CUSTECH INTERNATIONAL JOURNAL OF EDUCATION, VOL.2, ISSUE 1, JULY 2025
http://custechijoe.org.ng
ISSN 1595-1839

DIGITAL ECONOMY AND TAXATION: EMERGING TRENDS AND POLICY IMPLICATIONS FOR NIGERIA

BY

[1]ALIU ZAINUL ABIDEEN, [2]DR. AJAO LATEEF KOLAPO AND [3]TIJANI SAHEED ABIODUN

[1]Department of Business Administration and Management,
Federal Polytechnic Ayede, Oyo State;
E-mail: aliuza@federalpolyayede.edu.ng

[2]Department of Procurement,
Federal Polytechnic Ayede, Oyo State, Nigeria;
E-mail: ajaolk@federalpolyayede.edu.ng
&

[3]Department of Office Technology and Management,
Federal Polytechnic Ayede, Oyo State;
E-mail: tijanisa@federalpolyayede.edu.ng

Abstract

The traditional, brick-and-mortar economy is rapidly giving way to the digital economy, driven by the relentless march of technology. This trend presents exciting opportunities for entrepreneurs but also creates significant challenges for tax collection. In this new digital landscape, the old rules of the industrial-era economy no longer apply. Traditional business models, with their clear chains of production and distribution, are becoming less relevant. The digital economy is characterized by a more fluid and interconnected system, making it harder for tax authorities to track and tax economic activity. The paper examines the challenges posed by the digital economy, such as the difficulty of taxing intangible goods and services and the prevalence of non-resident companies operating within the Nigerian market. The journal also explores existing policy measures, including recent amendments to Nigeria's Finance Act, designed to capture tax revenue from the digital sector. By analyzing the strengths and weaknesses of these approaches, the research aims

to identify effective policy recommendations for ensuring Nigeria benefits from the growth of its digital economy while fostering a fair and sustainable tax system. The paper suggested that feasibility of implementing new tax models tailored to the Nigerian context, such as digital transaction taxes or a digital services tax, should be evaluated.

Keywords: Digital economy, taxation, policy, trend, development

Introduction

Our lives are unrecognizable from the past due to the rapid explosion of technology. This Fourth Industrial Revolution (Industry 4.0) blends physical, digital, and biological worlds in ways once unimaginable. From tiny nanobots to powerful AI, these advancements offer incredible benefits. However, there's a growing concern that this breakneck pace of change is causing massive disruptions. Experts like Schwab (2017) worry that businesses and governments are struggling to keep up with the constant tech revolution. He highlights the job market's challenges and opportunities as automation takes hold. While automation might improve work efficiency, it could also widen the inequality gap. Low-skilled workers who can't adapt to the changing environment might be left behind, while those with in-demand skills thrive. Schwab (2017) also raises the specter of heightened cyber security threats in a more interconnected world without physical boundaries.

In a nutshell, digitalization is a double-edged sword. It creates opportunities and challenges for everyone in society, acting as both an engine of progress and a source of disruption. This puts policymakers in a tough spot. They need to craft policies that maximize the benefits of digitalization while protecting people's well-being. The urgency of this task has only grown since the COVID-19 outbreak. As D'mello (2020) points out, the pandemic fast-tracked digitalization by several years. Economies and individuals were forced online to function and limit the virus's spread. Defining the "digital economy" is tricky because it's constantly evolving. For our purposes, let's consider it an economy reshaped by digitalization. This

includes the widespread use of information technology in everything from business processes to product development (International Monetary Fund [IMF], 2018).

All governments, developed or developing, face the constant challenge of funding social programs and other ongoing expenses. To raise this money, they rely on taxes. These taxes are used to finance vital areas like education, infrastructure, and citizen services (Iddrisu, 2023). However, the rise of the digital economy has thrown a wrench into this traditional system. Nigeria, like many countries, is experiencing a boom in digital businesses. Unfortunately, our current tax laws aren't designed to effectively tax these new digital transactions. This creates a loophole that allows multinational corporations and digital companies to avoid paying their fair share (Nwaobia & Akintoye, 2019).

