



STATES & LOCAL FINANCE

The IGR Initiative

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THE SIGNIFICANT GIFT OF the 21st century is the digitally-driven fast pace of change in virtually all of life's endeavours. Through a creative destruction process, everything – the way we think, work, and live, including our work tools – transforms beneficially. Like other countries, the Nigerian tax authorities have also unrolled structures and processes for capturing appropriate taxes from the transaction values facilitated through these technologies. However, tax administrations at the subnational level do not seem to be appropriating commensurate tax value as the federal. For instance, the Nigerian government intends to tax digital non-resident companies selling products to local customers at six percent (6%) of their turnover. Target services include digital applications, high-frequency trading, electronic data storage and online advertising.

Digital transformation driving the growth of the tech ecosystem also provides numerous opportunities for IGR expansion for subnational governments. Beyond computerization and information and telecommunications technologies, an interconnected and constantly evolving digital ecosystem, including the Internet, 5G networks, cloud computing, big data analytics, artificial intelligence, and blockchain technology further enlarge these opportunities. The challenge is usually in the capacity to see and optimally capture these revenue potentials. Within this technology-transforming system is an interconnected chain comprising technology innovation financiers and accelerator hubs, solution providers, tech-focused startups, a massive array of products, end customers, trading partners, digital applications, and third-party data service partners. Virtually all sectors of the economy benefit from these digital platforms and activities, which facilitate the exchange of goods and services and the resultant payments. Virtually all businesses use point-of-sale devices and mobile phones linked to a bank account. The Internet and social media have also become veritable markets for transacting.

Unfortunately, most Nigerian subnational government tax administrations cannot keep up with the pace of change orchestrated by the digital transformation of business exchange and economic activities. Subnational tax administrations must possess adequate digital capacity comprising the knowledge base and infrastructure to track, monitor, and optimise collection, effectively. However, political leader-

ship appears unwilling to make these critical investments across board.

The Finance Act of 2020 empowered the federal tax authority to tax digital businesses. These include five percent (5%) excise duties on telecommunication services provided in Nigeria. There are also electronic money transfer levies, proposed imposition of taxes on money transfers, e-commerce transactions, point of sale transactions and the power to utilise third-party payment platforms for collecting and remittance taxes due on international transactions. The 2019 Finance Act laid the foundation for ensuring that foreign business transactions leveraging complex digital technologies do not elude tax authorities' prying eyes. The amended relevant sections of the Act provided that if such business organisations with business interests in Nigeria also have a significant economic presence [SEP] in Nigeria, their profits from those activities are taxable. As good as the SEP framework was, technological complexities complicating transactions and profit traceability and the general borderless and 'non-physical-office' nature of several e-businesses and markets made implementation more complex and challenging. There were also concerns about the imposition of VAT on domestic consumers of foreign services and the burden of double taxation. The 2021 Act seemingly resolved most of the challenges associated with the profit attribution based on SEP by introducing the turnover assessment framework. The amendment provided the assessment and taxing of foreign businesses and their digital transactions based on a fair and reasonable percentage of that part of the turnover attributable to that presence. This estimated fraction is about six percent (6%) of turnover. In general, all digital transactions across the Nigerian ecosystem are now taxable through several mechanisms, including the value-added tax, withholding tax, corporate income tax, personal income tax and stamp duty.

Registered companies naturally expand their business activities by increasingly deploying digital technologies. Tax revenue opportunities are exploitable from these resultant marginal growths in corporate revenue and profitability. These opportunities are also available at the level of agents of registered companies and individual operators as long as they leverage digital infrastructure to create financial wealth. Some other tax types, such as education and technology taxes, ride on digital technologies.

Subnationals, digital services and taxation opportunities

Digital taxation opportunities for subnational governments are immense. The Internet of Things, with its various social media platforms, provides a comprehensive web-based office and a massive market for transactions. Bloggers and other social media marketers provide taxation opportunities on advert placements. The resulting collectable revenue includes value-added and withholding taxes. While these are federally collected tax items, excluding withholding tax in the case of individuals, subnational governments reap from their shares of the VAT revenue collections. But more directly, subnational tax authorities can identify and assess the income profile of these digital space users, including other professionals such as musicians and comedians whose business activities litter the Internet. They are also opportune to apply appropriate taxes to their income and staff members.

