice to the foregoing provisions, the total credit to be allowed to a company for any accounting period for foreign tax under all

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<sup>24</sup> OP. cit.

<sup>25</sup> In S.62(1)

<sup>26</sup> S.62(3), PITA

arrangements having effect under section 61 of the Act “shall not exceed the total tax which would be ultimately borne by that company, for that accounting period, if no such credit had been allowed”.<sup>27</sup>

Any claim for an allowance by way of credit or set off shall be made not later than three years after the end of the first accounting period. And in the event of any dispute as to the amount allowable, the FIRS shall give to the claimant a notice of refusal to admit the claim, which notice or decision (of the FIRS) shall be subject to appeal in like manner as an assessment.<sup>28</sup>

Where a company is not resident in Nigeria throughout an accounting period, no credit shall be allowed for it in respect of any income included in its profits for that period.<sup>29</sup>

Consequent upon these and other provisions of PPTA, Nigeria entered into a Double Taxation Agreement with Canada, titled: “Double Taxation Relief (Between the Federal Republic of Nigeria and Canada) Order 1997”. The petroleum profits tax is one of the taxes covered under the agreement or treaty.

The treaty, under Article 3(1)(c), defines the term “competent authority” as “..... in case of Nigeria, the Federal Minister of Finance and Economic Development or his authorized representative; and in the case of Canada, the Minister of National Revenue or his authorized representative”.

Chapter IV Article 23 of the agreement provides for the elimination of double taxation and states that:

**1. In the case of Canada, double taxation shall be avoided as follows:-**

- a.** *subject to the existing provisions of the law of Canada regarding the deduction from tax payable in Canada or tax paid in a territory outside Canada and to any subsequent modifications of those provisions-which*

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<sup>27</sup> *ibid*, sub-section 4

<sup>28</sup> *ibid*, sub-section 8

<sup>29</sup> *ibid*, sub-section 10

*shall not affect the general principle hereof- and unless a greater deduction or relief is provided under the laws of Canada, tax payable in Nigeria on profits, income or gains arising in Nigeria shall be deducted from any Canadian tax payable in respect of such profits, income or gains;*

- b. subject to the existing provisions of the law of Canada regarding the determination of the exempt surplus of a foreign affiliate and to any subsequent modification of those provisions-which shall not affect the general principle hereof-for the purpose of computing Canadian tax, a company resident in Canada shall be allowed to deduct in computing its taxable income and dividend received by it out of the exempt surplus of a foreign affiliate resident in Nigeria.*

What these provisions mean is that:(1) tax already paid in Nigeria shall be deducted from any tax payable in Canada, and (2) the exemptions, (from tax), that were allowed to the foreign affiliate of a company resident in Nigeria shall be set off against the tax payable by its Canadian principal.

Similarly, Article 23 (3) of the treaty provides, in the case of Nigeria, that:

- a. any income tax paid in Canada, (in accordance with the Agreement), shall be allowed as a credit against any Nigerian tax;
- b. in the case of a dividend paid by a company resident in Canada to a company resident in Nigeria, the credit shall take into account the income tax payable in Canada by the company in respect of the its out of which such dividend is paid, provided that the company to which dividend is paid controls at least 10% of the voting power in the company paying the dividend;
- c. in any case, the amount of the tax credit to be granted shall not exceed the proportion of Nigerian tax that the profits, income or gains in Canada bear to the entire profits, income or gains chargeable to Nigerian tax. That is, the amount to be set off as tax credit to a Canadian taxpayer shall not exceed what would have been assessed as Nigerian tax.

Article 26 of the Agreement provides for exchange of information on matters that would be necessary for “carrying out the provisions of the Agreement or of the domestic laws of the Contracting States concerning taxes covered by the Agreement”. However, under paragraph 2 of the Article, a Contracting State is not under any obligation to provide information on:

1. administrative measures at variance with the laws and practice of that or of the other Contracting State;
2. matters that would disclose any trade, business, industrial, commercial or professional secret or trade process or information, the disclosure of which would be contrary to public policy;
3. any matter which is not ordinarily obtainable under the laws or in the normal course of the administration of that or of the other Contracting State.

Again, the treaty between Nigeria and Canada made provisions on sundry other matters like non-discrimination, taxation of students, teachers and researchers, artistes and athletes.

### **3.6.3 The Personal Income Tax Act**

The Personal Income Tax Act<sup>30</sup>, in S.13, provides that “foreign income” is

*..... income from a dividend paid by a company other than Nigerian company, or from any other source outside Nigeria, shall be the amount of that income brought into or received in Nigeria, provided that, if the income arose in a country to which section 39 of this Act applies, the amount of that income to be taken for assessment shall be the amount computed under subsection (5) of section 39 of this Act.*

In other words, the PITA provides that foreign income is income from a dividend paid by a foreign company or income that accrued from a source outside Nigeria. In taxing such income, the section also provides that if the income accrued from a country with

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<sup>30</sup> Cap.P8, Laws of the Federation of Nigeria, 2004

which Nigeria has a double taxation agreement under S.39 of PITA, then that income shall be treated as a credit or relief or it shall be set off against the amount payable as tax in Nigeria, (under S. 39 (5) of the Act).

The Personal Income Tax Act also imposes tax on any business or trade that may only have been partially carried on in Nigeria.<sup>31</sup> The Act provides that where an individual, an executor or a trustee, outside Nigeria carried on a trade or business of which only part of the operations are carried out in Nigeria, the gains or profits of the trade or business shall be deemed to be derived from Nigeria to the extent to which such gains or profits are not attributable to that part of the operations carried on outside Nigeria. So, it is immaterial whether the business or trade of a company is wholly or partially carried out in Nigeria. Even the partial business activities are taxable in Nigeria.

However, this section is subject to the following provisions:

- a. that the individual, executor or trustee does not have a fixed base in Nigeria from which he carries on such trade or business;
- b. that the individual, executor, does not habitually operate a business or trade in Nigeria either by himself or through an agent;
- c. that the trade or business in Nigeria does not involve a single contract for surveys, deliveries, installations or construction; or
- d. that the trade or business is not a fictitious or artificial transaction, that is, a transaction between persons both of whom are controlled by some other person.

S.11 of PITA provides that a resident taxpayer, whose income is derived from a source outside Nigeria and brought into the country through Government approved

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<sup>31</sup> *ibid*, S.6



channels, shall be granted a tax credit against the tax payable by him, which credit shall not exceed “the proportion of his total tax for the year of assessment”.

This section is however subject to the provisions of S.38 of the Act, that is, if the income is derived from a country with which Nigeria has a double taxation agreement, then, the tax credit may be more than the proportion of his total credit for the year of assessment.

S. 38(1) of the Act provides that where Nigeria has entered into an agreement with any other country with a “view to affording relief from double taxation” in relation to any tax imposed under the Act, that agreement shall have effect upon ratification by the National Assembly.

Further to this, S.39 provides for the methods of calculating reliefs to be allowed for double taxation. For example, it states that foreign tax paid in a country with which Nigeria has a double taxation agreement “is to be allowed as a credit” against tax payable in respect of that income in Nigeria. It then defines ‘foreign tax’ as “any tax payable in that other country, which under the arrangements, is to be so allowed”.

Tax credit, under S.39(2) of the Act is to be allowed only for persons resident in Nigeria.

However, a taxpayer has a discretion, under subsection (8) of S.39 to elect that credit shall not be allowed in respect of his income for the particular year, but be carried forward.

The Act further provides that a claim for tax credit shall be made not later than two years after the end of the year of assessment.<sup>32</sup>

Consequent upon these and other provisions of the Personal Income Tax Act, Nigeria entered into Double Taxation Agreements (DTAs) with many countries of the world.

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<sup>32</sup> S.38(9), PITA

For example in the seventh schedule to the Personal Income Tax Act, it is provided that:

*The double taxation arrangements referred to in section 38(5) of this Act are contained in the Double Taxation Relief between the Federal Republic of Nigeria and the United Kingdom of Great Britain and Northern Ireland Order 1988, published as a subsidiary legislation.....and any other arrangements between the Federal Republic of Nigeria and any other country published as subsidiary legislation.*

Since no two tax treaties are the same in every respect, this writer will attempt to highlight the salient and distinct features in the double taxation treaty between Nigeria and the UK.

For example, on the concept of Permanent Establishment, (PE), the tax treaty between Nigeria and the UK provides that a subsidiary, an associated company or a personnel who acts on behalf of a principal will be a PE of that principal if he has an authority and he habitually exercises that authority to conclude contracts on behalf of the principal, or if he habitually secures orders for the sale of goods or merchandise on behalf of the principal or associated member. The Netherlands DTA with Nigeria differs from the UK DTA mainly in respect of the extent of the authority to be delegated by the principal to the agent. By the terms of the Netherlands DTA, the agent must have an authority to conclude contracts in the name of the principal for it to constitute a PE to the principal.

In addition, in the DTA between Nigeria and the UK, the principle of ‘force of attribution’ or ‘force of attraction’ was adopted.<sup>33</sup> This means that a permanent establishment or branch is taxed, under the treaty, on not only its own income, but also certain other income derived by its foreign head office from sources in the country. The OECD model treaty does not allow the use of this taxing principle. The UN model provides for limited force of attraction or attribution.

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<sup>33</sup> Arogundade, op.cit, page 552.

So, where, for example, an enterprise splits its operations into several units or sources to minimize or avoid tax, the profits from these other units or sources would be aggregated and taxed at source, especially where the products being sold or the business activities being carried out are 'of the same or similar kind.'<sup>34</sup>

Another distinct feature of the Nigeria-UK double taxation treaty is that it has an additional concept of 'subject to tax' as a condition for enjoying the treaty concessionary rate on dividends. This means that the recipient of a dividend must be subject to tax in the country of residence for the treaty rate (of 7.5%) to apply to him. For example, if the recipient is a government in Nigeria, Federal, State or Local, or an agency of that government, the treaty rate may not apply since these bodies are not, normally, subject to tax in Nigeria. So, if any of these bodies receives dividends from UK, such dividends will be taxed at the full UK tax rate, that is, 'source dividend' rate, and not at the treaty rate.<sup>35</sup>

Conversely, the double taxation treaties between Nigeria and the Netherlands and France have a different concept for the recipient, which is the concept of 'beneficial owner.' The import of this concept is that the recipient of the dividend must be the actual owner of the dividends and not acting as a proxy for the treaty rate to apply. Under this concept it is immaterial whether the true owner of the dividends is subject to tax in his country of residence or not. So, under the treaties between Nigeria and the Netherlands and France, the treaty rate will not apply to a trust but to a trustee.<sup>36</sup> This is to prevent persons not intended as beneficiaries under the treaties from taking advantage of the treaty benefits. The treaty rate at the time of signing the agreements was 12.5%. It has been reviewed downwards to 7.5%

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<sup>34</sup> *ibid*

<sup>35</sup> Arogundade, J.A. *op.cit.*, page 552

<sup>36</sup> *ibid*

Furthermore, in the area of taxation of interests, the Nigeria-UK treaty exempts interest on loans derived and beneficially owned by a Government or an agency or instrumentality of that Government.

The Nigeria-France treaty has additional qualifications for an exemption:

- a. the loan or credit coming to Nigeria from France must be supported by the Government of France; and
- b. the interest on such loans must not be on commercial basis.

The Nigeria-Netherlands DTA accommodates some other conditions:

- a. the term instrumentality of government is expanded to include a financial institution owned or controlled by the Dutch Government;
- b. it also includes interest on loans 'insured or guaranteed' by the Dutch Government; and
- c. for such interest payments to enjoy exemption from tax, the loans must be made at other than normal or at commercial basis.

Article 19 of the Nigeria-UK treaty provides for taxation of remunerations of those in 'Government Service'. These remunerations, (other than pensions), are taxable in the State where the payment is made, under Article 1(a) of the treaty. The above provision would however appear to be the general or common rule in the other DTA treaties, especially those between Nigeria and the Netherlands and France.

The Nigeria-UK treaty, however, contains a distinct exception to the above rule. It provides:

"However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that other State and the individual is a resident and a national of that State".

This means that for the employee to be liable to the UK tax, for example, the service must be performed in the UK and he must be a resident and national of UK. Under the Agreement therefore, residence or nationality alone will not confer the right to tax. For UK, as the host State to have the right to tax, the employee must be both ‘a resident and a national’ of that State’. A Nigerian resident in the UK who is employed to work in the Nigeria High Commission in London will be liable to tax in Nigeria. A UK national, resident in Nigeria and employed from Nigeria to work in the Nigeria High Commission in London is under the Nigeria tax jurisdiction.<sup>37</sup>

Most Double Taxation Agreements (DTAs) between Nigeria and other countries provide for taxation of other incomes from pensions, teaching, capital gains, artistes and athletes and even income accruing to students and trainees. The treaties also usually provide for the taxation of other sources of income not yet provided for in the Agreement, and which may arise in either of the treaty countries.

Where such an income is discovered, the Nigeria-France DTA specifically provides for the application of the domestic laws to such income. The Nigeria-Netherlands DTA grants exclusive right to tax such income to the country where the taxpayer is resident. But where it arises in the other State, that other State (of source) may also tax such income.

The Nigeria-UK DTA is (conspicuously?) silent on the taxation of such an income. What this means is that the provisions of the respective domestic laws would apply to such an income, wherever it may arise.

On exchange of information, the Nigeria-UK DTA provides for the disclosure of information received even in public court proceedings or in judicial decisions. The other treaties contain no such provisions.

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<sup>37</sup> Ibid, page 563

It is thus clear from the above analysis that the Nigeria-UK DTA contains salient and distinct provisions on personal income tax.

#### **3.6.4 Capital Gains Tax**

The Capital Gains Tax is another type of tax that is usually covered by a Double Taxation Agreement, (DTA) between Nigeria and other countries. However, the Agreement may provide for automatic inclusion of identical or substantially similar taxes, which may be imposed by either country after the Agreement has come into force. This may be in addition to, or in the place of, the existing taxes. The purpose is to prevent the re-negotiation of the Agreement each time either country has a change or amendment to her taxes. The country concerned, in the circumstance, undertakes to notify the other country of any such modifications to the tax laws.

Capital gains are, in Nigeria, taxed under the Capital Gains Tax Act.<sup>38</sup> The Act provides that capital gains tax is a tax imposed in respect of capital gains, that is, gains accruing to any person on a disposal of assets.<sup>39</sup> The rate of the tax, under S.2(1) of the Act, is 10%.

On chargeable assets, that is assets or properties that may be subjected to capital gains tax on disposal, S.3 of the Act provides that, subject to any exceptions that may be provided by the Act, all forms of property shall be assets for the purposes of the Act, whether situated in Nigeria or not. (Emphasis supplied).

The Act goes further to provide that assets include:

- (a) options, debts and incorporeal property generally;
- (b) any currency other than Nigerian currency; and

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<sup>38</sup> Cap.CI, Laws of The Federation of Nigeria, 2004

<sup>39</sup> S.(1(1) Capital Gains Tax Act

- (c) any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired.

This section shall have effect notwithstanding that some qualifying expenditure had been incurred in respect of the assets.

Furthermore, the Capital Gains Tax Act (CGTA), provides that disposal of assets situated outside Nigeria will be assessed to capital gains tax when they are received or brought into Nigeria, under the following circumstances:

- a. where the disposal of assets is by an individual, who is only temporarily resident in Nigeria for a period not exceeding 182 days; or
- b. where the disposal is by any trustee of a trust or settlement and the seat of administration of the trust or settlement is situated outside Nigeria during the whole of the year of assessment; or
- c. where the disposal is by a foreign company, whose activities are managed and controlled outside Nigeria during the whole of the year of assessment.<sup>40</sup>

The Capital Gains Tax Act also provides for Double Taxation Relief.<sup>41</sup> It states that, for purposes of giving relief on double taxation in relation to capital gains tax and tax on chargeable gains charged under the law of any country outside Nigeria, reference to income and it under S.38 of the Personal Income Tax Act,<sup>42</sup> and income tax under SS.44 and 45 of the Companies Income Tax Act,<sup>43</sup> should be substituted with reference to capital gains tax.

Consequent upon these and other provisions of the Capital Gains Tax Act, Nigeria entered into Double Taxation Agreements, (DTAs), on capital gains tax among other heads of tax with some countries of the world. For example, it entered into such an

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<sup>40</sup> *ibid*, S.4

<sup>41</sup> *ibid*, S.41

<sup>42</sup> *op. cit*

<sup>43</sup> *op. cit*

agreement with the French Republic, titled “Double Taxation Relief (Between the Federal Republic of Nigeria and the French Republic) Order”. The Agreement came into force on 1<sup>st</sup> January, 1991. It states that the aim of the Agreement is to afford “relief from double taxation in relation to ..... capital gains tax and taxes of a similar character imposed by the laws of the French Republic and the Federal Republic of Nigeria”. The Agreement also covers matters with respect to exchange of information and prevention of fiscal evasion with respect to the capital gains tax, among others.