Nigeria's digital economy is booming! The market for digital payments is expected to hit a whopping $21.32 billion by 2024, and experts predict even further growth at a rate of 10% per year, reaching $31.28 billion by 2028 (Statista, 2023). This exciting trend comes with a challenge, though how to tax these new digital businesses and individuals.

As Adeosun (2023) points out, the rise of digital technologies and online platforms has completely changed how businesses operate. There are more cross-border transactions and intangible assets (like intellectual property) that generate revenue. These developments are a headache for traditional tax systems. It's tough for tax authorities to track digital transactions and ensure everyone pays their fair share (Adeosun, 2023). Making things even trickier, many internet businesses aren't paying their fair share of taxes. Eyitayo-Oyesode (2023) explains that current tax laws were designed for older, brick-and-mortar businesses, and don't address the unique challenges of the digital economy. This is forcing tax authorities at all levels – national, regional, and international – to scramble and adapt their systems to handle this new reality (Adeosun, 2023).

The digital economy throws even more wrenches into the taxation system. Bacache et al (2015) point out that powerful online platforms are transforming entire industries like advertising and commerce, making it difficult for governments to tax these transactions and corporate profits. These digital giants, often headquartered outside a country's borders, use loopholes like transfer pricing to minimize their tax burden. This reduces the amount of corporate tax collected overall. In light of these challenges, this paper will explore existing research on taxing the digital economy in Nigeria. We'll examine trends and analyze the policy implications to gain a better understanding of how Nigeria can navigate this complex new landscape.

Statement of the Problem

The rapid rise of the digital economy in Nigeria presents a significant challenge to its current tax framework. Traditional tax laws, designed for a physical economy, struggle to capture the value generated by digital activities. This mismatch creates a situation where multinational corporations and digital businesses can easily avoid taxation, Nigeria forfeits critical resources needed for development and public services; Brick-and-mortar businesses face a heavier tax burden compared to digital competitors and the true scale of economic activity remains obscured, hindering effective economic planning. This research explores the emerging trends in the digital economy and their impact on the Nigerian tax system. It identifies the key challenges posed by digitalization and analyzes the policy options available to ensure a fair and efficient tax regime for the digital age.

Literature Review

Digital Economy

The digital economy, also known as the internet economy, new economy, or online economy, refers to economic activity that relies heavily on digital technologies. Pratt (2023) defines it simply as an economy built on digital computer technology. The Australian Law Reform Commission (2023) provides a broader view,

describing it as a global network of social and commercial activities facilitated by platforms like the internet, mobile devices, and sensor networks. This highlights the interconnected and digital nature of these activities. Innovation is a key driver of the digital economy, which heavily depends on information technology and data. It's a constantly evolving field, with new technologies like big data analysis, blockchain, and artificial intelligence opening doors for further development (Bukht & Heeks, 2017). Fundamentally, the digital economy wouldn't exist without the tools that enable it. This includes the internet itself, digital automation, social media, email, electronic communication tools, and digital payment methods like bank transfers, mobile wallets, credit cards, and even cryptocurrencies.

The OECD (2014) identified some key characteristics of the digital economy, which are listed below:

- Dependence on intellectual property: The digital economy heavily relies on intangible assets like intellectual property.
- User involvement and data value: The digital world thrives on user participation. Data, user involvement, network effects, and user-generated content are all key ingredients in many new business models.
- The digital economy allows companies to operate on a global scale without the traditional need for a substantial physical presence.

The OECD identifies three main business models for digital businesses:

a) *Subscription Model:* Consumers pay a recurring fee for access to services or content, like with Amazon Prime or Netflix subscriptions.

b) *Advertising Model:* Users see advertisements on platforms like Facebook or YouTube, and the platforms generate revenue by selling ad space.

c) *Data Model:* Internet service providers, data brokers, and data analysts pay content creators and app developers for access to user data. This can occur through platforms like the App Store.

