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Tax Alert

Nigeria enters Tax treaty agreement with ECOWAS member countries

Introduction

In addition to the 16 Double Tax Treaty Agreements that Nigeria has in force, Nigeria (through an Order signed by the Minister of Finance on 1st May 2023) has now adopted the Community rules for the Elimination of Double Taxation (taxes on Income, Capital, and Inheritance) Order 2023 with member states of the Economic Community of West African State (ECOWAS). These rules have been concluded with the 14 partners within the ECOWAS bloc[1].

Overview

In the case of Nigeria, these rules apply to: Personal Income Tax, the Companies Income Tax, Petroleum Profits Tax, Capital Gains Tax, Tertiary Education Tax, and National Information Technology Development Levy.

Key provisions in the Community Rules

- **Entry into force:** Nigeria has published these rules in the National Gazette and based on the Treaty, the rules begin to apply to relevant Nigerian taxpayers from 1 January 2024.

  The Nigerian Constitution stipulates that treaties must be ratified by the National Assembly for them to become binding. It is not clear whether the Community Rules were ratified by the National Assembly. Even though the rules were gazetted, this alone should not give validity to a treaty/legislation that has not undergone the due process of ratification. However, it appears unlikely that the tax authorities would dispute the effectiveness of a gazetted instrument.

- **Permanent Establishment (PE) rules:** The conditions in the Treaty that create a PE for ECOWAS countries are largely similar to the PE rules in the Companies Income Tax Act (CITA) and other treaties. However, the Community rules include some interesting updates / peculiarities:

  A PE is created for construction, installation, assembly projects including supervisory activities carried on in Nigeria, where such activities last for 6 months in any 12 month period. Technical, management or consultancy services for the same or a connected project for the same period, will also create a PE. Therefore, a PE will not be created where such activities do not meet the 6 months time threshold.

  The Treaty seems to have introduced a semblance of Significant Economic Presence (SEP) rules for technical, management and consultancy services (jointly called "technical services") remotely provided by ECOWAS member countries. Based on the Treaty, where a resident of a member state earns technical service fees from a resident of another member state, the entity paying the fees will deduct Withholding Tax (WHT) not more than 5% (for individuals as recipients) and 10% (for companies as recipients). This will not apply to fees paid as salaries or earned from teaching in an education institution.

- **Passive Income:** Dividends, Interest and royalties paid to beneficial owners in member countries are subject to WHT at a rate not higher than 10%. While this rate aligns with the maximum WHT rate charged in Nigeria, treaties between Nigeria and some non-ECOWAS countries (such as Singapore and China) impose a lower rate of 7.5% on passive income. This may reduce the attractiveness of investments in Nigeria from the ECOWAS region, compared to these other countries.

- **Shipping, Road and Airline Operations:** Based on the Community Rules, profits derived by a resident of a member state from the operation of ships, aircraft, boats or rails or road transport vehicles in international traffic will be taxable only in that state. This will be beneficial for operators of shipping, road and airline activities within the region as relevant income will only be taxed in the state where the provider is resident.

- **Capital Gains on disposal of shares:** Gains derived from the disposal of shares will be subject to Capital Gains Tax (CGT) only in the country of the shareholder, unless the company whose shares were disposed or transferred derived more than 50% of its value directly or indirectly from immovable property.

- **Non-discrimination:** Nationals of a member state shall not be subjected in another member state to any taxation requirements that are more burdensome than the taxation requirements that would apply to nationals of that state in the same circumstances.

The takeaway

Regional tax treaties such as the ECOWAS Community Rules boost regional trade and investment by eliminating the possibility of double tax on income earned by residents of member states. The benefits of these rules in addition to the acceleration of intra-African trade through the African Continental Free Trade Area Agreement (AfCFTA) present significant opportunities for Africa and boosts its trading position globally.

This signing of this treaty also showcases the political commitment for regional integration across the ECOWAS nations. However, the announcement of Mali, Burkina Faso and Niger notice to exit the ECOWAS bloc will potentially reduce the number of partners signed to this treaty and would impact on the value of possible investments into West Africa and even intra-regional trade.

Pre- ECOWAS treaty, Nigeria only had a ratified tax treaty with one other Africa country (i.e South Africa). While there are signed treaties with Ghana and Mauritius, these are yet to take effect as they have not been ratified. Therefore the introduction of these community rules is a positive development for the West African bloc. Signing up to a regional tax treaty does not prohibit member nations from concluding bilateral tax agreements with non-community members. However, it would have been preferable if the Community Rules were more competitive than existing treaties with other non-ECOWAS states. For example, it may be more favorable for entities in other treaty countries to provide technical services remotely to Nigeria, as income from such activities are only taxed in Nigeria under most other treaties, where a physical PE is created.

Companies that intend to take advantage of the benefits under the ECOWAS Treaty will need to obtain the administrative approvals from the Federal Inland Revenue Service, as applicable to other treaties.

[1]Some countries have recently pulled out of ECOWAS and so it is expected that this treaty may not apply to these countries.

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