Article 6(1) of the treaty provides that income derived by a resident of one of the States from immovable property situated in the other State may be taxed in that other State. This is an application of the residence, (as opposed to source), principle of international taxation.

Conversely, interest derived from a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State,<sup>44</sup> thereby applying the source system of international taxation. However, paragraph (2) of Article 11 provides that such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that State, but if the recipient is the beneficial owner of the interest, the tax so charged shall not exceed 12.5% of the gross amount of the interest. The Article exempts payment of tax on interest on loans to the government, local authority or its instrumentality.<sup>45</sup>

Article 13 of the Agreement specifically provides for the taxation of capital gains. It states as follows:

“13 (1) Gains derived from sale or alienation of movable and immovable property including shares in companies may be taxed in each of the Contracting States in accordance with the law in the respective State;

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<sup>44</sup> Article 11(1)

<sup>45</sup> Paragraph 3(a)(b), Article 11



(2) Gains from the alienation of ships and aircrafts operated in international traffic shall be taxable only in the Contracting State of which the enterprise is a resident.”

Thus, while capital gains derived from the sale or alienation of movable and immovable property may be taxed by the State in which the taxpayer is resident, such a taxpayer can be taxed only by his State of residence where ships and aircrafts are the subject of alienation. So, while Article 13(1) gives a concurrent power of taxation to any of the Contracting States, Article 13(2) gives an exclusive power of taxation only to the State where the taxpayer is resident. In either case the system or method of taxation is the `residence` system, as opposed to the `source` system.

Article 23 of the Agreement between Nigeria and France deals with the ways and manners in which double taxation may be eliminated.

It provides<sup>46</sup> that as regards Nigeria, any French tax on profits, income or chargeable gains payable in France shall be allowed as a credit against any Nigeria tax by reference to the same profits, income or chargeable gains by reference to which French tax is computed.

Where a dividend is paid by a company which is a resident of France to a company which is resident in Nigeria, (and which controls as least 10% of the voting power in the former company), the credit shall take into account the French tax payable by the French company in respect of the profits out of which such dividend is paid.

In the case of France, the provisions are different. For, “profits and other positive income” arising and taxable in Nigeria may also be taxed in France where such profits or income are received by a resident of France.<sup>47</sup> One wonders if this would not amount to double taxation which the treaty itself seeks to eliminate. This problem is

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<sup>46</sup> In paragraph 1(a)

<sup>47</sup> Article 23(2)

tackled by the next provision, which states that the beneficiary of such profit or income “shall be entitled to a tax credit against French tax on the basis of which such income is included”.<sup>48</sup>

Such credit, the Agreement between Nigeria and France states, shall be equal to the amount paid in Nigeria in the case of income derived from dividends, interests, royalties, capital gains and other income, but it shall not exceed the amount of tax payable in France on such income.

In cases where the Nigerian tax is wholly relieved or reduced below the rates specified in Articles 10, 11 and 12 of the Agreement, (that is for dividends, interests and royalties, respectively), in order to promote economic, industrial and commercial development in Nigeria, the tax credit shall be equal to the normal tax provided for in paragraph 2 of Articles 10, 11 and 12 or under the Nigerian domestic law, whichever is less.<sup>49</sup>

Thus, residents of both countries enjoy tax credits or set offs in respect of taxes paid in the other country. It would appear however that special provisions were made to cater for the economic, industrial and commercial needs of Nigeria, which is a developing country. This Article is based on the UN model of Double Taxation Agreements between developed and developing nations of the world. Such agreements or treaties tend to pander to the peculiar needs of the developing countries.

Article 27 of the Double Taxation Relief Agreement between Nigeria and France also provides that the “fiscal privileges” of diplomatic mission and their staff and members of consular or permanent missions shall not be affected by the Agreement.

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<sup>48</sup> *ibid*

<sup>49</sup> *ibid*

It also provides that, notwithstanding paragraph 1 of Article 4, (dealing with fiscal residence), “an individual who is a member of the diplomatic, consular or permanent mission of a Contracting State which is situated in the other State and who is subject to tax in the other State only if he derives income from source therein, shall be deemed to be a resident of that other State”.

So, if a French national, serving as a member of the diplomatic mission in the French embassy in Nigeria derives income in Nigeria, he shall be deemed to be a resident of Nigeria, for tax purposes. The reverse is also the case if a Nigerian, working in the Nigerian embassy in France derives income in France.

The importance of this provision stems from the fact that residence determines the basis of allocating the taxing rights between two tax jurisdictions. It determines which tax jurisdiction may tax exclusively, which has the first right to tax and which one has limited right to tax. The purpose is to avoid or eliminate double taxation, which is the main object of such Agreements.

From the above analysis of the legal framework for the taxation of foreign income, can it be said that Nigeria has achieved her aims for entering into tax treaties, like raising revenue, preventing double taxation and curbing tax evasion? A tax treaty involves a negotiated sharing of the tax revenue by two States. In developed countries with comparable tax systems, the treaty rules usually lead to a balanced sharing of tax revenues. But in developing countries like Nigeria, these negotiations may be governed by economic, industrial or commercial factors as well as revenue considerations. Many of the treaties between developed and developing countries are supposed to promote free flows of investments from the former to the latter, and also encourage capital, labour and technology flows through fiscal measures. However, a recent observation by the OECD bears repeating here:

*.....despite the agreements which were signed on the initiative of the investing countries, developing countries soon realized that the criteria which the former imposed in their negotiations, which were equivalent to those which they used in agreements amongst themselves, did not pay sufficient attention to developing countries' legitimate fiscal interest.....<sup>50</sup>.*

This, the study found, was not only because many developing countries allocate to themselves taxing powers strictly on the basis of the principle of territoriality of the source, and in consequence, do not tax income from external sources, but also because “the flow of investments and income between the two types of countries is almost always markedly one directional”.<sup>51</sup>

### **3.7 SUMMARY**

In conclusion, it is to be noted that, although developing countries adopted the principle of worldwide income (for example the DTAs between Nigeria and Belgium, Canada, UK, France, discussed above), they alone had to bear the tax sacrifices arising from signing a convention without deriving any real compensation or benefit from it. In other words, developing countries soon realized, to their chagrin that “.... in signing an agreement with a developed country, what in fact was being negotiated was the right to tax income generated under their jurisdiction by investments by developed countries”<sup>52</sup>

Furthermore, how have the signing of tax treaties between Nigeria and other countries helped the country in solving peculiar problems that double taxation agreements are supposed to solve? In addition, according to a public finance think-tank, tax authorities are facing new constraints in raising revenue as a result of increased

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<sup>50</sup> Tax Treaties and Investment Flows, OECD Publication, No.8, Session III, June, 1990, 31 Pages 4-5.

<sup>51</sup> ibid

<sup>52</sup> ibid

globalization and mobility of capital.<sup>53</sup> The report also stated that the encouragement of free international trade and moves towards single markets, (like the EU, ECOWAS), have made it difficult for the tax authorities to adopt protectionist steps to safeguard their own domestic tax base. These developments have placed added pressures on tax administrations to counter tax evasion and avoidance in recent years, even in the face of bilateral tax treaties. Nigeria, being in the global village, is not immune from this virus.

Also, in 2004, four countries, (Australia, Canada, the UK and the USA), formed a special group called the Joint International Tax Shelters Information Centre, (JITSIC), to share information on global tax evasion affecting them.<sup>54</sup> They have also enacted obligatory disclosure of tax avoidance schemes or “tax shelters” by tax payers and their advisors as an anti-avoidance measure. Non-compliance is subject to severe penalties.

This measure is strongly recommended for Nigeria and other countries of similar economic, technological and commercial needs, as it will help in curbing the intractable problems of tax evasion and avoidance.

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<sup>53</sup> See Financial Times of London, Sept. 4, 2006, “UK Institute for Fiscal Studies”

<sup>54</sup> Rohatgi, op.cit, Vol.II, page 292

## CHAPTER FOUR

### TAX INCENTIVE REGIMES AND FOREIGN DIRECT INVESTMENT

#### 4.1 INTRODUCTION

*Over the past two decades, most Governments have been actively promoting their countries as investment locations to attract scarce private capital and associated technology and managerial skills in order to help achieve their development goals. They have increasingly adopted measures to facilitate the entry of foreign direct investment (FDI). Examples of such measures include liberalizing the laws and regulations for the admission and establishment of foreign investment projects; providing guarantees for repatriation of investment and profits; and establishing mechanisms for the settlement of investment disputes. Tax incentives are also part of these promotional efforts.<sup>1</sup>*

While the efficacy of tax incentives as a determinant for attracting Foreign Direct Investment, (FDI), is often questioned, more and more countries have increasingly resorted to such measures in recent years. In particular, many countries have been offering tax incentives to influence the location decisions of investors, (especially the Multi-National Corporations, MNCs). This is because foreign direct investment is increasingly being recognized as an important factor in the economic development of countries. Besides bringing capital, it facilitates the transfer of technology, organizational and managerial practices and skills as well as access to intermediate markets.

It is true that the role of tax incentives in promoting or attracting FDI into especially developing countries has been the subject of many studies or controversies. It is however, the opinion of this writer that their obvious positive effects have never been in doubt. Because of these effects of tax incentives on FDI, this writer will, in this chapter, examine the types, objectives, design and administration of tax incentives.

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<sup>1</sup> United Nations Conference on Trade And Development, (UNCTAD), ASIT Advisory Studies, No.16, Tax Incentives And FDI, UN, Geneva, 2000, Page 11.

## 4.2 International Taxation and Tax Incentives

It is easy to know that the goal of the Nigerian Government is to use its tax regime to attract FDI for its obvious advantages of capital formation, economic growth and development, technology transfer, job creation, financial resources, . And the goal is to be achieved through the provision of tax incentives to Multi National Corporation (MNCs) that bring in FDI. Tax incentives are by far, the most critical issue regarding tax policy and the rate of foreign investment in Nigeria as they have the potential to influence FDI in the country.<sup>2</sup>

It is true that taxation policies if not properly articulated and managed, can cause serious distortions and create economic inefficiencies and alter revenue potentials in a given society. Conversely however, tax incentives can be deployed under international taxation to encourage, promote and enhance growth and development. In Nigeria, for example, international taxation (through tax incentives) can have the following effects on MNCs and FDI:

- a) it can influence their decisions on location of investments;
- b) it can influence their decision on method of financing an investment, that is whether through equity or loan, (debt), capital, with varying tax implications;
- c) it can affect their intra-firm transfer pricing decisions.<sup>3</sup>

As we shall see shortly, tax incentives have had positive effects on FDI in Nigeria as far as 'a' above is concerned. But that argument is hardly tenable for 'b' and 'c'.

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<sup>2</sup> Kanyip, B.B., "Taxation Issues in Foreign Investment" Financial Investment Law Journal, MPJIL, Vol.2, No.1, Jan. 1998, page 110

<sup>3</sup> Timothy J. Goodspeed, *ibid*, page 268

### 4.3 Types of Tax Incentives

Tax incentives are any incentives that reduce the tax burden of an enterprise in order to induce it to invest in particular projects, sectors or locations<sup>4</sup>. They are exceptions to the general tax regime, since they decrease or lessen the amount of tax otherwise realizable. Tax incentives may also be measures that make one investment more attractive than another<sup>5</sup>. In general, they are meant to provide a more favourable regime to investors, as they often offset the disadvantages that investors face due to high taxes, inadequate infrastructure, bureaucratic bottlenecks and/or poor administration in the host country. Very few countries do not give tax incentives<sup>6</sup>.

A tax incentive may be any of the following types:

- (i) **Tax holidays.** These are a common form of tax incentive used by developing countries and countries with economies in transition, to attract FDI. Under a tax holiday or exemption, qualifying newly established firms are exempt from paying corporate income tax for a specific period, (for example 3 or 5 years). Tax holidays eliminate tax on net revenues from investment projects over the holiday period. This is aimed at encouraging investment. At the same time, tax holidays deny firms certain tax deductions over the holiday period, (e.g. depreciation costs or interest expenses), tending to offset, at least in part, any stimulative effect<sup>7</sup>.

Tax holidays or exemptions are simple incentives with a relatively low compliance burden. For example, there is no need to compute income tax during the holiday period. However, in a developing country like Nigeria, tax

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<sup>4</sup> Ibid, page 12

<sup>5</sup> Rohatgi, Vol.I, op.cit. page 246

<sup>6</sup> For example, Austria, Croatia, Czech Republic, Malawi.

<sup>7</sup> UNCTAD Asit Studies, op. cit, page 19



holidays, as incentives, should be designed with due consideration for the type of investment they are targeted to attract. This is because, tax holidays are best suited for firms that make profits in the early years of their operation, such as firms in trade or short-term construction. Thus, businesses with long gestation periods may take advantage of tax holidays, and, at the end of the period, simply pack up and leave the country, probably to set up a new operation in another country that also offers a similar tax holiday incentive. So, in designing a tax holiday incentive, Nigerian tax planners and administrators should be vigilant about some of these drawbacks. This problem can be solved if the investor is required to sign a bond to continue operation for a specific period after the time granted as tax holidays.

- (ii) **Investment allowances or credits.** These are deductions from taxable income based on some percentage of new investment (depreciation). They tend to lower the effective price of acquiring new capital. Both investment allowances and investment tax credits are given as a specified percentage of qualifying investment expenditures. Because they are deducted against the tax base, however, their value to the investing firm depends, *inter alia*, on the value of the corporate income tax rate applicable to the tax base. That is, the higher the tax rate, the higher is the amount of tax relief on a given amount of investment allowance claimed, and vice versa. In contrast, variations in the corporate tax rate do not affect the value of investment tax credits<sup>8</sup>.

Under an investment allowance, firms are provided with faster or more generous write-offs for qualifying capital costs. Thus, an investment allowance is of two types: (1) accelerated depreciation allowance, under which

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<sup>8</sup> *Ibid*, page 20

firms are allowed to write off capital costs in a shorter time than is dictated by the useful economic life of the capital, (which is generally the accounting basis for depreciating capital costs), and (2) enhanced deduction allowance under which firms are allowed to claim deductions for the cost of qualifying capital that are a multiple of the actual cost, (that is, one- and half times or twice the price).<sup>9</sup>

Tax investment credits, on the other hand, may either be flat or incremental. A flat investment tax credit is earned as a fixed percentage of investment expenditures incurred in a year on qualifying, (targeted), capital. In contrast, an incremental investment tax credit is earned as a fixed percentage of qualifying investment expenditures in a year in excess of some base that is typically a moving-average base. An example here is the average investment expenditure by the taxpayer over the previous three years. The rationale behind the incremental tax credit allowance is “to improve the targeting of the relief to incremental expenditures that would not have occurred in the absence of the tax relief”.<sup>10</sup>

What happens in a situation where investment tax credits, for example, are not earned? Such credits or allowances may be carried forward for a limited number of years to offset future tax liabilities. For, investment tax credits or allowances are meaningful only if they can be carried forward, (or even backward), as they may not be used or earned in any particular year or period. Alternatively, unused tax credits should be refundable, that is, their value may be claimed in cash in the particular year that they are supposed to be earned.

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<sup>9</sup> Ibid, page 21

<sup>10</sup> Clark W. S., “The Design and Assessment of Corporate Tax Incentives for FDI, a paper submitted at UNCTAD Ad Hoc Expert Meeting on Tax Incentives, 8 – 9 July, 1999, page 18

Even though this may have serious revenue implications for the Government, (and may even be abused), it can considerably increase the attractiveness of the incentive for FDI purposes.

**(iii) Accelerated Depreciation Allowance.** This is a tax relief or incentive, which allows taxpayers to claim a higher depreciation deduction in the first year or earlier years of the useful life of business assets<sup>11</sup>. For tax purposes, depreciation is the decline in the value of fixed assets resulting from their use, exhaustion, wear and tear or obsolescence. This loss in value is deductible in computing the taxable income of firms. To attract investment, a domestic law may grant a tax deduction as capital or depreciation allowance, (sometimes called wear and tear allowance), over the economic life of various assets<sup>12</sup>.

Generally, this type of allowance is usually granted for investment in plant, machinery, heavy equipment, industrial undertakings and other inputs.

**(iv) Reduced Corporate Income Tax Rate.** Governments may set a lower corporate income tax rate as an exception to the general tax regime in order to attract FDI into specific sectors or regions. Hong Kong, Indonesia, Ireland, the Lao People`s Democratic Republic, Cambodia and Estonia are a few countries that use this type of incentive. Nigeria also uses it. In general, corporate income tax rate in Nigeria is 30%. But it has fixed a rate of 7.5% corporate income tax rate where the taxpayer comes from any of the countries with which it has entered a tax treaty<sup>13</sup>. Reduced corporate income tax rate may be targeted at the income of foreign investors who meet specified criteria, or it

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<sup>11</sup> Rohatgi, op. cit., page 297

<sup>12</sup> Richard K. Gordon, "Depreciation, Amortization," London, 2000 pages 682 – 717.