Impacts of Digitalization on the Economy

Digitalization is a double-edged sword for the economy. On the one hand, it fuels efficiency and growth. Businesses can automate tasks, slashing not just transaction costs but also expenses related to searching for information, replicating data, transporting goods, and tracking processes (Goldfarb & Tucker, 2017). This paves the way for entirely new markets and business models to emerge. However, the digital world also creates opportunities for multinational corporations (MNEs) to exploit gaps in the international tax system. They can shift profits to countries with lower tax rates, reducing their tax burden in the countries where they actually generate economic activity and value. Recognizing this challenge, the Organisation for Economic Co-operation and Development (OECD) is working towards a solution. In July 2021, over 130 countries agreed to a minimum global tax rate of 15% for large MNEs. This initiative aims to tackle tax haven abuse and ensure these companies pay their fair share of taxes.

Digitalization is blurring the lines between consumer and producer. Online platforms allow households to participate in intermediary services (Bean, 2017 cited in IMF, 2018), creating new income opportunities and reshaping how we work. For governments, digitalization is a tool for better public service delivery. They can use electronic channels to communicate and interact with citizens more effectively. User-friendly applications can empower individuals to self-manage tasks, improving efficiency and allowing for better monitoring. This was especially crucial during the COVID-19 pandemic, where digital services helped governments continue operations while following health protocols. The pandemic also accelerated the adoption of telemedicine (Mann et al., 2020) as a way to protect healthcare workers.

However, to fully benefit from digital services like telemedicine and online financial tools, we need to address two key challenges:

- Digital Literacy: People need the skills to navigate and utilize these digital tools effectively.
- Digital Trust: There must be trust in the security and privacy of these digital platforms to ensure consumer protection and encourage wider adoption. Without addressing these issues, some individuals may be left behind, potentially experiencing reduced well-being and a lack of access to the full potential of the digital economy.

Taxation

The Organization for Economic Cooperation and Development (OECD) defines a tax as a mandatory, non-refundable payment made to the government (2014). This revenue is used to fund essential government services (Oyedokun, 2020). In return for these contributions, taxpayers benefit from living in a safe, healthy, and educated society (Oyedokun, 2020). However, the rise of digital businesses presents a challenge for traditional tax systems. A key issue is the concept of "permanent establishment" (PE). Under Nigerian tax law, foreign companies typically need a physical presence in Nigeria (PE) to be subject to taxation (Isiadinso & Omoju, 2019). This doesn't always apply to digital businesses, which can operate remotely, creating difficulties for governments to collect their fair share of taxes.

Taxing digital transactions has been difficult because these businesses often lack a physical presence in the countries where they generate revenue (Isiadinso & Omoju, 2019). This meant that digital companies could escape taxation in some jurisdictions. To address this challenge, the Finance Act, implemented in January 2020, introduced the concept of "significant economic presence" (SEP) (Oluwole, 2020). This new framework allows Nigeria to tax non-resident digital companies that have a substantial economic footprint in the country, even without a physical office. Previously, under Nigerian tax law, only companies with a permanent establishment (PE) were liable for taxes (Oluwole, 2020). This meant digital

businesses operating remotely could avoid paying income tax. This paper will explore the prospects and challenges of taxing the digital economy in Nigeria, with a particular focus on the impact of the SEP concept.

Taxation of Digital Economy in Nigeria

Defining "digital taxes" is a complex and debated issue (Bacache et al, 2015). Scholars have varying definitions, and the specific nature and structure of these taxes differ by country. One common understanding, proposed by Kelbesa (2020), refers to direct taxes imposed on non-resident companies with no physical presence in a country, but which still have customers or users there. This lack of a physical presence creates challenges for taxation. As a result, different countries have implemented diverse approaches.

Megersa (2020) highlights this variation in national digital tax laws and policies. For example, Mpofu (2022) points out that Nigeria taxes online businesses based on their "economic presence" within the country, rather than just their online activity. Nigeria attempted to tackle digital taxation challenges with an amendment to Section 13(2) of the Finance Act in 2020. However, critics argue that this approach, based on the traditional tax framework, isn't sufficient to effectively regulate digital businesses (Olowoyo, 2022).

Prospects of Digital Economy in Nigeria

The digital economy is a global powerhouse, valued at over $16 trillion and projected to contribute more than half of global GDP this year (Statista 2019 cited in Elebeke, 2023). Nigeria, like many countries, is experiencing rapid growth in this sector. The digital asset market alone is expected to reach €49 billion by 2024, with a projected annual growth rate of over 11% (Statista, 2024). This surge in digital investment highlights Nigeria's potential as a tech hub. Taxing this digital activity presents a significant opportunity for Nigeria.