A wide array of electronic payment facilitation services also provide tax revenue opportunities for subnational governments. One good example is agency banking services. While the principals [licensed agents] offering digital services may be required to pay corporate income taxes, their operating structure usually comprises multiple kiosk-like outlets manned by a lone staff and share the same characteristics as informal roadside enterprises. Subnational governments can, therefore, expropriate such taxes as self-assessment PIT, business premises registration, development levies and so on from such operations. Similarly, by directly facilitating the emergence of the tech ecosystem, subnational governments can widen the tax base on digital services. The computer village in Lagos and the Yaba technology hub are good examples. Despite the government not necessarily facilitating their emergence, the latter taps generously from their provision of the platform for expanded digital services. By establishing technology hubs, state and local governments reap the tax benefits from software and digital application developer communities, attract accelerators, and drive the digitalization of the operations of several businesses.

Revenue optimization opportunities expand when tax administrations become digital service providers rather than merely appropriating taxes from digitally-driven transactions. With the digitalization of its services, tax authorities have become providers of digital services. However, such capacity improvement only enhances its ability to expand the size of potentially collectable revenue. Two examples suffice. Substantially integrated databases and attendant database intelligence and deployment of e-processes permitting taxpayers to

easily self-assess and file returns will not only considerably reduce the cost of the collection but will enhance taxpayer tracking and monitoring of their business activities and will generally lead to more tax revenue. Secondly, the digitalization of business premises and property ownership will in no small measure enhance the enforcement of property taxes, an area that many state and local governments consider an untapped goldmine.

As global business operations become increasingly digitised, most IRS's critical challenges in optimising tax revenue opportunities include skills and inadequate physical infrastructure. Tax administrations would contend with emerging challenges in cyber security risk management and data protection over time as they make efforts to digitalize. Albeit a national crisis, the activities of state and local government administrations in Nigeria suffer from a tremendous shortage of the right competencies for optimally exploiting tax revenue in the digital space. Subnational governments require workforce compliments that are adequately digital-aware to make a success of digital taxation. The range of challenges includes the classification and registration of digital business organisations. Since most business operations have solid digital components, such clear-cut categorizations become difficult. Tax administrations also have issues with the assessment and accrual of digital taxes, application of presumptive digital taxes and the enforcement of digital tax claims. This capacity weakness makes it challenging for state and local government tax administrations to effectively evaluate the adequacy of compliance with digital business operations and transactions. Businesses that significantly leverage digital technologies can efficiently operate in ways that enable them to successfully avoid, remove, or significantly reduce their tax liabilities. Additionally, the fast pace of digital transformation in businesses targeted by tax authorities makes it even more difficult for tax administrations that lack the technological nimbleness to keep up with that speed.

Subnational governments also face considerable political challenges in exploiting the opportunities to tax digital services. The first level of manifestation is the apparent lack of government support and funding for digital infrastructure. As pointed out, the subnational tax administration will best optimise opportunities in digital taxation by creating an enabling environment for the emergence of digital services, technological hubs, and direct investment in digital infrastructure, permitting them to track, monitor and assess digital tax-

payers easily. Again, government interference and sometimes lack of interest in digitised business operations substantially proves how political factors hinder digital tax opportunity exploitation. An often-cited example is the ban or restriction of O'ride [the commercial motorcycle equivalent of Uber and Taxify]. Other examples include the recent Twitter ban and sometimes restrictions on social media platforms. This politically motivated shrinkage of the operating space for digitised business activities also reduces the size of collectable revenue.

Beyond the general infrastructure requirements for facilitating the ease of doing business, usually provided by the government, subnational tax administrations must make specific investments for capturing the opportunities in digital taxation. These expected investments include sensors, geographic information systems, digital portals, and electronic payment system facilities. Real-time and exceptionally reliable sensor-generated data enhances digital taxpayer tracking and monitoring capacity. Some more recently developed sensors have real-time communication and self-learning capabilities, making them remarkably effective in systematically detecting tax events, reporting, and payments. Secondly, IRSs need to make solid investments in geographic information systems which permit geo-location referenced digitization of resource data. By integrating the resulting data with other vital databases, subnational governments fully hold on to most tax sources and payments.

Finally, subnational tax administrations must pay attention to evolving digital technologies and how they are changing business models and orchestrating value transformations as part of their capacity-building efforts. Complementary to capacity improvement is an investment in critical infrastructure for exploiting digital tax revenues. However, before or with all these efforts, state and local government IRS must conduct appropriate digital tax impact assessments to determine the extent to which they constitute an additional financial burden that may have a rebound effect on growth and future fiscal diversification.

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