<sup>13</sup> For example, Britain, France, Belgium, Netherlands,

may be applied for the purpose of attracting additional FDI. Malaysia did this in the mid-1980s when investment inflows were below expectations<sup>14</sup>.

- (v) **Loss Carry Forwards.** Governments that employ a low corporate profit tax rate often also use the loss carry forward tax incentive to allow investors to carry losses forward (or backward) for a specified number of years (usually three to five years) for tax accounting purposes. Usually, only a fixed ratio of the loss with an upper limit is allowed to be carried forward, (or backward). This measure or incentive is particularly valued by investors whose projects are expected to run losses in the first few years as they try to increase production and penetrate markets. A new investment normally makes losses in the start-up period. If the tax holiday period is not long enough, there may be no taxable profits to provide a shelter. The tax losses during the period may be lost, unless they can be carried forward beyond the holiday period. Moreover, the taxes in the post-holiday period may be increased since there are no carry-forward losses available to offset the profits.

Income is taxed only when it is positive. That is, while a company or firm pays tax when it makes profits, it is not given a tax refund when it makes losses, (that is negative its)<sup>15</sup>. However, when tax losses are allowed to be carried forward as an incentive, they constitute tax benefits, since the losses can be offset against future, (or sometimes past), taxable profits.

The rules on loss carry forward vary from country to country, and they are generally subject to restrictions. Some countries restrict the offset of tax losses

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<sup>14</sup> UNCTAD, *Asit Studies*, op. cit. page 19

<sup>15</sup> Alworth, J. S., "The France Investment and Taxation of MNCS, Basil, 1988 page 47.

to income from the same source<sup>16</sup>. Others allow losses, (both capital and exchange losses), to be offset against future profits from all sources<sup>17</sup>.

For a developing country like Nigeria it is imperative that there be a maximum period for carry-forward or (carry back), losses. In other words, a firm should not be allowed to continue to claim loss carry forward relief *ad infinitum*, as this can have serious revenue implications for the country. Secondly, a subsidiary company should not be allowed to claim loss carry forward relief in respect of its principal outside the country. This is to avoid the type of problem that arose in *Reiss & Co. (Nig.) ltd V.FBIR*<sup>18</sup>, where the court failed to allow a subsidiary company doing business in Nigeria to be assessed to tax because its principal is based outside the country.

- (vi) **Zero or reduced tariffs.** Governments usually grant two types of tariff incentives. First, they may reduce or even eliminate tariffs on imported capital equipment and spare parts for qualifying investment projects. This has the effect of reducing the cost of investment. On the other hand, they can increase tariffs on the final products of the investor in order to protect the domestic market from import competition.

Tariff protection has been quite a common form of investment incentive in many countries. Its use however, has decreased over the decades as developing countries have lowered their tariffs following agreements under the World Trade Organization, (WTO), and other various regional trade arrangements. Also, many developing countries have come to the conclusion that investment stimulated or attracted through tariff protection often leads to

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<sup>16</sup> For example, Argentina, Canada, Norway, UK and Israel .

<sup>17</sup> For example, Malta, Poland and Spain.

<sup>18</sup> Supra, Chapter Two, paragraph 2.1.7

an inefficient, high-cost, distorted industrial structure<sup>19</sup>. This is because the WTO,<sup>20</sup> (which replaced the General Agreement on Trade and Tariffs, GATT), is a collection of other international instruments like the Multilateral Agreements on Trade in Goods, General Agreement on Trade in Services, (GATS), and the Agreement on Trade Related Aspects of Intellectual Property Reliefs. WTO, (and the other constituent instruments), has, as its principal aim, the promotion or coherence and harmony in global economic relations between countries<sup>21</sup>. So, where a tax incentive like increasing the tariffs on the final products of a foreign investor would distort or even disturb the existing trade harmony between nations, then it will be jettisoned altogether.

**(vii) Tax credits for value addition.** In order to promote domestic capacity building and discourage export of raw materials, Governments may provide tax credits or allowances for value addition in, for example, processing or for the net local content or outputs. This is the value of sales less depreciation or capital equipment, and the value of imported raw materials and supplies.

**(viii) Tax credits for foreign hard currency earnings.** One of the reasons many developing countries encourage export is in order to earn much needed foreign hard currency. Thus, they establish export processing zones. In addition, they provide tax credits or tax reductions to many industries in the services sector, (like tourism and hotels), based on their earnings of such hard currency.

Under this tax incentive, the central aim is attraction of foreign hard currency. Nigeria has many export processing zones across the country. Activities in these zones attract zero tax, just as the firms operating therein are allowed free

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<sup>19</sup> UNCTAD, op. cit. page 22

<sup>20</sup> Established in 1994

<sup>21</sup> Landan, M. T. op. cit.

repatriation of profits. As for those companies in the services sector, it appears that they will enjoy this type of tax incentive only if they are able to attract patronage by those who can pay for their services in foreign hard currency. Thus, places like the Tinapa Resort in Cross River State, Yankari Games Reserve in Bauchi State and the Transcorp Hotel in Abuja, among others may take full benefit of this head of tax incentives.

In granting these tax incentives however, Nigeria must not lose sight of the most important role of any tax system, which is its revenue-raising function. In other words, while tax incentives are being used to influence economic behaviour and promote growth and development, the Nigerian Government should not 'fritter' away its scarce resources through that process. An alternative to granting tax incentives is the provision of solid infrastructure, stable power supply, good roads, security and skilled labour. This is because the role of tax incentives in facilitating or attracting FDI into a developing country like Nigeria has remained largely controversial. As a factor in attracting FDI, tax incentives, as discussed earlier,<sup>22</sup> are secondary to more fundamental determinants like market size, access to raw materials and availability of skilled labour.

#### **4.4 Objectives of Tax Incentives**

The main reason why FDI is attracted to a country is to facilitate economic growth and development.

However, apart from this broad objective of tax incentives, there are many other reasons why Governments grant them to companies. Some of these reasons are:

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<sup>22</sup> In paragraph 4.2 of this Thesis

**A. Regional Development.** Countries often employ a mix of incentives to channel investment for the development of a particular locality, area or region. Regional development objectives include support for rural development, building industrial centres away from major cities, (and thereby reducing environmental and/or health hazards), tackling the problem of over-urbanization and concentration of population. Angola, Brazil, Ecuador, Ghana, India, Pakistan and Thailand are some of the countries that employ tax incentives for this purpose. In Egypt, tax incentive schemes for the reclamation and cultivation of barren and desert land also fall under this category.<sup>23</sup>

The target of this type of incentive may also be to attract investment in areas or regions that are disadvantaged due to their remoteness from major urban centres. Operating in a remote area may entail significantly higher transportation and communications costs in accessing raw materials to be used in production and in delivering end products to markets. In any case, such firms may not be in a taxpaying situation in the initial years. And reduced tax rates or tax holidays may not produce the required results. So, measures like investment tax credits that provide upfront funding may be a more effective instrument to attract them to such rural areas.

Egypt has such an incentive for firms that establish poultry and animal husbandry, provided they contribute to decentralization and are set up in new industrial zones. And in Colombia, a special tax incentive regime is employed for firms that establish business in the Rio Paez region, south of the country.

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<sup>23</sup> UNCTAD, *op. cit.* page 15



The tax incentives include a 10-year tax holiday, free remittance of profits and free customs duties<sup>24</sup>.

Nigeria also has a regional tax incentives system that gives allowances ranging from 100% to 5% to companies that establish operations in rural areas where there are no facilities such as electricity, tarred roads, telephones and water supply.<sup>25</sup>

In addition to these tax incentives, or instead of them, Nigerian Government should develop the infrastructure so as to reduce these costs, which would provide permanent solutions to the problems. Then, the Government can later recoup the expenses of providing the infrastructure through taxation. Secondly, the Nigerian Government should enter into an agreement with the firms that seek to do business in the rural areas with a view to getting them to develop the infrastructure and later compensate them.

**B. Sectoral Development.** Countries employ tax incentives in order to promote sectors of industry or activities considered crucial for development. These may be targeted, for example, at mining and industrial parks, export-led activities or business with new technologies or that will drastically reduce unemployment.

Singapore, for example, provides exemption from income tax for 5 years to pioneer companies involved in industries that are not adequately developed in the country. Costa Rica has special incentives for tourism applicable to hotel services, air and water transportation of tourists, travel agencies and car rentals. In Pakistan, hi-tech industries, which include power tools, information

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<sup>24</sup> ibid

<sup>25</sup> 2nd Schedule, Tables I and II, CITA, Cap.21, Laws of the Federation of Nigeria, 2004.

technology and solar energy utilization benefit from a wide range of tax incentives<sup>26</sup>.

Majority of tax incentives granted by developing countries like Nigeria relate to investment in manufacture, exploration and extraction of mineral reserves, promotion of export and, increasingly, the tourism and leisure sectors. Developing countries generally do not attract headquarters of companies and service activities. Therefore, few developing countries have incentives aimed at the service sectors. Some exceptions are Malaysia, Singapore and the Philippines, which employ incentives, primarily reduced corporate tax rates, to attract headquarters of companies into their countries.

**C. Transfer of technology.** An important objective of using incentives to attract investment, (or FDI), to developing countries is the transfer of technology. Certain types of tax incentives are designed specifically for this purpose. Some countries<sup>27</sup> have introduced a specific set of incentives directed towards research and development, (R & D) activities and technology projects. These tax incentives include tax-exempt technology development funds, tax credit for expenditures on R & D, and for up-grading human resources related to R & D. In particular, deduction is allowed for certain types of expenditure, and income tax exemption is offered for a period of time, while machinery, equipment and raw materials are exempt from import duty and sales tax. For import of technology, tax incentives take the form of deductions allowed for transfer costs of patent rights and import fees, exemption of income from consulting and the granting of other tax privileges to R & D projects.<sup>28</sup>

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<sup>26</sup> UNCTAD, op. cit. page 13

<sup>27</sup> For example, Singapore, Malaysia, .

<sup>28</sup> UNCTAD, op. cit. page 13

Similarly, cooperation and partnership agreements among firms for R & D are often exempt under competition laws, particularly in developed countries like the United States and member States of the European Union.<sup>29</sup> By different competition regulation exemptions, it is possible to grant increasing legal certainty to technology holders and licensees willing to invest in new projects using new technologies within a country<sup>30</sup>.

**D. Performance enhancement.** As noted earlier<sup>31</sup>, tax incentives can be targeted at export promotion, employment/skills training, domestic value added and headquarters location. Free trade zones, (FTZs), typically cover incentives for export-oriented manufacturing activities. Panama, for example, has an export processing regime to promote the export of goods that are manufactured, assembled or processed in Panama. Qualifying enterprises in the zone are exempt from direct and indirect income taxes, import duties and value added taxes.

In Nigeria, companies operating in a free trade zone are exempt from payment of all taxes, federal, state or local government. In addition, such companies are allowed full repatriation of capital at any time. They are also exempt from payment of import or export licenses. Furthermore, they are allowed to sell up to 25% of their products in the domestic market.

#### **4.5 Design and Administration of Tax Incentives**

Tax incentives, usually, are only a part of a package of policy objectives to achieve broad economic, social and political goals. The legal instruments that grant tax incentives should therefore be drafted carefully so that these goals can be achieved

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<sup>29</sup> UNCTAD, World Investment Report, 1997, pages 205 – 208.

<sup>30</sup> UNCTAD, Asit Studies, op. cit. page 13

<sup>31</sup> Paragraphs B & C above

with minimum leakage of tax revenues. The legal instruments should be drafted, expressed or worded as precisely and clearly as possible so as to avoid the need for frequent corrections or changes, as this may lead to the perception that the tax system is complex and difficult to comply with. On the other hand, the incentives should be implemented with minimum inconvenience to the investor himself. This is because stability and predictability of the whole tax system are major factors that influence firms whenever they decide to make long-term investments.

There are therefore four broad steps in developing tax incentive policies:

- (i) designing the incentives;
- (ii) granting the incentives;
- (iii) implementing the incentives; and
- (iv) following up compliance by firms that have benefited from the incentive measures.<sup>32</sup>

In this respect, tax incentives as a concept, involves both financial and administrative costs. Administration of tax incentives is easier to achieve if the incentives system itself is transparent, less cumbersome and simple to understand by the investors.

More often than not, monitoring or following up the firms that benefit from tax incentives is neglected in Nigeria. If investors are required, for example, to fulfill certain conditions as part of granting incentives, (such as import of certain types of machinery, creation of jobs, ), within a certain time frame, it is imperative that after granting the incentives, the investors be monitored to ensure full compliance both with the conditions and the investment itself. The capacity to effectively monitor or follow up is particularly weak in Nigeria.

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<sup>32</sup> UNCTAD, *Asit Studies*, op. cit. page 23

Furthermore, the Nigerian tax system is such that implementation of the tax system is done by different organs of Government. For example, tax deductions or allowances in respect of the public or civil servants are administered by the various Ministries, Departments and Agencies, (MDAs). Duty exemptions are implemented by the Department of Customs & Excise, while income and it tax, (especially on business concerns), is administered by the States Boards of Internal Revenue. Value Added Tax, (VAT), is administered directly by the various sales out-lets. It is true that these various taxes end up in the coffers of the Boards of Internal Revenue or the Federal Inland Revenue Service, (FIRS). But the diversity of the agencies that deal with tax incentives tends to increase the inconvenience of doing business in Nigeria. Investors should deal with one Government agency, and they should be able to determine, from the start, the total package of tax incentives that is available.

In addition, some of the agencies mentioned above are either Federal or State. Where both tiers of Government offer tax incentives to investors, there may be no coordination between them concerning the total package of tax benefits that the investors may finally receive. On the other hand, competition between the Federal Government and a State Government, or between the State Governments *inter se* to attract investment for economic gains may result in windfall benefits for investors. This will be counter-productive.

Nigeria should learn a lesson from the United States of America, U.S.A. The State of Alabama in the USA spent \$250m in the late 1980s to attract a Mercedes-Benz car plant to locate its operations in Tuscaloosa, when the company itself had planned to invest only \$300m in the business. The State of Alabama spent the \$250m as financial incentives for site development, infrastructure and job training, among others. Because the company had considered other locations in the States of Georgia,

Nebraska, North Carolina, South Carolina and Tennessee, Alabama had to attract it with that enormous sum of money as an incentive.<sup>33</sup>

In the mid-eighties, competition among provincial (state) governments in Brazil to attract Ford Motor Company to establish an automobile assembly plant not only pitted the state governments of Rio Grande do Sul and Bahia against each other, but also drew the Government of Argentina, (a neighbouring country), into the fray. Originally, the State of Rio Grande do Sul was thought to be the beneficiary of the investment by Ford Motor Company. But as a result of negotiations with the State of Bahia and the Federal Government, the assembly plant was finally located in the State of Bahia. Ford was able to negotiate a number of benefits, including import tax exemption for machinery and equipment, a 90% reduction in import tax on tyres and other components, exemption from tax on industrialized products and exemption of tax on net income generated by the plant. In addition, the federal government owned bank agreed to finance the undertaking under favourable terms and conditions, among others.<sup>34</sup>

The feud took an international dimension when Argentina felt that the liberal tax incentives offered by the State of Bahia in Brazil, were effectively pulling enterprises away from its country. In revenge, it offered generous tax incentives, infrastructure subsidies and other benefits to Volkswagen to attract it to install a factory for the manufacture of gearboxes in the country.<sup>35</sup>

#### **4.6 Tax Incentives in Nigeria**

With a population of over 140 million people, Nigeria is not only Africa's most populous nation, but also a destination of choice for serious investors looking to take

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<sup>33</sup> UNCTAD, DITC, World Investment Report, 1998, page 79

<sup>34</sup> Gomes, G.M., "A Short Note on Tax Incentives in Brazil," UNCTAD, 1999

<sup>35</sup> South-North Development Monitor No.4629, 20/3/2000, page 9

advantage of a potentially large market. In addition to this, Nigeria is also the 7<sup>th</sup> largest producer of oil in the world, with oil exports accounting for 95% of its foreign exchange earnings and 80% of budgetary revenue.<sup>36</sup>

In order to encourage investors to tap these and other potentials, the Nigerian Government has offered generous tax and fiscal incentives to companies that are desirous of doing business in the country.

To start with, the Government has introduced a new visa policy to enable genuine foreign investors to procure a visa to Nigeria within 48 hours of submission of the required documentation.

**(i) Pioneer Status**

This takes the form of a holiday (of between 3 to 5 years) for qualifying industries anywhere in the country, but particularly in economically disadvantaged areas. The aim is to enable such a company make reasonable it during its formative years. The profits so made are expected to be ploughed back to the business in order to facilitate expansion and growth of the company or industry. Sixty-nine companies engaged in the cultivation and processing of food crops, vegetables and fruits, manufacture of cocoa products, glass and glassware, pharmaceutical products, educational and science equipment, building and home furnishing materials, mining of lead and zinc ores have been granted pioneer status in Nigeria.<sup>37</sup>

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<sup>36</sup> CBN Annual Statistics Bulletin, Vol. 25, December, 2014.