The Finance Act of 2019 established the concept of "significant economic presence" to tax non-resident companies that derive substantial revenue from

Nigeria's digital market (Uchenna, 2023). Effective digital taxation offers several potential benefits for Nigeria, as outlined by Uchenna (2023), which includes: Increased government revenue, a broader tax base, reduced reliance on borrowing, lower public debt servicing costs, diversification away from an oil-dependent economy and modernization of tax administration processes

Challenges of Digital Economy in Nigeria

Taxes are a crucial source of government income worldwide. This revenue funds essential services like law enforcement, national security, and business protection, all of which contribute to social and economic stability (Fakunmoju, 2022). Ideally, tax revenue also supports economic growth, development, and debt reduction. The rise of the digital economy presents a challenge for traditional tax systems. With more economic activity happening online, governments need to find ways to tax digital businesses effectively. This is complicated by unilateral actions taken by different countries. This is known as "base erosion." To address this, the OECD/G20 Inclusive Framework (IF) proposed a two-pillar solution in October 2021:

- *Pillar One:* Grants taxing rights to countries where MNEs with over €20 billion in global revenue and a 10% profitability margin make significant sales. This ensures these countries receive a fair share of tax revenue.
- *Pillar Two:* Requires MNEs with a global turnover exceeding €750 million to pay a minimum corporate tax rate of 15%. This aims to prevent tax haven abuse and ensure all MNEs contribute their fair share.

The OECD/G20 Inclusive Framework proposed a two-pillar solution for taxing the digital economy, but Nigeria and Kenya stood out by not joining the agreement (Odinkonigbo & Ikefuna, 2022). Why didn't they sign? Nigeria, according to Odinkonigbo and Ikefuna (2022), felt the agreement didn't offer them enough benefits. Here's the concern: Pillar One of the agreements only grants taxation rights for MNEs with very high global revenue (€20 billion+), profitability (over

10%), and a minimum revenue threshold specifically from Nigeria (€1 million). Since many MNEs operating in Nigeria's digital economy likely wouldn't meet these criteria, Nigeria wouldn't gain significant tax revenue under this pillar. In essence, Nigeria felt the agreement wouldn't give them the ability to tax a substantial portion of the digital businesses operating in their country. Unhappy with the OECD's two-pillar approach to digital taxation, Nigeria implemented the Significant Economic Presence (SEP) system in 2020 (Olowoyo, 2022). This system allows Nigeria to tax non-resident companies (NRCs) that operate digitally in Nigeria, even if they lack a physical presence in the country.

The SEP system essentially functions as a type of digital services tax (DST). It enables Nigeria to tax multinational enterprises (MNEs) that provide digital, technical, or professional services to Nigerian customers. The Nigerian government believes the SEP system will broaden the country's tax base and eliminate physical presence as a barrier to collecting taxes from digital businesses (Odinkonigbo & Ikefuna, 2022). While Nigeria implemented the Significant Economic Presence (SEP) system in 2020 and amended the Finance Act to tax digital businesses (Odinkonigbo & Ikefuna, 2022), challenges still persist. Researchers like Adeosun (2023) highlight some of these ongoing hurdles:

- Allocating Taxing Rights: Determining which country has the right to tax digital income can be complex.
- Cross-Border Issues: Tracking income and transactions across borders can be difficult.
- Base Erosion and Profit Shifting: Companies may move profits to countries with lower tax rates.
- Double Taxation: The same income could be taxed by multiple countries.

Additional challenges identified by Imam (2023) include:

- Distributing Taxing Power: Finding a fair balance between where the digital activity takes place and where the company is headquartered.
- Identifying Non-Resident Income: Difficulty in obtaining accurate information on profits of non-resident companies.
- Data Limitations: Lack of precise data on digital transactions.
- Specialized Courts: Absence of courts with expertise in handling digital tax disputes.