<sup>37</sup> A Compendium of Workshop materials of the ALPHA-JURIST Education Series, "Legal Mechanism for Corporate Tax Reliefs", page 125

**(ii) Capital Allowance.**

Capital allowances can be claimed for many different types of capital expenditures: industrial buildings, plant and machinery, mines and oil wells, dredging, agricultural and forestry land and buildings, scientific research patents and know-how.

Capital allowance is basically of the following types:

- (1) initial allowance, which is claimed in the first year when the qualifying capital expenditure is first put into use;
- (2) annual allowance, which is claimed on the straight-line basis over the estimated tax life of the qualifying capital expenditure; and
- (3) investment allowance, which is claimed on certain specific assets. It is claimed only once, and usually in the first year of use, but it cannot be carried forward if it is not utilized in the year when it is claimed. So, it is always better, for tax management purposes, to claim it ahead of the other two, since these other two can be carried forward.<sup>38</sup>

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<sup>38</sup> *Ibid*,



The following are the rates of initial and annual capital allowances in Nigeria:

CAPITAL ALLOWANCE	Initial %	Annual %
1. Qualifying Building Expenditure (Industrial and Non Industrial)		10%
2. Qualifying Mining Expenditure	15%	Nil
3. Qualifying Agricultural Production Expenditure	95%	Nil
4. Qualifying Plant Expenditure:	95%	
(i) Agricultural Production	95%	Nil
(ii) Others	95%	25%
5. Qualifying Furniture and Fittings Expenditure	25%	20%
6. Qualifying Public Transportation Expenditure (not less than 3 buses)	95%	Nil
7. Qualifying Motor Vehicles Expenditure	50%	25%
8. Qualifying Plantation Equipment Expenditure	95%	Nil
9. Qualifying Housing Estate Expenditure	50%	25%
10. Qualifying Ranching and Plantation Expenditure	30%	50%
11. Qualifying Research and Development Expenditure	95%	Nil <sup>39</sup>

The above allowances are for the initial and annual capital allowance. However, as discussed in the preceding paragraph, there is also a third type of capital allowance, that is, investment allowance. Prominent in this category of allowance is the rural investment allowance which can be claimed on capital assets acquired for use at locations that are at least 20kms away from certain facilities, as follows:-

- (i) No facilities at all.....100% of capital expenditure in the first year only.
- (ii) No electricity.....50% of capital expenditure in the first year only
- (iii) No water.....30% of capital expenditure in the first year only
- (iv) No tarred road.....15% of capital expenditure in the first year only
- (v) No telephone.....15% of capital expenditure in the first year only.<sup>40</sup>

<sup>39</sup> Tables I and II, 2nd Schedule, CITA.

<sup>40</sup> *ibid*

These allowances, however, cannot be claimed when a company has already been granted a pioneer status. In addition, these allowances were granted in 1996 when CITA, (the Companies Income Tax Act), was amended by Decree № 32 of that year. At that time, GSM (Global System of Telecommunication) was unknown in Nigeria. Now that it is a very common and cheap system of communication across the length and breadth of the country, the investment allowance of 15% of capital expenditure for locating industries where there are no telephone facilities should be discontinued. That head of allowance or incentive no longer serves any useful purpose. Similarly, the allowance of 30% of capital expenditure for locating industries where there is no water should be reduced, if not cancelled all together. This is because, with the rapid spread in modern technology, bore-holes are now common features in Nigerian villages.

**(iii) Research and Development (R & D) Incentives**

In Nigerian, up to 120% of expenses on R & D (Research and Development), are tax deductible, provided that such R & D activities are carried out in Nigeria, and are connected with businesses to which tax allowances are granted. As a further incentive, the result of such research can be patented and protected in accordance with internationally accepted industrial property right. Where R & D is carried out on local materials, the allowable deduction is raised to 140% of expenses.<sup>41</sup>

**(iv) Local Raw Materials Utilization.**

Tax concessions are given for five years to industries that attain the stipulated minimum local raw materials utilization as follows:-

- a. Agriculture.....80%
- b. Agro-allied.....70%

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<sup>41</sup> <http://www.fditaxincentives.org.nig.com>, 12/9/13

c. Engineering.....65%

d. Chemical.....60%

e. Petro-chemical.....70%

**(v) Labour Intensive Mode of Production.**

Nigeria grants 15% tax concession to companies that are labour intensive for five years. This rate is graduated in such a way that an industry or company that employs 1,000 persons or more will enjoy 15% concession while an industry that employs 100 will enjoy only 6%. Those industries that employ 200 will enjoy 7% concession.<sup>42</sup>

**(vi) Local Value Added**

100% tax concession is granted to companies that use local materials in the production of finished goods. This applies essentially to engineering industries, which may however use some finished imported products to serve as inputs. This incentive is aimed at encouraging local fabrication, instead of merely assembling completely knocked down parts. Closely related to this is the 2% tax incentive given to companies as the cost of facilities used for in-plant training of employees.

**(vii) Export Oriented Industries**

In addition to the tax incentives for companies operating in Free Trade Zones (FTZs) discussed above,<sup>43</sup> a general 10% tax concession is granted to companies that are export-oriented. This incentive applies to industries that export not less than 60% of their products.

**(viii) Infrastructure**

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<sup>42</sup> ibid

<sup>43</sup> Chapter 3, paragraph 3.4.3

20% of the cost of providing basic infrastructures such as roads, water, electricity, , where they do not exist, is tax deductible once and for all.

**(ix) Investment in Economically Disadvantaged Areas**

30% tax incentive is granted for seven years and an additional 5% depreciation cost over and above the initial capital depreciation is also granted to companies that operate in economically disadvantaged areas.

**(x) Abolition of Excise Duty**

All excise duties are abolished with effect from 1<sup>st</sup> January, 1999<sup>44</sup>. Earlier on, a 25% import duty rebate was introduced in 1995 to ameliorate the adverse effect of inflation, and to ensure increase in capacity utilization in the manufacturing sector.

**(xi) Re-Investment Allowance**

This incentive is given to manufacturing companies that incur capital expenditure for purposes of approved expansion of production capacity, modernization of facilities and diversification in related products. It is aimed at encouraging re-investment of its.

**(xii) Investment Tax Allowance**

Under this head of tax incentive, a company would enjoy generous tax allowances in respect of qualifying expenditure incurred within five years from the date of the approval of the project.

Dividends derived from manufacturing companies in petro-chemical and qualifying natural gas sub-sectors are exempt from tax. Furthermore, companies with a turnover of less than One Million Naira are taxed at a low rate of 20% for the first five years of

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<sup>44</sup> <http://www.fditaxincentives.org.nig.com>, 12/9/13, 8:52pm

operation if they are into manufacturing. Dividends for companies in the manufacturing sector with a turnover of less than 100 Million Naira are tax free for the first five years of their operation.<sup>45</sup>

**(xiii) Investment Guarantee/Effective Protection**

S. 25 of the NIPC Act<sup>46</sup> guarantees transferability of funds of a foreign investor in an approved enterprise. The section further provides that such fund shall be unconditionally transferable through an authorized dealer in freely convertible currency. The transferable funds are:

- (a) dividends or profits, (net of taxes), attributable to the investments;
- (b) payments in respect of loan servicing where a foreign loan has been obtained;
- (c) remittance of proceeds, (net of all taxes), and other obligations in the event of sale or liquidation of the enterprises; or
- (d) any interest attributable to the enterprises.

**(xiv) Guarantees against Expropriation**

The NIPC Act<sup>47</sup> also provides that no enterprise shall be nationalized or expropriated by any Government of the Federation unless the acquisition is in the national interest or for public purpose; and no person who owns, (either wholly or in part), the capital of any enterprise shall be compelled by law to surrender his interest in the capital to any other person.

Expropriation or nationalization can only be done under a law that makes provision for:

- a. payment of fair and reasonable compensation; and

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<sup>45</sup> ibid

<sup>46</sup> Cap. N117, Laws of the Federation of Nigeria, 2004.

<sup>47</sup> In Section 25

- b. right of access to the court for the determination of the investor's interest or right and the amount of compensation to which he is entitled.

In addition to all these safeguards, the Nigerian Government is prepared to enter into Investment Protection Agreement with foreign enterprises wishing to invest in Nigeria.<sup>48</sup>

**(xv) Access to Land**

Any company incorporated in Nigeria is allowed to have access to land for the purpose of its activity in any state of the country. It is however a requirement that industrial companies should comply with regulations on use of land for industrial purposes and with environmental regulations. Land lease is usually for a term of 99 years unless the company requires a shorter duration.

**(xvi) Oil and Gas Sector**

The following tax incentives have been approved by the Government in the Oil and Gas Sector:

- a. The tax rate under the Petroleum Profits Tax Act<sup>49</sup> is 30%;
- b. Capital allowance is 20% per annum in the first four years, 19% in the 5<sup>th</sup> year and the remaining 1% in the books;
- c. investment tax credit is granted at 5%; and
- d. royalty is granted at the rate of 7% on shore and 5% offshore.<sup>50</sup> Furthermore, the Petroleum Profits Tax Act,<sup>51</sup> provides that the following incentives shall apply to a company engaged in the utilization of associated gas:

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<sup>48</sup> <http://www.fdi.ng.com>

<sup>49</sup> Cap. P13, Laws of the Federation of Nigeria, 2004, op.cit

<sup>50</sup> <http://www/whosts/charlesanthonylaw.com>, 17/5/2013, 2:10pm

<sup>51</sup> In Section 11(1)

- i. Investment required to separate crude oil and gas from the reservoir into usable products shall be considered as part of the oil field development;
- ii. Capital investment on facilities equipment to deliver associated gas in usable form at utilization or designated custody transfer points shall be treated, for tax purposes, as part of the capital investment for oil development; and
- iii. Capital allowances, operating expenses and basis of tax assessment shall be subject to the provisions of the Act and the tax incentives under the revised Memorandum of Understanding.

However, these incentives are subject to some conditions laid down in subsection 2 of Section 11 of PPTA, some of which are: that the company shall pay a minimum amount charged by the Minister of Petroleum Resources for gas flared by the company, and all capital investments relating to the gas-to-liquids facilities shall be treated as chargeable capital allowance and recovered against the crude oil income.

For those companies operating Oil and Gas business in the Free Trade Zone, the following additional tax incentives have been granted by the Nigerian Government:

- a. There shall be no personal income tax;
- b. They are allowed 10% repatriation of capital and profits;
- c. There shall be no foreign exchange regulations applicable to them;
- d. They will not be subjected to pre-shipment inspection for goods imported into the Free Zone;
- e. They do not have to apply for an expatriate quota;
- f. The initial tax holidays incentive has been extended from 3 to 5 years and renewable for another 2 years;
- g. Investment capital allowance has been increased from 5% to 15%; and

- h. All dividends distributed during the tax holiday shall be tax free.<sup>52</sup>

**(xvii) Liquefied Natural Gas (LNG) Projects**

Nigeria has also granted the following tax incentives under the Liquefied Natural Gas (LNG) Projects:

- a. the applicable tax rate under the Petroleum Profits Tax Act (PPTA) is 45%;
- b. capital allowance is 33% per annum on-sight-straight-line-basis in the first three years with 1% remaining in the books;
- c. investment tax credit is 10%; and
- d. royalty of 7% on shore and 5% offshore tax is deductible.<sup>53</sup>

**(xviii) Agricultural Sector**

Without prejudice to the Government's deregulation of the financial sector, banks have been enjoined to recognize the differences in the gestation periods within each category of agriculture loans, ranging from 6 month to 10 years for crops, livestock, fisheries, forestry and wild life. In addition, the following tax incentives are available in the agriculture sector:

1. Companies in the agro-allied business do not have their loans guaranteed by a mere 60% but in full, that is, 100%;
2. Agro-allied plant and equipment enjoy initial capital allowance of 95%.<sup>54</sup>

**(xix) Solid Minerals Sector**

The following tax incentives are available in this sector:

- a. 3 to 5 years tax holiday;

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<sup>52</sup> <http://www.fdi> in nig. 17/5/2013, 2:43pm

<sup>53</sup> *ibid*

<sup>54</sup> <http://www.15projects.com>, 2/9/2013, 6:48 pm



- b. deferred royalty payments, depending on the magnitude of investment and strategic nature of the project;
- c. possible capitalization of expenditure on exploration and surveys;
- d. provision of 100% foreign ownership of mining companies or concerns;
- e. in addition to the roll-over relief under the Capital Gains Tax Act,<sup>55</sup> companies replacing their plants and machinery are to enjoy once-and-for-all 95% capital allowance in the first year, with 5% retention value until the asset is disposed of.<sup>56</sup>

**(xx) Tourism**

This sector was accorded a preferred status in 1991, which qualifies it for such tax incentives as tax holidays, longer years of moratorium and import duty exemption on tourism related equipment. Furthermore, 25% of income derived from tourists by hotels in convertible currencies are tax exempt, provided such income is put in a reserve fund to be utilized within 5 years of expansion or the construction of new hotels, or conference centres that are useful for tourism development.<sup>57</sup>

**(xxi) Energy Sector**

All areas of investment in this sector, that is, generation, transmission or distribution are considered to be pioneer product or industry. So, there is a tax holiday of 5 to 7 years for investment in the sector. In addition, there has, of recent, been a deregulation and total sale of the sector resulting in the emergence of Independent Power Producers (IPP) that will soon start operation in Nigeria.

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<sup>55</sup> Cap. C1, Laws of The Federation of Nigeria, 2004

<sup>56</sup> <http://www.15projects.com.2/9/2013>, 5:21 pm.

<sup>57</sup> *ibid*

In fact, the Nigerian Government has now handed over the successor companies of the Power Holding Company of Nigeria (PHCN) to the new owners. These new investors are six power generating companies and nine distribution firms that have completed payments of their bid amounts. They include Mainstream Energy, Amperion Power, West Power Gas, and Integrated Energy .<sup>58</sup>

**(xxii) Telecommunications Sector**

Nigeria is one of the biggest and fastest growing telecommunications market in Africa, attracting huge amounts of foreign investment, and is yet standing at relatively low levels of market penetration. That is, its potentials in this sector have not been fully tapped. Far reaching liberalization efforts of the telecommunications sector by the Government have led to many companies providing virtually all kinds of telecommunications services in an independently regulated market. After a decade of failed privatization attempts, the incumbent national telephone provider, NITEL, and its mobile arm, M-Tel, are currently in liquidation.

Nigeria has overtaken South Africa to become the continent's largest mobile market, with an estimated 100 million subscribers, and yet, market penetration is now over 70%.<sup>59</sup> The telecommunications industry has also provided jobs to millions of Nigerians.

The growth in investment in telecommunications in Nigeria has been made possible because of the incentives provided by the Government. Some of these incentives are:

- A. Provision of national infrastructure such as:
  - (i) Back bone networks; and
  - (ii) Fibre to the Home (FTTH) optic infrastructure.

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<sup>58</sup> Daily Trust Newspapers, Tuesday, 1/10/2013, pages 1-6  
<sup>59</sup> <http://www.nipc.gov.ng: 30/8/15, 4:09am>

B. Provision of international infrastructure such as:

- (i) Submarine fibre;
- (ii) Terrestrial fibre; and
- (iii) Satellite.<sup>60</sup>

In addition, the telecommunications sector has been totally liberalized. This, the Government did by:

- (i) Granting Globacom and others an SNO, (Second National Operator), licence;
- (ii) Granting Regional fixed-wireless access, (FWA), licence to the GSM operators;
- (iii) Granting International gateway licences to the operators; and
- (iv) Providing a unified licensing regime.

The major GSM mobile operators in Nigeria are: MTN Nigeria, Bharti Airtel (formerly Zain/Celtel Nigeria), Globacom and Etisalat Nigeria (EMTS, Mubadala). The services rendered by these providers have penetrated the nooks and crannies of the country. The 30% market that is still available is mostly in the rural areas.

The greatest prosperity Nigerians have enjoyed in the last decade is arguably in the area of the GSM revolution. Communication among friends and relatives is now much easier, faster and cheaper. And GSM has also provided jobs for millions of young Nigerians as they sell re-charge cards, sim cards, handsets and its accessories, among others. Registration of sim cards is free, and handsets are relatively cheap, what with the Chinese models flooding the market. Re-charge cards can also be purchased for as low as N50. For the first time, the Nigerian Government deserves a pat on the back for the tax incentives provided for the GSM operators. For, of all the incentives (tax, fiscal ,) provided for foreign companies to operate in Nigeria, those of

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<sup>60</sup> ibid

the GSM industry have had the greatest impact on the generality of the poor, hopeless and disgruntled Nigerian masses.

#### **4.7 SUMMARY**

A basic feature in the tax incentives in Africa generally is the promotion of export of non-traditional goods, as the region's economy is heavily dependent on exports of primary commodities. Wherever special economic zones or free trade areas are present, (and they are present in most African countries), the countries offer liberal exemptions from profit tax, customs duty, VAT and other generous fiscal incentives like free repatriation of its profits. Also in Africa, agriculture, manufacturing, plantation and tourism are encouraged by offering reduced tax rates and exemption from duty and VAT. This array of tax incentives were put in place to promote regional development and growth. This objective has been partly achieved.

A common trend in all the countries studied is the offer of tax holidays to investors, either fully or partially. Another trend is the prevalence of accelerated allowances, generally for investment in plant, machinery or industrial buildings, or a combination of allowances for investment in training, research and development, (R & D), or similar activities. Such allowances have the capacity of enhancing the community or immediate locality, the business environment and the overall growth of the country. Nearly all the countries studied offer export incentives. This is with a desire to boost their foreign currency earnings.

Attracting FDI is an important policy goal for all countries, as it enhances productivity and economic growth. Taxation generally, and tax incentives in particular, do not play a very significant role in attracting FDI in any country. Access to basic inputs and infrastructure are important for FDI in any country. A related

factor is the size of the market, as FDI will be encouraged by the existence of a large potential in the host country. Conversely, if demand for a particular product in a region is low and export costs are relatively high, FDI is likely to be located in an alternative site. Political stability and stability in the macro-economic environment are also important components for a successful framework to encourage FDI, especially into a developing country.

Transparency and certainty of the tax law and its administration are also crucial in attracting FDI into a country. In Nigeria, an additional requirement is the provision of security. Curbing the activities of the 'Boko Haram' sect, the kidnappers and armed robbers is imperative. Finally, corruption is a hydra-headed snake that must be tackled decisively.

**CHAPTER FIVE**  
**INTERNATIONAL TAXATION AND FOREIGN**  
**DIRECT INVESTMENT IN NIGERIA**

**5.1 INTRODUCTION**

Foreign Direct Investment, (FDI), is increasingly being recognized as an important factor in the economic development of countries. Besides bringing capital, it facilitates the transfer of technology, organizational and managerial expertise, skills acquisition as well as access to international markets. More and more countries, (both developed and developing), are therefore striving to create favourable and enabling climate to attract FDI as a policy priority, because of the strong impetus it can provide for the overall economic growth and development.

On the part of the investor firm, FDI can play an extraordinary role in global business as it can provide it with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing.

Merger and Acquisition, (M & A), of an unrelated company is a common method by which a foreign investor directly comes to do business in another country. Other methods of FDI are by incorporating a wholly owned subsidiary or company; by acquiring shares in an associated company; or by participating in an equity joint venture with another investor or enterprise; or strategic alliance with a local firm with attendant input of technology; or by licensing of intellectual property.<sup>1</sup>

In 2012, most regions of the world experienced a decline in FDI, with the exception of Chile, Spain, Indonesia, Poland and Oman, all of which experienced strong growth in inward investment projects. Chile replaced Brazil in 2012 as the star performer in FDI. In North America, most states experienced a decline in FDI, with the exception

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<sup>1</sup>. UNCTAD, Investment Report, <http://www.understandingFDI.com>, 23/10/2013

of Michigan, which achieved a 60% growth in FDI projects. In the BRIC countries, (Brazil, Russia, India and China), while a 22% growth rate in FDI projects was recorded in recent years, this declined to 17.6% in 2012.<sup>2</sup> In the same vein, most countries in Africa also experienced a decline in FDI projects in 2012. However, between January and May of that year alone, Nigeria achieved a total of over \$672 million worth of FDI projects in equity and other capital.<sup>3</sup>

So, the importance of FDI to the countries of the world cannot be over-stressed. Consequently, we, in this chapter, shall examine the meaning and types of FDI, its advantages and disadvantages, (if any), as well as the legal framework for its operation in Nigeria. We shall also discuss the impact of international taxation on FDI in Nigeria, and finally, embark on a case study of the operations of FDI in selected jurisdictions in Africa, Asia, America and Europe for comparative analysis.

## **5.2 International Taxation and FDI**

Multinational Corporations, MNCs, that invariably carry on international trade and business and thereby bring in foreign investment to a country expect to enjoy the principles of equity and neutrality under international tax law. International Taxation on capital therefore aims to address complicated issues of allocation of capital, the distribution or gains from foreign investment between home and host countries, the returns to residents and non-residents in the host country, and the relative treatment of residents in the home country with domestic income and those with foreign source income.<sup>4</sup>

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<sup>2</sup> <http://www.fdiintelligence.com.htm>, 23/10/2013

<sup>3</sup> CBN (Central Bank of Nigeria) Press Release, Oct., 2013

<sup>4</sup> Eden, Lorraine, "Equity and Neutrality in the Int'l Taxation of Capital"., Osgoode Hall Law Journal, Osgoode Hall Law School, New York University, Ontario, Canada, 1989 page 367.

In furtherance of the resolution of these and other issues under international taxation of capital, and to assist MNCs in carrying out international trade and business, the Organization for Economic Cooperation and Development, (OECD), Fiscal Committee, in 1963 adopted a Model Tax Treaty Convention on Income and Capital to clarify what is called “good behavior” in these areas. The Convention assigns the source or host country the primary right to tax business income earned within its borders. The tax base of MNCs that are mostly involved in FDI activities is allocated internationally according to the concept of a Permanent Establishment, PE. And the various affiliates of MNCs are treated as separate legal entities and income is apportioned between them with the assumption that intra-firm transaction took place at arm’s length prices. The Convention then assigns the residence or home country the right to tax remitted income, with the host country having the prior right to levy a withholding tax, and recommends that the home country grant a foreign tax credit.<sup>5</sup> This statutory provision is aimed at eliminating double taxation. But more importantly, it is also targeted at preventing fiscal evasion and transfer pricing. Fiscal or tax evasion is the refusal to pay tax at all, while transfer pricing is the transaction between two closely related companies (usually a parent company and its subsidiary), which transaction is usually not at arm’s length. Because of the benefits, both the United Nations’ (UN), and Nigeria Model Tax Treaty Convention on Income and Capital have similar provisions.<sup>6</sup>

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<sup>5</sup> Op. cit.

<sup>6</sup> For example, see Article 22 of the Tax Treaty between Nigeria and the United Kingdom



## 5.3 MEANING AND TYPES OF FOREIGN DIRECT INVESTMENT

### 5.3.1 Meaning of Foreign Direct Investments

Foreign Direct Investment, (FDI), is an “investment made to acquire a lasting interest in an enterprise operating in an economic environment other than that of the investor, the investor’s purpose being to have an effective voice in the management of the company.”<sup>7</sup>

According to Guobadia,<sup>8</sup> FDI is a component of Foreign Investment, which involves the transfer of a package of resources including capital, technology, management and marketing expertise. Such resources, the author further observed, usually have the effect of extending the production capabilities of the recipient country, and the purpose of FDI is to acquire a lasting interest and effective control in the management of an enterprise without necessarily having majority shareholding in it.

Another writer<sup>9</sup> is of the view that foreign direct investment as a “means whereby capital, technology and other managerial expertise are sourced outside the country.....”, and that it covers such activities as manufacturing, provision of services and trade.

Akper<sup>10</sup> posits that foreign investment involves “the transfer of tangible or intangible assets from one country to another for the purpose of use in the country to generate wealth under the total or partial control of the owner of the assets.” The writer, in addition, observed that foreign investment is also the injection of such foreign sourced resources directly into the real sector of the economy. The resources, he said, are

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<sup>7</sup> UNCTAD, “World Investment Report”, 1992 (UN 1992)

<sup>8</sup> Guobadia, D. A., in “Issues in facilitating foreign investment for National Development in Nigeria” FIPGW Journal, Nigerian Institute Of Advanced Legal Studies, (NIALS), Lagos, 2006 page 79

<sup>9</sup> Odiase – Alegimenlen, O. A., in “An appraisal of the legal and institutional regime for Foreign Investment Promotion and Protection in Nigeria” FIPGW Journal, NIALS, LAGOS, 2006.

<sup>10</sup> Akper, P.T., in “Infrastructural Development as an imperative for the attraction of Foreign Investment in Nigeria”, FIPGW Journal, NIALS, Lagos, op.cit, page 101

converted not just into financial (paper) assets such as shares and bonds, but factories, goods and services.

A further definition of foreign investment was proffered by Okon,<sup>11</sup> as the acquisition of physical assets and/or securities of companies by either the nationals or the government of one country in another. He said foreign investment is “a cross border acquisition of financial or physical assets. It is the use of funds in the conduct of an enterprise that distinguishes foreign investment from foreign trade.”

In a nutshell, foreign direct investment can be said to be the net inflows of investment to acquire a lasting management interest (10% or more of voting stock<sup>12</sup>) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earning and other long-term and short-term capital. Broadly, it includes mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intra company loans. In a narrow sense, FDI refers just to building new facilities.<sup>13</sup>

### **5.3.2 Types of Foreign Investment**

From the above presentation, it is clear that the term foreign direct investment is only a component or constituent of the generic term foreign investment. In other words, foreign investment includes foreign direct investment and what is also known as portfolio investment. Our discussion in the preceding paragraph relates, in the main, to foreign direct investment (FDI). Portfolio investment, on the other hand, refers to passive investment in securities, shares or bonds. Thus, while foreign direct investment refers to acquisition of substantial shares, (at least 10%), adequate enough

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<sup>11</sup> Okon, E. E., in “Foreign Investment and National Security...”, FIPGW Journal, NIALS, Lagos, op.cit, page 116

<sup>12</sup> By OECD standard

<sup>13</sup> [http://www.econlibid.org/library/encyclopedia.](http://www.econlibid.org/library/encyclopedia/), 23/10/2013, 1:09pm

to actively and effectively manage and control an entity, portfolio investment (or PI), on the other hand, is directed merely at “earning dividends, interests, and capital gains without participating in management.”<sup>14</sup> When portfolio investment carries control and management, it becomes FDI. This research is focused, in part, on FDI, as it is the main vehicle of foreign investment in Nigeria.

Guobadia<sup>15</sup> is of the view that loans to government, that is, foreign debts have also been categorized as foreign investment.

From the economist’s point of view, FDI can be further categorized into Horizontal FDI and Vertical FDI. Horizontal FDI is where a company duplicates its entire production process, or a part of it, in order to improve its competitive position in the market. The production process is replicated by the establishment of additional plants or machinery to supply different locations with its products.<sup>16</sup> Horizontal FDI is usually a substitute for international trading since the parent company replaces exports with local production (and consumption) in order to reduce costs that are otherwise involved in supplying overseas markets, such as tariffs, transport cost.<sup>17</sup>

On the other hand, Vertical FDI involves the slicing or cutting of a chain of production, and its subsequent relocation to a low-cost location. An example of Vertical FDI is the production of electronics, say in Asia, in which many other component parts and final sale may take place elsewhere, say in U.S.A, Europe or Africa. The rationale for Vertical FDI may be availability of labour, (cheap or skilled), primary commodities, intermediate goods,

Another type of foreign direct investment is platform FDI. This is where a firm invests in a destination country for the purpose of exporting its produce to a third

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<sup>14</sup> Guobadia, op.cit, page 6

<sup>15</sup> ibid

<sup>16</sup> ibid

<sup>17</sup> Aremu, J. A. op.cit. page 71

country. Thus, considering the economies of scale, it may be cheaper to produce in a particular country, and yet, the profit margins after sale may be higher in another country.

#### **5.4 AN APPRAISAL OF THE LEGAL FRAMEWORK FOR FDI IN NIGERIA**

There is always the need for a Government to strike a balance between the promotion and protection of foreign investment and curbing or controlling its activities. This is because of the obvious advantages and disadvantages of FDI, which we shall discuss in this chapter. In Nigeria particularly, it appears that the Government is more interested in the benefits that FDI can bring to the country. Thus, it has enacted many statutes and made numerous regulations and policies for the promotion and protection of FDI in the country. We shall analyze some of these statutes and policies, starting with the ground norm itself, that is, the 1999 Constitution of Nigeria, as amended.

##### **i) The Constitution.**

It appears that S.16 (c) and (d) of the 1999 Constitution of the Federal Republic of Nigeria,<sup>18</sup> gives the State the exclusive right to participate, manage, operate or control the “major sectors” of the economy. The section may be seen to be a disincentive to foreign direct investment, as this exclusive right to the State may imply that the private sector has no role to play in the management and operation of the Nigerian economy.

However, the section is only one of the many sections in chapter II of the Constitution that deal with the issue of the power of the State. Chapter II contains provisions that are merely directive of the principles of State policy. They are provisions on the general ideals, goals, objects, models, concepts, visions or dreams of the State.

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<sup>18</sup> Cap. C23, Laws of the Federation of Nigeria, 2004.

Specific provisions in chapter IV of the same Constitution actually encourage, promote and protect foreign investment in Nigeria. For example, S.43 provides that: “subject to the provisions of this Constitution, every citizen of Nigeria shall have the right to acquire and own immovable property anywhere in Nigeria.” A citizen of Nigeria would include a foreign company that was duly registered or incorporated in Nigeria, under the provisions of CAMA. From the date of registration it becomes a Nigerian company or a Nigeria citizen, since a registered company is a person in the eyes of the law.<sup>19</sup>

Another fundamental Constitutional guarantee for investment promotion and protection in Nigeria is S.44 of the Constitution. The section protects every person, company or investor against compulsory acquisition of his/its moveable property or of any interest therein in any part of Nigeria.

The protection provided by the two sections cited above are sacrosanct as they are fundamental rights of citizens, which can be ventilated by a special expeditious procedure for the enforcement of fundamental human rights. Thus, as Umenweke observed,<sup>20</sup> if the current democratic dispensation in Nigeria can be sustained, “the Constitutional guarantees against expropriation of property and other personal liberties provided for in the 1999 Constitution are adequate to safeguard investment in the Nigerian economy”.

## **ii) The Nigerian Investment Promotion Commission Act**

The Nigerian Investment Promotion Commission, (NIPC), Act,<sup>21</sup> is a general statute, which applies to the totality of the Nigerian economy.<sup>22</sup> It was enacted in 1995 to

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<sup>19</sup> Ss. 37, 38, CAMA, Cap.C20, Laws of the Federation of Nigeria, 2004

<sup>20</sup> Umenweke, M.N. op.cit. page 346

<sup>21</sup> Cap. N117, op.cit.

<sup>22</sup> Oidase – Alegimenlen, op.cit.

encourage the inflow of foreign investment into Nigeria. It is charged with the sole responsibility of “coordinating and monitoring such investment promotion activities as:

- (a) the initiation and fostering of measures to enhance the nation’s investment climate for all investors;
- (b) the promotion of investments within and outside Nigeria;
- (c) the collection and dissemination of information concerning investment opportunities and sources of investment capital, as well as advising on the availability, choice or suitability of partners in joint-ventures; and
- (d) the provision and dissemination of up-to-date information on incentives available to investors.”<sup>23</sup>

Of particular relevance to this research are the provisions of the Act relating to investment. S.17 thereof provides that with the exception of the following, viz:

- i) production of arms and ammunition;
- ii) production of and dealing in narcotic drugs and psychotropic substances;
- iii) production of military and paramilitary wears and accoutrement, including those of the Police, Customs, Immigration and Prison Services, a non-Nigerian may invest and participate in the operation of any enterprise in Nigeria.

According to Guobadia,<sup>24</sup> this enabling provision in S.17 of NIPC Act “is the kernel of government policy regarding foreign investment”. She said that, in opening up the economy to foreign investment on just about any area of the economy, the Act “represents a major shift in government policy”. This observation by the author is apt because, in the 1970s, the emphasis of government in the area of foreign investment

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<sup>23</sup> S.4(6) NIPC Act, op.cit.

<sup>24</sup> Guobadia, D. A. op.cit, page 6.

was to encourage and emphasize indigenous participation in the investment process. Thus, government restricted foreign investment or participation in some industries to 40% or 60%, with Nigerians taking up the rest. The legal framework for this indigenization policy was provided by the Nigerian Enterprises Promotion Decrees.<sup>25</sup>

Local industries were thus shielded by these protectionist policies of the government. However, when the country later began to have resort to the international financial institutions and realized the need for foreign capital inflow, attempts were made to deregulate the economy. In fact, there arose a conflict of sorts in the economy. The protectionist policy of the government led to the loss of foreign investor confidence. This, in turn, limited the deregulation process of the government as foreign investment came only in trickles, if any at all. Consequently, the government had to repeal the Indigenization Decrees and the Exchange Control (Anti-Sabotage) Decree № 7 of 1984. These Decrees were replaced by the Foreign Exchange (Monitoring and Miscellaneous Provisions) Act of 1995, (The FFMM Act), and also the NIPC Act of 1995, both of which seek to throw open the investment field to all foreigners and Nigerians alike.