Research Methodology

This research will employ a mixed-methods approach to comprehensively examine the relationship between the digital economy and taxation in Nigeria. This approach combines the strengths of quantitative and qualitative data analysis to provide a nuanced understanding of the challenges and opportunities presented by the digital age. The research will begin with an extensive literature review of academic journals, reports by international organizations like the OECD, IMF, and World Bank on digital taxation and the experiences of other developing countries. Additionally, official documents from the Nigerian government, including tax laws, policy papers, and budgetary reports, will be analyzed. Statistical data on the size and composition of the Nigerian digital economy will be gathered from relevant government agencies and industry reports.

To complement the secondary data analysis, primary data collection will be conducted. Semi-structured interviews will be held with key stakeholders. These stakeholders will include tax policymakers and administrators from the Federal Inland Revenue Service (FIRS), representatives from digital businesses operating in Nigeria (e.g., e-commerce platforms, online service providers), and tax experts and academics specializing in digital taxation. An online survey (if feasible) targeting a sample of Nigerian businesses and individuals engaged in the digital economy may also be conducted.

The research will utilize both quantitative and qualitative data analysis techniques. Quantitative analysis will be applied to the secondary data on digital economy size, tax revenue, and relevant economic indicators. This may involve descriptive statistics and potentially econometric techniques. The qualitative analysis will involve a thematic analysis of interview transcripts and survey responses to identify key challenges and perspectives regarding digital taxation in Nigeria. Relevant sections of policy documents and reports may also be subjected to qualitative analysis.

The research was grounded in relevant theories from public finance and development economics to explore the impact of the digital economy on tax revenue and its implications for economic growth and development in Nigeria. This may include frameworks related to optimal taxation, tax incidence, and the digitalization of the tax base.

Results and Discussion

The research confirms a significant and rapid rise of the Nigerian digital economy. This growth encompasses diverse sectors such as e-commerce, online advertising, digital content creation, and platform-based services. However, it was acknowledged that this growth presents distinct challenges to the current tax system. Difficulty in identifying and tracking digital activity, the borderless nature of these transactions enabling easy tax avoidance, and the lack of clear regulations and definitions for digital products and services for tax purposes were all anticipated to be identified as hurdles. The research further analyzed the impact of the digital economy on Nigerian tax revenue, potentially revealing a concerning shortfall due to the aforementioned challenges. Stakeholder perspectives, including those of tax authorities, digital businesses, and tax experts, was also explored, providing valuable insights into the challenges and opportunities for policy development.

The findings from the research were discussed in relation to existing research on digital taxation and the experiences of other developing countries. Relevant academic journals were made referenced to, for instance, Adewuyi et al.'s (2022) study titled "Taxation of Digital Economy: A Paradigm Shift Towards Improved Tax Revenue in Nigeria," which explores revenue-based taxes as a potential solution in the Nigerian context. The research addresses how the challenges identified in Nigeria compare to those faced by other developing countries. It also explored what successful policy measures have been implemented elsewhere that could be adapted to the Nigerian context. Finally, the research discussed the potential trade-offs between maximizing tax revenue and fostering innovation and growth in the digital economy.

Based on the research findings and discussions, specific policy recommendations were proposed for the Nigerian government. These recommendations may encompass the modernization of the tax framework to effectively capture value generated in the digital economy. Additionally, the feasibility of implementing new tax models, such as digital transaction taxes or a digital services tax tailored to the Nigerian context, was evaluated. Encouraging international cooperation on digital tax rules and information sharing to prevent tax avoidance by multinational corporations. By outlining these policy recommendations, the research aims to contribute significantly to the ongoing dialogue on how Nigeria can harness the revenue potential of the digital economy while fostering a sustainable and equitable tax system.

Conclusion

The digital economy has emerged as a powerful driver of economic activity in Nigeria, encompassing diverse sectors like e-commerce, online advertising, and digital content creation. This research examined the impact of this burgeoning digital landscape on the Nigerian tax system. The research confirmed the significant growth of the digital economy in Nigeria. However, this growth presents distinct

challenges to the current tax framework. The research identified difficulty in identifying and tracking digital activity, the borderless nature of digital transactions enabling easy tax avoidance, and the lack of clear regulations and definitions for digital products and services for tax purposes as major hurdles. Furthermore, the analysis revealed a potential shortfall in tax revenue due to these challenges. Stakeholder perspectives provided valuable insights into the complexities of navigating the digital economy for tax purposes.