The NIPC Act specifically seeks to promote and protect FDI by guaranteeing:

- a) unconditional transferability of funds in freely convertible currency of dividends or profits (net of taxes) attributable to the investment;
- b) transferability of payments in respect of loan servicing where a foreign loan has been obtained; and

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<sup>25</sup> Of 1972 and 1989

- c) the remittance of proceeds (net of all taxes), and other obligation in the event of a sale or liquidation of the enterprise or any interest attributable to the investment.<sup>26</sup>

S.25 of the Act also provides guarantees against expropriation and nationalization. Where acquisition of such an enterprise has to take place in the national interest under a law providing for payment of fair and adequate compensation, such compensation shall be paid without undue delay. And such compensation may also be repatriated in convertible currency.

Also protective of FDI are the dispute settlement procedures under the NIPC Act. The Act provides that in the event of disputes between a foreign investor and any government in Nigeria, where there exists a bilateral or multi-lateral agreement on investment protection between the Federal Government of Nigeria and the home government of the foreign investor, such disputes shall be settled within the framework of such an agreement,<sup>27</sup> or in accordance with any other national or international machinery for the settlement of such disputes, which the parties may agree upon.<sup>28</sup>

These, indeed, are laudable provisions. However, the realities on ground do not justify the abandonment of the indigenization policy in favour of deregulation of the investment climate. It has been argued in some quarters that “there is not enough or any good faith on the part of the foreign investor as he simply milks the system for next to nothing while nothing commensurate is left by way of returns for the host country”<sup>29</sup>. For example, Guobadia<sup>30</sup> observed that these incentives in the NIPC Act can easily be manipulated by a foreign investor to the detriment of the host country.

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<sup>26</sup> S.24, NIPC Act

<sup>27</sup> S.26(2), NIPC Act

<sup>28</sup> S.26(2)(c)

<sup>29</sup> Guobadia, D. A. op.cit.

<sup>30</sup> *ibid*



For instance, she said that, in exercising the right to transfer payments in respect of loan servicing for foreign loans, a foreign investor may arrange his affairs in such a way as to reflect the existence of a foreign loan. Such loan transaction, the jurist further observed, may not really be transactions at arms length between unrelated interests. In like manner, the right to remit all proceeds of a sale and any interest attributable to the investment “could be exercised in such a manner as to leave a hollow shell behind”.

One cannot agree more with the jurist. For, the primary interest of a foreign investor is profit maximization. Development of the host country is usually of little or no concern for him. So, there is the need for close monitoring of the activities of foreign investors in Nigeria.

**iii) The Foreign Exchange (Monitoring and Miscellaneous Provisions) Act of 1995, (The FEMM Act)<sup>31</sup>**

“This law is the antithesis of the Exchange Control Decree of 1962, (as amended), and the Exchange Control (Anti-Sabotage) Decree № 7 of 1984”<sup>32</sup>. It repealed the two earlier laws and seeks to liberalize the foreign exchange regime through the establishment of an Autonomous Foreign Exchange Market. The law authorizes any person, including a non-Nigerian, to deal in, invest in, acquire or dispose of, create or transfer any interest in securities and other money market instruments whether denominated in foreign currencies in Nigeria or not.<sup>33</sup> It further provides that any person may invest in securities traded on the Nigerian Capital Market or by Private Placements in Nigeria<sup>34</sup>. The FEMM Act also guarantees unconditional transferability of funds through an Authorized Dealer in freely convertible currency, relating to:

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<sup>31</sup> Now Cap. F34, Laws of the Federation of Nigeria, 2004

<sup>32</sup> Odiase – Alegimenlen, op.cit. page 11

<sup>33</sup> S.26(1) FEMM Act., op.cit

<sup>34</sup> Ibid, S.26(2)

- a) dividends or profits, (net of taxes), attributable to the investment;
- b) payments in respect of loans servicing where foreign loan has been obtained;  
and
- c) the remittance of proceeds, (net of all taxes), and other obligations in the event of sale or liquidation of the enterprise or of any interest attributable to the investment.<sup>35</sup>

The aim of these provisions is to inject scarce foreign capital into the Nigerian economy. The FEMM Act compliments the NIPC Act, and the combined effect of both laws is to liberalize the country's investment climate, by encouraging the inflow of foreign investments as investors will now have relative freedom to import and export capital, as well as purchase securities and other money market instruments in any currency.

iv) **The Nigeria Export Processing Zones Act of 1992**<sup>36</sup>

As observed earlier in Chapter Three of this work, export processing zones are designated physical areas set aside by government to encourage foreign investment in the production of goods for export.

The export processing zones scheme is a clear attempt to attract foreign investment into the country. Some of the provisions of the Act try to address underlying concerns of the prospective investor, such as the permission granted by law to employ foreign managers and other qualified personnel and the non-applicability of legislative provisions pertaining to taxes, levies or duties.

However, even though the intention of the law is that production in the export processing zones be targeted at the export market to earn foreign exchange, it has

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<sup>35</sup> Ibid, S.15(4)

<sup>36</sup> Now Cap. N107, Laws of the Federation of Nigeria, 2004

been observed that the bulk of the goods produced in the zones have found their way into the Nigerian market.<sup>37</sup>

Furthermore, all the commendable provisions contained in the enabling statutory framework are only one of the several requirements for attracting and promoting foreign investment in Nigeria. The socio-economic and political environment must also be conducive.

v) **The Intellectual Property Law**

The Copyright Act<sup>38</sup> and the Trademark Act<sup>39</sup> and Patents and Designs Act<sup>40</sup> are also important legal framework for FDI in Nigeria. This is because Multinational Corporations, (MNCs), that are mainly involved in FDI, control both the capital and technology market, and for them to invest in any nation, they need statutory guarantees that their technology will be safe and protected, especially from piracy. In fact, developed nations would not encourage their companies to invest in places where their technology will not be protected.<sup>41</sup> So, intellectual property rights legislation is a significant aspect of foreign investment promotion. In Nigeria, there are three main statutes that regulate intellectual property. These are:

- a. The Copyright Act;<sup>42</sup>
- b. The Trademarks Act;<sup>43</sup> and
- c. The Patents and Designs Act<sup>44</sup>.

These laws ensure that the incoming technology and rights protected works, (like films), are protected such that they will not be utilized without the permission of the

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<sup>37</sup> Odiase –Alegimenlen, op.cit.

<sup>38</sup> Cap. C28, Laws of the Federation of Nigeria, 2004, in S.5

<sup>39</sup> Cap. T13, Laws of the Federation of Nigeria, 2004, in S.44

<sup>40</sup> Cap. P2, Laws of the Federation of Nigeria, 2004, in S.3

<sup>41</sup> Guobadia, D. A. op.cit.

<sup>42</sup> Op.cit

<sup>43</sup> Op.cit

<sup>44</sup> Op.cit

owner. Use of the technology or copyrighted work is usually on the payment of a fee, (which is often quite exorbitant). In addition, once technology is registered in a State, it is not available for use by other parties in that State.

vi) **The Arbitration and Conciliation Act**

The Nigerian Arbitration and Conciliation Act<sup>45</sup> is based on the rules of the United Nations Commission on International Trade Law, (UNCTRAL). According to Odiase-Alegimenlen,<sup>46</sup> the importation of this international instrument into Nigeria is an attempt to assure the foreign investor that there is a mutually acceptable and fast mode of settling commercial investments disputes in Nigeria. The advantages of Arbitration as a quick, confidential and efficient means of resolving disputes involving foreign investors is an incentive to them. Specifically, the rules contained in the International Centre for the Settlement of Investment Disputes, (ICSID), are applicable to the foreign investor. In addition, another independent arbitration forum, known as the Regional Centre for International Commercial Arbitration was also established in Lagos to cater especially for foreign investment disputes.<sup>47</sup> Its function is to assist in the settlement of foreign investment disputes in a fast, efficient and effective manner. It administers the UNCTRAL rules and enforces arbitral awards. It makes use of all dispute resolution mechanisms like negotiation, mediation, and conciliation, and its jurisdiction covers all international commercial transactions. Because of its status as a private sector endeavour, it is more likely to enjoy the confidence of the foreign investors than government bodies.<sup>48</sup> However, arbitration under the Regional Centre for International Commercial Arbitration, like all other arbitrations, is subject to an agreement by the parties to that effect. Commercial

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<sup>45</sup> Cap. A18, Laws of the Federation of Nigeria, 2004

<sup>46</sup> Op.cit

<sup>47</sup> ibid

<sup>48</sup> ibid

agreements usually have arbitration clauses, containing mode of settlement of disputes, the body that will arbitrate and venue of arbitration. The importation of international instruments of arbitration will, no doubt, boost foreign investor confidence in Nigeria, what with the loss of faith in our judicial system.

vii) **Tax Reliefs**

We have, in Chapters Three and Four of this work, discussed tax reliefs or incentives for FDI in Nigeria. Thus the provisions of the Personal Income Tax Act, the Companies Income Tax Act, the Petroleum Profits Tax Act, and the Capital Gains Tax Act have all been analyzed in relation to FDI in Nigeria. There is no need repeating the discussion here.

However, it is imperative to mention a law that appeared to have also been targeted specifically at foreign investment in Nigeria and that is The Industrial Development (Income Tax Relief) Act.<sup>49</sup> This law has been in existence since 1971, and it was enacted to provide tax reliefs for certain industries designated pioneer industries, with a view to encouraging their development in Nigeria. The Act sets out the conditions under which an industry will be granted a pioneer status. And where an industry is granted a pioneer status, it is entitled to income tax relief for three years, subject to renewal for either one more year or one period of two years. This extension of the period of relief will only be granted where the appropriate authority is satisfied with:

- a) the rate of expansion, standard of efficiency and level of development of the company;
- b) the implementation of any scheme:

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<sup>49</sup> Cap. 17, Laws of the Federation of Nigeria, 2004

- i) for the utilization of local raw materials in the processes of the company; and
  - ii) for the training and development of Nigerian personnel in the relevant industry;
- c) the relative importance of the industry in the economy of the country.<sup>50</sup>

According to Guobadia,<sup>51</sup> these conditions compare favourably with the aims and potential benefits of foreign investment in Nigeria. The benefit of pioneer status is available to the foreign investor, particularly one who wishes to establish a viable industry in the country. There is also an added advantage where a foreign investor chooses to locate his industry in a part of the country considered to be economically disadvantaged. According to the jurist, that decision could facilitate the even development of the different parts of the country.

#### viii) **Other Legal Frameworks**

- A. Nigeria also has some regulations on FDI, such as the (i) Investment Procedures Regulation And Operational Guidelines For Free Zones in Nigeria, (2004), and (ii) the Oil And Gas Export Free Zone (OGEFZ) Regulations, (2003).
- B. Furthermore, Nigeria is a party to Bilateral Investment Treaties (BITs) with 21 countries of the world,<sup>52</sup> including the UK, France, China, Netherlands, Switzerland, Germany, Turkey, among others.

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<sup>50</sup> Ibid, S.10(3)

<sup>51</sup> Op.cit

<sup>52</sup> <http://www.cia.gov.libidrary.com> 27/10/2013

C. Nigeria is also a member of the following organizations, and is therefore bound by their rules:

i) **World Trade Organization, (WTO)**, which is a trade organization established to encourage the free flow of international trade. WTO administers the various Agreements<sup>53</sup> that regulate trade among nations, just as it facilitates trade interaction and discourages unfair trade practices. WTO therefore provides an international forum for the regulation of foreign investment. Foreign investment is an aspect of international trade, because Transnational Corporations, TNCs, that engage in international trade are the owners of both capital and technology, the basic ingredients of international trade and foreign investment.<sup>54</sup>

ii) **World Intellectual Property Organization, (WIPO)**. This is a specialized agency of the United Nations system that administers Agreements in respect of protection of international intellectual property. TNCs own a lot of intellectual property, and so, the general protection of that property is usually a basic feature in efforts to attract foreign investment. Intellectual property includes Patents, Trademarks, Copyright and Designs.

iii) **International Centre for Settlement of Industrial Disputes, (ICSID)**.

All interactions or commotions sooner or later result in misunderstandings of the magnitude that require a mechanism for resolving them. In the case of international investments, it is necessary to have an acceptable and effective body or method that can resolve such disputes. Such a body must be neutral and must also inspire confidence in the foreign investors. So

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<sup>53</sup> For example, Trade-Related Aspects of Intellectual Property Rights (TRIPS)

<sup>54</sup> Odiase –Alegimenlen, op.cit. page 20

nations usually draft an international code on dispute settlement, which is usually based on the ICSID draft code. Nigeria is a signatory to the agreement on ICSID draft code, and she has, in fact, adopted it in S. 26(3) of the NIPC Act. The intention is to provide an alternative means of settling an international dispute outside the nation`s law, and thereby reassure the foreign investor in his dealings with the government.

iv) **Multilateral Investment Guarantee Agreement, (MIGA).** To a foreign investor, investing in a developing country like Nigeria is fraught with risks, what with, for example, the unending security challenges of the country. In addition, there is also the likelihood of a change in laws, policies and even the general operating climate. So, measures are usually taken to protect international capital at both national and international levels. The Multilateral Investment Guarantee Agreement, (MIGA), then comes handy, as it is an investment insurance scheme established through an international convention. It is an insurance facility for member nations and enterprises registered under it. It helps to boost the confidence of the foreign investor that his capital will be adequately protected.

Apart from the statutory or legal framework discussed above,<sup>55</sup> other factors that the Nigerian government need to address in order to promote, protect and maintain investor`s confidence is that of stability in economic policy. Stability or consistency in policy is very crucial, because an investor ought to be able to take far-sighted decisions and plan or project on a long-term basis. Thus, a change in government should not necessarily lead to a change in policy.

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<sup>55</sup> Ibid, page 23



In addition, the protracted problem of infrastructure has to be tackled head-long. Good system of transportation, good roads, adequate water supply, stable electricity and sound financial infrastructure are essential in the effort to promote and protect FDI in Nigeria.

## **5.5 ADVANTAGES AND DISADVANTAGES OF FDI IN NIGERIA**

### **A. The Advantages/Benefits**

“The most profound effect [of FDI] has been seen in developing countries, where yearly, foreign direct investment flows have increased from an average of less than \$10 billion in the 1970’s to a yearly average of less than \$20 billion in the 1980’s, to explode in the 1990’s from \$26.7 billion in 1990 to \$179 billion in 1998 and \$208 billion in 1999, and now comprise a large portion of global FDI.....Driven by mergers and acquisitions and internationalization of production in a range of industries, FDI into developing countries [in 2004] rose to \$636 billion”<sup>56</sup>

Nigeria is a chief beneficiary of FDI, which is seen as an important catalyst for economic growth in the country. FDI is also a valuable vehicle of technology transfer from developed countries to developing ones, just as it stimulates domestic production and facilitates improvements in human capital and institutions in the host country.

The Nigerian Investment Promotion Commission, (NIPC) reported recently that African Textiles Manufacturing Ltd, a Nigeria/India joint venture company, invested over \$1.9 billion in the country, and thereby created 1,425 jobs. In the same year, West Africa Portland Cement, (a wholly foreign company), invested \$43,308,464.00, (with N300 million equity) in Nigeria, and also created 611 jobs.

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<sup>56</sup> UNCTAD, Investment Report, op.cit, 27/10/2013

In 2003, according to the NIPC report, Dufil Prima Foods Ltd and Food Agro & Allied Industries ltd, (both of which are foreign companies), invested \$2,250,000.00 and \$3,746,242.19 in the country, and created 256 and 1,098 jobs, respectively.

In 2004, another wholly foreign enterprise, Apex African Gas ltd, invested \$1,581,525.40 and created 100 jobs in Nigeria. And in 2005, Amioun Steel ltd, MINL ltd and Global Infrastructure Nig. ltd invested a total of over \$2 billion in Nigeria, and created over 4,000 jobs. These three companies were wholly foreign owned, and they were engaged in manufacturing business.<sup>57</sup>

**i) Financial and Investment Resources**

From 1970 to 2011, Net Capital Inflow from Foreign Direct Investment in Nigeria is as follows:-

1970	\$205,000,000.00
1971	\$286,000,000.00
1972	\$305,000,000.00
1973	\$373,000,000.00
1974	\$257,000,000.00
1975	\$470,000,000.00
1976	\$339,000,000.00
1977	\$440,514,200.00
1978	\$210,933,300.00
1979	\$309,598,900.00
1980	\$739,870,000.00

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<sup>57</sup> NIPC, Dept. of Investor Relations, or [www.nipc.nig.com](http://www.nipc.nig.com) 28/10/2013

1981	\$542,327,300.00
1982	\$430,611,300.00
1983	\$364,434,600.00
1984	\$189,164,800.00
1985	\$485,581,300.00
1986	\$193,214,900.00
1987	\$610,552,100.00
1988	\$378,667,100.00
1989	\$1,884,250,000.00
1990	\$587,882,900.00
1991	\$712,373,400.00
1992	\$896,641,300.00
1993	\$1,345,369,000.00
1994	\$1,959,220,000.00
1995	\$1,079,272,000.00
1996	\$1,593,459,000.00
1997	\$1,539,446,000.00
1998	\$1,051,326,000.00
1999	\$1,004,917,000.00
2000	\$1,140,138,000.00
2001	\$1,190,632,000.00
2002	\$1,874,042,000.00
2003	\$2,005,390,000.00
2004	\$1,874,033,000.00
2005	\$4,982,535,000.00

2006	\$4,854,417,000.00
2007	\$6,034,971,000.00
2008	\$8,196,606,000.00
2009	\$8,554,841,000.00
2010	\$6,048,560,000.00
2011	\$8,841,953,000.00 <sup>58</sup>

The Central Bank of Nigeria, (CBN), in 2013, released the Net “International Investment Position of Nigeria” in billions of Naira. The following are the net figures, because the liabilities of the companies involved were first deducted from their assets to give a net value. The figures cover between 2005 and 2014.

2005	-	₦2,859.2
2006	-	₦709.2
2007	-	₦1,036.6
2008	-	₦1,958.2
2009	-	₦740.8
2010	-	₦2,421.6
2011	-	₦3,151.4
2012	-	₦2,466.9
2013	-	₦5,562.5
2014	-	₦10,258.6 <sup>59</sup>
<b>Total</b>	<b>=</b>	<b>₦31,165.00</b>

(Thirty-one trillion, one hundred and sixty-five billion Naira only)

<sup>58</sup> NIPC, Dept. of Investor Relations, or [www.nipc.nig.com](http://www.nipc.nig.com) 29/10/2013

<sup>59</sup> CBN Annual Statistics Bulletin, vol.25, December, 2014

And in October, 2012, the European Union (EU), was reported to have said that its stock of investment in Nigeria had hit 30billion Euros (about N6 trillion).<sup>60</sup> Head of delegation of the EU to Nigeria and the Economic Community of West African States, (ECOWAS), David Macrae, who disclosed this in Lagos on 4<sup>th</sup> Oct. 2012, said this development was a reflection of the interest the EU has in Nigeria. He said the Union is committed in the negotiations of an Economic Partnership Agreement with Nigeria and the West African region with the ECOWAS, adding that the Agreement is an opportunity for Nigeria in terms of attracting foreign investment to the non-oil sectors and improved access to the EU market and economic governance.<sup>61</sup> Macrae gave the break-down of the sectoral investments to include N20 billion invested to support the justice, anti-corruption and drugs sectors, N16 billion to finance the implementation of the second phase of the water supply and sanitation projects in Anambra, Cross River, Jigawa, Kano, Osun, and Yobe States, N9.2 billion for the funding of micro-project programmes in the nine Niger Delta States under the 9<sup>th</sup> European Development Fund.<sup>62</sup>

Furthermore, at the end of 2012, the United Nations Conference on Trade and Development, (UNCTAD), reported that Nigeria tops the chart as the biggest destination for FDI in Africa in 2011, with \$8.92 billion. This is contained in its 2012 World Investment Report.<sup>63</sup> Nigeria, the report added, has beaten South Africa to a second position, and it attributed Nigeria's impressive performance to oil (as the major means of attraction), and the general positive economic outlook in sub-Saharan Africa.

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<sup>60</sup> Daily Trust Newspaper, Friday, 5th Oct. 2012, page 17

<sup>61</sup> *ibid*

<sup>62</sup> *ibid*

<sup>63</sup> Sunday Trust Newspaper, 16th Dec., 2012, page 27.

Earlier on, in September 2012, the Nigerian Minister of Trade and Investment, Mr. Olusegun Aganga, predicted that Nigeria will attract fresh FDI worth \$12 billion, (about N1.89 trillion), into the country within the next four years through the proposed “Train 7” of the Nigeria Liquefied Natural Gas project. He said the project is also expected to generate additional \$3 billion revenue for the Federal Government annually, and create about 13,000 new jobs.<sup>64</sup> The “Train 7” project is the planned expansion and diversification of the operations of the Nigeria Liquefied Natural Gas in seven areas of petrochemicals, textile, plastic, chemical and pharmaceutical industries.

In addition, on Thursday, 1<sup>st</sup> August, 2013, the Managing Director and Country Chair of Shell Petroleum Development Company (SPDC) in Nigeria, Mr. Mutiu Sunmonu, disclosed that between 2008 and 2011, the Multinational Company, (MNC), generated \$69 billion revenue to the Federal Government of Nigeria.<sup>65</sup> The Managing Director said this huge revenue represented taxes and royalties remitted to the government between the four years. Shell Petroleum Development Company is a major player in foreign direct investment in Nigeria. And its impact in the economic growth and development of the country is quite enormous. For example, in the same report, Mr. Sunmonu said the company contributed \$178 million to the Niger Delta Development Commission, (NDDC) in 2011, and another \$103million was invested in addressing social and economic development challenges in the same Niger Delta region.<sup>66</sup> The Managing Director also informed the world that Shell paid \$635 million into the Federal Government’s education fund in the last five years, and awarded \$2.4

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<sup>64</sup> Daily Trust Newspaper, Wednesday, 20th Sept., 2012, page 19

<sup>65</sup> The Nation Newspaper, Friday, 2nd August, 2013, page 11

<sup>66</sup> *ibid*

billion contracts in 2011 to indigenous contractors, representing 64% of the total expenditure on contracts during the year<sup>67</sup>.

Another FDI from which Nigeria has benefitted tremendously is that done by the mobile communications giant, the Mobile Telecommunications Network, (MTN). A South African company, MTN was recently reported to have invested about N9 billion in executing projects in 338 locations across the 36 States of Nigeria through its Foundation, the MTNF.<sup>68</sup> The Corporate Services Executive of the company, Mr. Akinwale Goodluck said such projects include MTN-Science and Technology Scholarship Scheme, MTNF-Scholarship Scheme for the Blind, MTNF-Rural Telephone Projects and MTNF-Emergency Relief Fund.

According to Aremu,<sup>69</sup> these “external financial resources” made available to the host economy of Nigeria by FDI for development purposes is very significant, because it is based on a long-term view of the market, the growth potential of the economy and the structural characteristics of the country. For this reason, he said, it is “less susceptible to reversals and volatility in adverse circumstances such as during financial crisis .....” The economist said this is so because FDI is usually involved in the creation of physical assets, which do not easily perish, and which cannot be easily disposed of at volatile times.<sup>70</sup>

One cannot agree more with Aremu, because, in FDI, it is only when the project that was financed yields returns that profits are repatriated to the home country. Consequently, FDI does not create debt, unlike bank credits, for example. In any case, parts of the profits realized by FDI are usually reinvested in the host economy, either directly or through the multiplier effects. Furthermore, of all other sources of capital

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<sup>67</sup> *ibid*

<sup>68</sup> The Nation Newspaper, Thursday, 19th Sept., 2013, page 59

<sup>69</sup> Aremu, *op.cit*, page 37

<sup>70</sup> *ibid*

such as bank credits, bonds or even portfolio equity capital, FDI remains the only one that practically internalizes foreign savings. So, MNCs that bring in FDI can thus affect investment directly through their own investment activities in the host countries and indirectly by affecting other indigenous or local firms in the host economies.<sup>71</sup>

Thus, the advantage or benefit of the provision of financial and investment resources by FDI to Nigeria cannot be over-emphasized. This is because the country's access to foreign capital and investment opportunities is limited. Yet, the country is in urgent need of foreign capital and investment, what with its growing population, vis-à-vis dilapidated infrastructure in roads, power, housing, education, health services, .

## **ii) Technology transfer**

This is arguably one of the most important reasons why host countries attract FDI in their countries. Virtually all the countries studied in the preceding chapter offer generous tax incentives to foreign investors that engage in research and development, (R & D), that is, foreign firms that innovate, invent, develop, create or devise new technology and expand the frontiers of knowledge in science and technology for development. Technology facilitates globalization. Yet, it has been argued that there is nothing like 'technology transfer' as no nation would willingly transfer its technology to another, for that would adversely affect the competitive advantage it may have over that other.<sup>72</sup>

Be that as it may, there is no doubt that MNCs introduce new machinery, plants, technology or what is generally called technical know-how into host countries. These new inputs naturally accompany their investment, and they are consciously or

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<sup>71</sup> *ibid*

<sup>72</sup> Moghalu, K.C., Deputy-Governor, CBN, on "One-on-One" NTA Programme, 9th Oct., 2013.



unconsciously applied, absorbed and integrated into the production process in the host economies.

Technology transfer is effected or achieved through four interrelated channels:

- a) vertical integration with suppliers or purchasers in the host countries;
- b) horizontal integration with competing or complementary companies in the same industry;
- c) migration of skilled labour; and
- d) the internalization of R & D.

What is popularly referred to as a 'spillover' in FDI is nothing more than backward vertical integration with local suppliers or purchasers in host countries. That is, a spillover effect is when foreign affiliates of MNCs bring in more efficient technical capabilities, know-how, new products, processes, , that simultaneously accompany their investment. The spillover effect occurs when domestic firms in host economies of FDI are integrated into the application of these modern production processes, such that they leave a long-lasting effect in the economy.<sup>73</sup>

The benefits of spillover effects of FDI to a developing country like Nigeria can be phenomenal indeed. However, such effects depend on the general market conditions, as well as the level of technological preparedness of the country before the arrival of the TNCs. For example, for inflow of TNCs to result in a positive spillover effect on domestic firms, the host country must:

- a) have effective industrial policies in place;
- b) possess a strong local labour skill base;
- c) allow competition through an export oriented trade policy;

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<sup>73</sup> *ibid*

- d) provide and support domestic research institutions to carry out R & D programmes; and
- e) provide conducive operational conditions for TNCs.<sup>74</sup>

Nigeria still has a long way to go in the technology transfer rhetoric. For, after over 50 years of independence, Nigeria is still technologically dependant on Europe, America, and surprisingly even Asia and the Pacific region. Even though Peugeot exports its parts from France into Nigeria, the later has not, even after over five decades, been able to manufacture a single Peugeot car, or any type of car, for that matter. The same argument can be advanced for virtually every modern appliance or devise for the basic convenience and comfort of life. Hot as the weather in Nigeria can sometimes be, it has not been able to produce a single air-conditioner, refrigerator or even a fan. And even though agriculture is the predominant occupation of most Nigerians, not a single tractor has been manufactured in the country. Thus, even though FDI in Nigeria dates back to the 19<sup>th</sup> century<sup>75</sup>, the country remains heavily dependant on the import of virtually everything, from automobiles to bicycles, electronic and electrical appliances to even rice!

#### **iv) Enhancement of Export Competitiveness**

The comparative advantage of most developing countries lies in primary commodities as well as cheap unskilled-labour-intensive production.<sup>76</sup> As a pre-requisite for development therefore, these economies have to upgrade, enhance or boost their production capacities and structures. Consequently, many developing countries expect MNCs to assist them in this aspect, as this is the only way that their comparative

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<sup>74</sup> *ibid*

<sup>75</sup> With the coming of the Royal Niger Company, John Holts, CFAO and SCOA.

<sup>76</sup> Aremu J. A. *op.cit* page 49

advantage can be achieved. Developing countries expect MNCs to help them achieve this goal from the angle of exports of primary products to the export of locally manufactured goods.

According to an author,<sup>77</sup> two reasons account for why developing countries expect FDI, (through MNCs), to help them boost this comparative advantage.

- a) MNCs are generally better placed to transform the domestic economic resources, skill and technical competence towards the modern realities for export production. They also find it easier to overcome the cost of marketing, brand name and other assets needed to generate exports. A study conducted by the UNCTAD, (United Nations Conference on Trade and Development), according to Aremu, established a significant positive relationship between FDI inflows and export performance of 19 countries, including Argentina, Malaysia Indonesia and India. The positive relationship was stronger for developing countries than their developed counterparts like France, UK, Finland and China.<sup>78</sup>
- b) The second reason why developing countries woo FDI towards enhancing their export sector is based on the fact that MNCs act as catalysts for restructuring domestic enterprises that are directly involved in activities linked to their affiliates, and indirectly by the consequent emerging competition between domestic and foreign firms. That is FDI is not just an international transfer of capital, but also the extension of competitive enterprise from its home country into the foreign host country. This extension of enterprise involves flows of capital, technology and entrepreneurial skills. In more recent times, it also involves inflow of management practices to host countries. The

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<sup>77</sup> ibid

<sup>78</sup> ibid

internalization of these advantages to host countries enables them to learn, emulate and imbibe them, with the aim of not only using them locally, but also exporting them at a later stage. On their own, most developing countries would not be able to begin the process that would later lead to competitive export capabilities. South Korea and Taiwan provide good examples for Nigeria. These two countries succeeded, through these “domestic linkage opportunities” provided by FDI in their countries, to acquire technological competence, and with government support, were able to penetrate into the export markets with their products.<sup>79</sup> The local firms in these two countries, learning from the MNCs in their countries, increased their level of competence to the extent that they became international competitors also.

Consequently, they engaged in independent R & D activities to copy, absorb and create prototypes of MNCs technologies.

Nigerian local firms should therefore establish greater links or bonds with the MNCs operating in the country and endeavour to satisfy the corporate requirements and international standards that MNCs expect of them. In particular, Nigerian indigenous firms should jettison the tendency to be parasitic or dependant on MNCs, but should, instead, exhibit some level of their own competence and independence, by acquiring essential information, experience, expertise and contacts as well as human and financial resources. In fact, as Aremu puts it, “indigenous firms aspiring to gain recognition in international markets for their products must be strong and be able to invest

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<sup>79</sup> *ibid*

sizeable amount of funds to develop an acceptable independent brands.....or licence from an established TNC.”<sup>80</sup>

## **B. Disadvantages of FDI in Nigeria**

Our discussion so far would seem to suggest that FDI can only portend good for Nigeria. However, looking at the other side of the coin, there are disadvantages of FDI in Nigeria.

### **i) Portfolio Investment**

In spite of the advantages of FDI enumerated above, there is a school of thought that, in reality, what Nigeria witnesses in the drive for FDI is portfolio investment, that is, foreign companies and individuals come to Nigeria to sell their finished products and go back to their home countries, without leaving any trace of real investment in the country. Portfolio investment also involves passive investment by earning dividends, interest and capital gains without actively participating in the management of an enterprise.<sup>81</sup> In other words, MNCs use FDI more as a market entry strategy rather than an investment strategy. Foreign companies and individuals come to Nigeria with their briefcases and containers, sell their finished products or acquire dividends or interests and leave, without any real, meaningful, positive impact on the Nigerian economy.

### **ii) Dumping of foreign goods**

Closely related to the above disadvantage is the practice of dumping finished, sub-standard goods or products in the Nigerian markets by these foreign investors.

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<sup>80</sup> Ibid, page 54

<sup>81</sup> Guobadia, D. A., op.cit

The systematic flooding of Chinese products into the Nigerian markets is very well organized and coordinated. The main outlet is the popular China Town in Lagos, from where major markets in Lagos and other parts of Nigeria are infiltrated. Apart from the China Town market, Chinese investors go round other markets like the Alaba International market and the Balogun market in Lagos looking for more channels to ship and dump their sub-standard products. The popular Computer village in Ikeja, Lagos, is almost like a Chinese colony,<sup>82</sup> with innumerable computer accessories and mobile phones from China.

China is `exporting` (or dumping) these and other goods, (like textile materials, bags, generators, wears), at rock-bottom prices to Nigeria, and because Nigerian consumers are highly price-sensitive, they keep buying them without bothering about their quality.

Other Asian countries, (like South Korea, Japan, Taiwan, Hong Kong), are also involved in this dumping exercise. None of them has cited an industry in Nigeria for manufacturing any of their products in the country. For example, no automobile company has even an assembly plant for Toyota, Honda, Kia or Hyundai cars in Nigeria, in spite of the large market that there is in the country for these products.

### **iii) Technology Dependency**

The practice of dumping goods discussed above has resulted in technology dependency among Nigerians. That is, the people no longer see the need to strive to develop their own technology. Nigerians are complacent, relaxed and contented with foreign goods and products so much so that no effort is being made to create, manufacture or produce indigenous cars, computers, bicycles or even toothpicks in the country.

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<sup>82</sup> Nigerian Orient News, April 8, 2013, "The Unproductive Side of FDI", p.6, [www.nigerianorient.news.com](http://www.nigerianorient.news.com)

What is so worrisome is that, even with the establishment of the Peugeot Automobile Assembly in Kaduna over 40 years ago, not a single car has been produced in the country. Yet, Nigeria boasts of the best brains in all fields of human endeavour.

It has been argued in some quarters that FDI has not contributed significantly to the economic growth and development of Nigeria, because of:

- a repatriation of profits;
- b corruption (manifesting in contract fees, kickbacks, ); and
- c interest payment on foreign loans.

But equally instrumental is the inertia of Nigerian entrepreneurs, as demonstrated in their refusal to create or innovate their own technology or even adapt foreign technology to suit indigenous needs and circumstances.

iv) **Environmental Degradation**

The history of oil exploration in the Niger Delta of Nigeria has put people, politics and the oil industry at loggerheads. This is because oil exploration in that region, particularly in Ogoniland, has attracted a lot of criticisms in the activities of the Multinational Oil Corporations. There have been complaints of environmental degradation, serious threats to human health and total destruction of the entire ecosystems. Nothing epitomizes these problems more than the challenges associated with oil exploration and production in Ogoniland.