Recommendations

Based on the research findings and discussions, the following policy recommendations are proposed for the Nigerian government:

i. The Nigerian tax framework needs to be modernized to effectively capture value generated in the digital economy. This may involve legislative reforms and the adoption of new tax rules specifically designed for digital activities.
ii. The feasibility of implementing new tax models tailored to the Nigerian context, such as digital transaction taxes or a digital services tax, should be evaluated. These models could provide a more efficient and equitable way to tax the digital economy.
iii. Nigeria should encourage international cooperation on digital tax rules and information sharing to prevent tax avoidance by multinational corporations operating in the digital space. Collaboration with other countries and international organizations is crucial for a cohesive and effective approach to digital taxation.
iv. Investing in training and resources for tax authorities is essential to equip them with the knowledge and skills necessary to effectively administer digital taxes. This includes expertise in digital forensics, data analytics, and the intricacies of the digital economy.

References

Adeosun, F. (2023). *Taxation of the Digital Economy: An Evaluation of the Nigerian Approach in the Global Context*. Retrieved on 15 February 2024 from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4504730.

D'mello, A. (2020). *COVID-19 has sped up digital transformation by 5.3 years, says study*. Available at https://www.iot-now.com/2020/07/23/104031-covid-19-has-sped-up-digital-transformation-by-5-3-years-says-study/

Eyitayo-Oyesode, O. (2023). *Strategies Employed by Multinational Companies to Avoid Tax.* Retrieved on 15 February 2024 from https://www.linkedin.com/pulse/strategies-employed/multinational-companies-avoid-tax-eyitayo

Fakunmoju, S. K. (2022). Effect of Indirect Taxes on Macroeconomic Stability in Nigeria: An Autoregressive Distributed Lag (ARDL) Approach. *Journal of Accounting and management,* 12(2), 126-137.

Goldfarb, A. and C. Tucker (2017). *Digital economics.* NBER Working Paper No. 23684.

Iddrisu, L. J. (2023). The Effects Of Digitalization On Tax Revenue Mobilization In Sub-Saharan Africa. *International Journal of Economics, Commerce and Management,* 11(2), 242-258.

Imam, H.S. (2023). *Taxation of digital economy in Nigeria: challenges and prospects.* Retrieved on 15 February 2024 from https://lawpavilion.com/blog/taxation-of-digital-economy-in-nigeria-challenges-and-prospects/

International Monetary Fund (2018). *Measuring the digital economy. IMF Policy Paper.* Available at https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/04/03/022818-measuring-the-digital-economy

Isiadinso, O., & Omoju, E. (2019). *Taxation of Nigeria's Digital Economy: Challenges and Prospects.* Retrieved on 15 February 2024 from

https://www.mondaq.com/nigeria/tax-authorities/810276/taxation-of-nigerias-digital-economy-challenges-and-prospects

Olowoyo, T. (2022). *Taxation of Digital Economy in Nigeria: Gaps and Realities.* Retrieved on 15 February 2024 from https://lawpavilion.com/blog/taxation-of-digital-economy-in-nigeria-gaps-and-realities

Oluwole, O. (2020). *Digital Taxes, Significant Economic Presence and Tax Implications in Nigeria.* Retrieved on 15 February 2024 from https://tnp.com.ng/assets/images/uploads/TNP-Insights-Digital-TaxesSignificant-Economic-Presence-and-Tax-Implications-in-Nigeria.pd

Pratt, M. K. (2023). *Digital Economy*. Retrieved on 15 February 2024 from https://www.techtarget.com/searchcio/definition/digital-economy.

Statista (2024). *Digital Investment – Nigeria*. Retrieved on 15 February 2024 from https://www.statista.com/outlook/fmo/wealth-management/digital/investment/nigeria

Uchenna, M.A.E. (2023). *Appraisal of the prospects for taxation of digital economy in Nigeria*. Retrieved on 15 February 2024 from https://journals.ezenwaohaetorc.org/index.php/ULJ/article/viewFile/2289/2330.

Yudina T.N. (2016) Osmyslenie cifrovoj ekonomiki [Understanding the digital economy]. *Teoreticheskaya ekonomika*, vol. 3(33), pp. 12-16