Consequently, the Federal Government of Nigeria invited the United Nations Environmental Programme, UNEP, to conduct an Environmental Assessment of the

oil pollution in Ogoniland, with a view to providing scientific evidence on the nature, extent and impacts of oil contamination in Ogoniland. UNEP was also mandated to determine the environmental and public health impacts of oil pollution in Ogoniland.<sup>83</sup>

Ogoniland is a kingdom situated in the Niger Delta of Nigeria, the largest river delta in Africa and the third largest in the world. It is a region covering some 1,000km<sup>84</sup> in the South East of Niger Delta basin in Rivers State of Nigeria. It has a population of close to 832,000 people, according to the 2006 National Census. It is characterized by typically deltaic features; uneven terrain, numerous creeks, shallow brackish water bodies and a variety of vegetation types including mangroves, swap forests, .<sup>2</sup>

Mangrove ecosystem in Ogoniland together with sea grasses and coral reefs, are among the world's most productive natural ecosystems. The mangrove trees and bushes are keystone species of central importance for brackish wetland ecosystems and the terrestrial and aquatic organisms which inhabit them. Consequently, mangroves are not just ecologically significant but are also critical to the livelihood and food security of the entire delta community.<sup>85</sup>

Unfortunately, UNEP found that mangroves in the creeks around Ogoniland have been badly affected by physical disturbance, both by increasing use of saturated hydrocarbons and by organic chemicals. Impacts vary from extreme stress to total destruction, for mangroves coated with oil eventually die.

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<sup>83</sup> [www.unep.org/nigeria](http://www.unep.org/nigeria), accessed on 30/8/2015, at 11:42am

<sup>84</sup> Op.cit

<sup>85</sup> Op.cit



Furthermore, UNEP's field observers and scientific investigators also found that soil contamination in Ogoniland is widespread and severely impacting many components of the environment. Ogoniland has high rainfall, and so oil spill sometimes get washed away, spreading and traversing vast farmlands, almost always ending up in the creeks. When oil reaches the root zone, crops and other plants begin to wither and experience stress and they invariably die. For example, in Ejama-Ebulu Community in Eleme Local Government Area of Rivers State, UNEP study found heavy contamination present 40 years after an oil spill occurred, despite repeated clean-up attempts.

Specific investigation on contamination of soil and groundwater revealed that pollution of soil and petroleum hydrocarbons in Ogoniland is extensive in land areas, sediments and swap land. Since there is no continuous clay layer across Ogoniland, the ground water is usually exposed to hydrocarbons spilled on the surface of the soil, sometimes at least 5m deep, thereby contaminating community wells and other portable water.

On vegetation, UNEP found that oil pollution in many intertidal creeks had left mangroves denuded of leaves and stems, leaving roots coated in a bitumen-like substance sometimes 1cm or more thick. Mangroves are spawning areas of fish and nurseries for juvenile fish and the extensive pollution of these areas is impacting the fish life-cycle. UNEP went on to observe that root crops like cassava are sometimes rendered unusable, just as other vegetation is killed by the usual outbreak of fire following oil spills.<sup>86</sup>

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<sup>86</sup> Op.cit

On aquatic life, UNEP observed that surface water throughout the creeks contains hydrocarbons. Floating layers of oil vary from thick black oil to thin sheens, which cause serious pollution of clean water, with the result that fish and fisheries get destroyed.

And on public health, UNEP found that the Ogoni community is exposed to petroleum hydrocarbons in outdoor air and drinking water, sometimes at elevated concentrations. They are also exposed to hydrocarbons through dermal (or skin) contacts from contaminated soil, sediments and surface water. Since the average life expectancy in Nigeria is less than 50 years, it is a fair assumption that most communities of the current Ogoniland have lived with chronic oil pollution throughout their lives, according to UNEP. It then gave an example of community members in Nisiosioken Ogale where drinking water from wells is contaminated with benzene, a known carcinogen, at levels over 900 times above the World Health Organization, WHO, guidelines.<sup>87</sup> This, UNEP observed, could lead to cancer. And, it went on, the same can be said of at least 28 other wells in 10 communities in Ogoniland, as they have no alternative source of clean water.

Many multinational oil companies are the culprits in this whole unfortunate saga. They are the vehicles or instruments through which foreign direct investment, FDI, is brought into the country. Environmental degradation therefore constitutes a disadvantage of FDI in Nigeria.

However, UNEP made many far-reaching recommendations. For example, at the Ogoniland community level, it recommended that all drinking water wells where

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<sup>87</sup> Timothy J. Goodspeed, *op. cit.*, page 259

hydrocarbons were detected be marked and the people be informed of the danger. It also recommended that the Federal Government should create an Ogoniland Environmental Restoration Authority and an Environmental Restoration Fund for Ogoniland. More importantly, UNEP also recommended that the Federal Government of Nigeria should set up the Hydrocarbon Pollution Restoration Project (HYPREP) to ensure the implementation of all UNEP Reports on Ogoniland. UNEP also recommended that oil companies operating in Ogoniland should make remediation in the areas of oil pollution and provide portable water to the communities.

In furtherance of this report, the Federal Government of Nigeria on Wednesday, 5<sup>th</sup> August, 2015, approved measures to fast-track the implementation of the UNEP Report on Environmental Restoration of Ogoniland.<sup>88</sup> The measures include the amendment of the official Gazette that established the Hydrocarbon Pollution Restoration Project (HYPREP) to reflect a new governance framework that will comprise a Governing Council, a Board of Trustees and Project Management, all with new compositions or members.<sup>89</sup>

## **5.6 SUMMARY**

Countries compete to attract FDI because FDI inflows help to boost productivity. FDI also encourages the diffusion of technology management know-how, just as it provides more efficient resource allocation and utilization. Domestic firms that interact with foreign subsidiaries of MNCs also benefit from these transfers of technology and knowledge. Ultimately, FDI leads to higher productivity, improved

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<sup>88</sup> Daily Trust Newspaper, Thursday, 6<sup>th</sup> August, 2015, Page 7

<sup>89</sup> Op.cit, at page 7

quality of products and increased competitiveness, among numerous other benefits. However, FDI flows between developing countries are rare except the recent development between Nigeria and South Africa.

Because of these advantages, FDI is arguably a substitute for international trade. This way, tariff barriers are avoided as MNCs now simply set up branch plants in another market. The new international trade paradigm-“integrative trade” recognizes that inward FDI be encouraged without barriers, difficulties or hiccups that WTO’s trade instruments (like TRIM),<sup>90</sup> seek to address. Thus, the most important international legal mechanism for the encouragement and governance of FDI is not any instrument under international trade. It is Bilateral Investment Treaties (BITs), signed by contracting parties, especially developing countries, to attract more FDI into their countries. Thus, the phenomenon of increased FDI inflows across the world can be attributed to Bilateral Investment Treaties (BITs) entered into by the respective countries.

Furthermore, since both rich and poor countries have generally witnessed more FDI inflows in the recent past, it means there must have been a common cause for this trend. That common precursor is sound infrastructure and institutional quality. These are what the USA, Malta and the UK have in common. And this is what CAR and Nigeria lack. So, again, there is the urgent need to improve our infrastructure, provide skilled manpower and fight insecurity and corruption frontally and decisively.

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<sup>90</sup> Agreement on Trade-Related Investment Measures (TRIMS)

## CHAPTER SIX

### SUMMARY, FINDINGS AND RECOMMENDATIONS

#### 6.1 SUMMARY

This research is built around the need to discuss and analyze the interface between the principles of international taxation and foreign direct investment, (FDI), in Nigeria. The research appraised the key components of the two concepts that formed the bedrock of the entire work. Thus, the principles of international taxation, as encapsulated in the various tax treaties entered into between Nigeria and other contracting nations, were, *inter alia*, highlighted.

Most of the provisions of these tax treaties have been incorporated into the Nigerian tax legislation, like the Free Trade Zones Act, the Companies Income Tax Act, the Petroleum Profits Tax Act, the Personal Income Tax Act and the Capital Gains Tax Act.

The effect of these analyses is that what appears as principles of international taxation have been ‘internalized’ or ‘domesticated’ in the Nigerian tax legislation. The aim is to provide a broad basis for the application of the two principal methods of international taxation, that is, the source (or territorial) rule and the residence (or world-wide) rule. In other words, a tax payer is liable to tax from wherever he derives his income or from his place of residence, respectively.

Tax incentives, *inter alia*, are the bait used in attracting foreign direct investment into a country. Thus, the various tax incentives in Nigeria were discussed and analyzed in this work. In the final analysis, we carefully crafted salient research questions targeted at the effectiveness (or otherwise) of these tax incentives both in Nigeria and other jurisdictions.

In designing tax incentives, the main aim of most developing countries is the attraction of foreign direct investment, FDI. The advantages or benefits of FDI to the country were also highlighted. Thus, a direct nexus or link between the Nigerian tax incentives regime and FDI was established in this work.

## **6.2 FINDINGS**

The prominent findings from the analysis of the principles of international taxation and foreign direct investment (FDI) in Nigeria are as follows:-

### **6.2.1 Effect of Tax Haven and Deferral practices**

To avoid payment of tax in a resident state, many companies pile up their taxable income in tax havens, that is low tax jurisdictions. Such companies hoard their taxable income in the resident states and accumulate or pile it up in countries where tax rate are minimal or non-existent.

### **6.2.2 Effect of Tax Avoidance through thin capitalization acts**

It has also been found that many companies doing business in Nigeria avoid taxation by excessive debt (or thin) capitalization, as opposed to equity capitalization. In other words, such companies usually claim that their capital is raised through debt or loan instruments, (the interest on which is tax deductible), as opposed to equity capital, raised through the issuance of shares, which is not tax deductible. The former attracts no tax, while the latter does.

### **6.2.3 Effect of Treaty Shopping**

Most multinational corporations prefer to do business in the countries that have signed treaties on tax incentives or even tax forbearance. They do this through their subsidiaries or permanent establishments, and this results in loss of much needed revenue for a country like Nigeria.

### **6.2.4 Effect of Inadequate Macroeconomic Policies**

Macroeconomic policies in Nigeria, especially in the areas of corporate tax and exchange rate, are inadequate and ineffective. For example, even after paying the corporate tax, companies' shareholders are still assessed to tax on declared dividends.

### **6.2.5 Effect of Multiplicity of Laws on FDI**

Too many laws, (constitutional law, company law and labour law), and too many government departments are involved in the attraction and regulation of foreign investment in Nigeria. This is burdensome, and it hinders foreign investment into the country.

### **6.2.6 Effect of Multiplicity of Taxes on FDI**

All the Governments of Nigeria, Federal, State and Local, have embarked on serious revenue campaigns. The effect is that companies receive tax demands from diverse and multifarious sources. Again, this is a serious disincentive to foreign investment.

## **6.3 RECOMMENDATIONS**

We stated early in this research<sup>1</sup> that the sources of international taxation include treaties, and customary international law and general principles of law. Thus, treaties form the major source of international taxation. We also stated that avoidance of

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<sup>1</sup> Chapter One

double taxation is a major reason for international taxation.<sup>2</sup> However, while nations make efforts to achieve this goal, tax authorities are also increasingly concerned with the loss of their share of domestic and global tax revenues to other countries and corporate bodies through unacceptable tax avoidance schemes.

We recommend the following measures on how Nigeria can, through its Double Taxation Avoidance Agreements, (DTAAs), avoid or minimize double taxation, and still maximize its tax revenue yields.

### **6.3.1 Anti-haven or anti-deferral measure.**

Many companies avoid current taxation in the residence State through the accumulation of taxable income abroad, particularly in low tax jurisdictions. Since Nigerian domestic laws cannot tax foreign income until it is received or remitted, the tax authorities should effectively extend the residence rules to tax passive income retained overseas by Nigerian residents, on a current basis.

### **6.3.2 Anti-Thin Capitalization Rules**

A company may be financed in two ways: (i) by equity capital, (that is, capital derived from money received through the issue of shares from shareholders), or (ii) by debt capital, (that is, capital raised through debt or loan instruments). Usually, a company is financed through both ways. A company is said to be “thinly capitalized” when its equity capital is small in comparison with its debt capital. So, thin capitalization measures that are suggested for Nigeria will prevent companies from financing their operations with high debt capital, compared with equity capital, (that is debt capital will not be disproportionate to equity capital). This is because interest paid on debt is tax deductible, while dividend payments are not. Therefore, high debt capital has the effect of reducing tax on business profits. So, under these rules, more

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<sup>2</sup> *ibid*



income will not only be available to be taxed, but interest payment by thinly capitalized companies will be minimized, and the little available may be taxed as constructive dividends.

### **6.3.3 Anti-treaty Shopping Provisions**

Treaty shopping is the use of a tax treaty by a person, (or company), who is not resident in either of the treaty countries, usually using a conduit entity resident in one of the countries. Since treaty shopping leads to a loss of tax revenues in the source State, Nigeria should have specific anti-treaty shopping provisions in its domestic laws and tax treaties. For example, there should be provisions on limitation of benefits to counter unintended treaty shoppers.

### **6.3.4 Evolving Effective Macroeconomic Policies**

Nigeria should devise sound macroeconomic policies aimed at attracting FDI. It is the opinion of this writer that some of the most effective macroeconomic policies that can affect FDI in Nigeria are the corporate tax rate and the exchange rate. A high corporate tax rate would have a negative influence on FDI location in Nigeria, as it would not only increase the cost of doing business, but it will also reduce the profits that can be earned. That is, although a high corporate tax rate would lead to increased revenue in the hands of the Nigerian government; it would also reduce the profits of companies, and thereby discourage FDI into the country. The current companies income tax rate is 30%. It is suggested that this should be drastically reduced to, say 20 or even 15% of assessable profits. This is because, after paying 30% as corporate tax, individual shareholders also pay 10% on declared dividends, which, in fact, amounts to economic double taxation. So, corporate tax should be reduced. And since dividends are franc investments (because the receiver did not directly participate in

earning them), there is really no justification in taxing it, for the person who participated in earning it, (that is, the company), had already been taxed at source. Furthermore, it is, in fact, the larger society that really bears the brunt of corporate taxes by way of increased prices paid for companies' products and services, as VAT. So, a reduction in corporate tax rate in Nigeria will not only lead to increased FDI into the country, but it will also be ultimately beneficial to the generality of the people.

The effect of the exchange rate on FDI inflow in Nigeria is no less complicated. A depreciation of the country's currency will make it cheaper for a foreign company to set up production in Nigeria, but it will also reduce the value of repatriated profits, thereby leading to low FDI in the country. So, a balance has to be struck between the two ends of the pendulum. While a depreciation in the value of the Naira will make it cheaper for FDI to come into the country, it will also reduce the value of repatriated profits, which will in turn discourage FDI in the country. It is therefore suggested that the value of the Naira be beefed up against foreign currencies, especially the American dollar. This is because big foreign conglomerates may not necessarily be dissuaded by the cost of setting up production, so long as they know that they can recoup their investments and be able to repatriate profits made in the country.

### **6.3.5 Harmonizing our laws on FDI**

Umenweke is of the view that the diversity of the laws that regulate foreign investment in Nigeria is "immense".<sup>3</sup> He said too many laws: constitutional law, law of contract, labour law, company law and land law regulate foreign investment in Nigeria, thereby making the whole process cumbersome and difficult to keep tract with. This observation is apt. In addition, there are too many departments of

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<sup>3</sup> Umenweke, M. N. op.cit., page 352

government that a foreign investor has to deal with before he can start any business in Nigeria. The foreign investor has to deal with the Corporate Affairs Commission, The Nigeria Investment Promotion Commission, the Immigration Service and the Security and Exchange Commission to make sure that he gets the necessary information and approvals for his investment in the country. Even though all of these government departments are now in Abuja, they are not in the same building or even premises.

Consequently, it is recommended that Nigeria enact a comprehensive uniform investment Act to cover all relevant laws on investment. This investment Act, in a single document, will make it easy for cross-references of the investment laws, just as it will make their review or revision easier for the legislators.

Secondly, Nigeria should provide a `one-stop shop` for foreign investors. That is, all ministries, departments, bodies or agencies of government that are responsible for, or are in-charge of foreign investment matters should be accommodated in one building or premises in Abuja. This will make it easier for a prospective foreign investor to process and get approvals for his investment from this one-stop shop, thereby reducing the stress involved in running from one end of the Abuja city to another. This will, in turn, boost foreign investment in the country.

### **6.3.6 Need for a unified tax assessment and collecting system**

The system of taxation of foreign interests in Nigeria should also be standardized. Thus, the practice where the Federal, State and Local Governments levy and collect different types of taxes on the same business, should be stopped, as this constitutes a disincentive to foreign investment in the country.

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