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A Conceptual Review of Nigerian Tax Administration in Globalisation and Profit Shifting Challenges

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Abstract

The concept of globalisation presents independent tax jurisdictions with opportunities as well as challenges. This study appraises the Nigerian tax administration in the context of globalisation effect and the incidence of profit shifting through the use of systematic conceptualisation and the use of relevant connected theories to bring out the key elements of the study. It went ahead to discuss the weaknesses and challenges faced by the Nigerian tax administration in the wake of globalisation, linking globalization to digitalisation and how it facilitates the profit shifting phenomenon. It further recommends that the Nigerian tax administration should engage in a critical assessment of information technology infrastructure and policy infrastructure to find areas of weaknesses and improve on those weaknesses.

Subject Areas

Accounting

Keywords

Digitalisation, Globalisation, Nigeria, Profit Shifting, Tax Administration

1. Introduction

In today's age of globalisation, mobility of capital and labour allows companies to seize investment opportunities in different locations to maximize their profits. This is done through the process of establishing controlled foreign corporate entities in jurisdictions outside their permanent establishment giving rise to several phenomena, which result in issues in the financial system of the jurisdiction where the controlled foreign corporate entities or subsidiaries are established, one of which is the issue of profit shifting.

Profit shifting involves the process of creating fictitious companies in tax havens, diverting profits generated in developing or developed countries thus eroding their tax base [1]. This process is done through various mechanisms which include manipulating transfer pricing for international transactions within a company, affecting the distribution of international accounting profits in a company's financial structure, or reallocating overhead costs to high taxing countries thereby reducing accounting returns in those countries. This act causes a reduction in taxable income in those countries thereby affecting the revenue generating capabilities of these countries, which ultimately affect government revenue streams. Profit shifting practice has seen countries suffer the loss of billions of dollars, Organisation for Economic Cooperation, and Development (OECD) estimated global corporate income tax (CIT) revenue losses between 4% and 10% of global CIT revenues, *i.e.*, USD 100 to 240 billion annually [2].

The global community has recognised the challenges profit shifting poses to tax jurisdictions, especially developing countries and has made conscious efforts to tackle this issue. Some of these efforts include the OECD/G20 inclusive framework on BEPS: 15 action plan and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI) in 2017. As of November 2021, 141 countries and jurisdictions have signed up to the OECD/G20: 15 action plan to combat profit shifting and general tax avoidance schemes by multinational corporations [2]. The success of these initiatives is highly dependent on the level of technical know-how and flexibility of individual countries' tax administration.

Tax administration relates to the framework, procedures, principles, and strategies applied by any government to achieve effective tax planning, mandatory tax collection, easy collection and proper accounting and utilization of the tax revenues [3]. Tax laws and policy help to define the tax administration's strength in coping with new issues affecting its tax jurisdiction.

Nigeria's large economic prospect allows it to have a presence of several multinational companies within its jurisdiction, which invariably results in the movement of capital in and out of its jurisdiction thereby creating an environment that can be subjected to profit shifting and globalisation issues. Considering the evidences identified by Oyeyinka [4], which include collusion amongst revenue officials and tax payers, tax evasion activities, errors arising from manual computations, and inadequate management of taxpayers' database amongst others, the question thus arise is the Nigerian tax administration techniques and policies adequate to deal with issues that may result from globalisation (rapid digitalisation of business) and profit shifting. To address this, the paper aims to conceptually review the Nigerian tax administration in the face of globalisation and profit shifting challenges.

The novelty in this research work is derived from the authors' attempt to establish globalisation as a premise for profit shifting and how developing countries like Nigeria should view the profit shifting agenda promulgated by the more developed countries like the OECD countries.

2. Conceptualisation

This section will aim to conceptualise key variables related to this study.

2.1. Globalisation

Globalisation defines the process which results in the strengthening of global social relations that connect distant locales in such a way that local events are impacted by events occurring thousands of miles away and vice versa [5]. This provides a situation of cross border interaction which leads to the active movement of labour, people, and capital. The concept of globalisation deconstructs large independent countries and jurisdictions into smaller interdependent units that conduct business and interact seamlessly with one another which is further aided by the growth of digitalisation and the need to rapidly expand the frontiers of commercial influence beyond their immediate environment. It is important to understand that globalisation as a concept is multidisciplinary and is subject to different interpretations based on perception, but for the purpose of this paper, globalisation will be addressed in the context of profit shifting and tax administration.

Globalisation is defined as the process by which firms move their money, factories, and products around the world at faster rates in search of cheaper labour, and raw materials, governments are willing to ignore or forsake consumer, labour, and environmental protection regulations [6]. The IMF [7] referred to globalisation as the increasing economic interdependencies of countries around the world because of the volume and variety of cross border transactions in goods and services, as well as international capital flows, and rapid widespread diffusion of technology. From the definitions outlined one thing is certain globalisation can be said to be the growth of interdependency of national economies on one another. However, the growth of interdependency does not stop the competitive nature of national economies as independent economies strife to maximize the generation of wealth through the use of taxation and other mechanisms available to them. The huge gap between the ability of different countries to generate this wealth results in some countries setting lower tax rates to attract more investment into their countries [8]. This disparity in tax rates because of competition through globalisation gives rise to the challenge of profit shifting by individual firms that seek to reduce their tax liability. The ease of mobility of capital and profit because of globalization allows individual firms to take advantage of the resources in one country and transfer the profit generated in that country to another for the sole purpose of reducing tax liability, usually, this transfer takes place between a high tax rate countries to a low tax rate country. This act is further enhanced by the rapid digitalisation of world economies as the transfer of profit from one country to another can be initiated by just the click of a button, making it difficult and sometimes impossible for tax authorities to trace the movement of profits for tax purposes. The continuous nefarious act of shifting profits erodes the tax base of the host country (country of permanent establishment) thereby causing heavy losses in potential internally generated revenue and funds to cater for capital expenditure in their country, especially in developing countries [9].

Globalisation in its purest form fosters the development of individual countries assuming each individual nation has the adequate infrastructure in place to utilise the product of this development and administrative capability to monitor and prevent the destructive trends associated with aspects of development. In a situation where administrative and infrastructural paraphernalia is unavailable to individual countries for the purpose of absorbing new developmental trends, it creates a rather unfavourable situation where countries or entities (individual firms) take advantage of this unavailability to carry out aggressive and smart financial planning activities like profit shifting, which erode the tax base of these countries and reduces their income from tax generation.

2.2. Profit Shifting

Profit shifting is a tactic used by multinational organizations to pay less tax than they should. It entails a multinational corporation relocating profits made in the country (country of permanent establishment) where it manufactures items or sells goods and services to a tax haven. This is done by relocating profits to a tax haven, a multinational corporation underreports the value of its profits in the countries where it manufactures or sells goods and services, resulting in lower or no taxation in those nations. Profits transferred to a tax haven are subsequently taxed at a very low rate or not at all, depending on whether the tax haven has a very low corporation tax rate or no corporate tax rate [10]. The most typical form of profit shifting is for a multinational firm to employ a subsidiary in a tax haven to charge costs to companies in other countries [10]. For example, in the Paradise Papers affair, journalists revealed that Nike was transferring large portions of its revenues to Bermuda (a zero-tax jurisdiction) by registering their intellectual property (*i.e.*, logo, branding, shoe designs) there [11]. The Bermudian firm then charged exorbitant royalty payments to Nike companies across the world for using the intellectual property. This allowed Nike to pay less tax in the nations where it sold shoes while amassing billions of dollars in untaxed profits abroad. Every year, multinational firms are estimated to move $1.38 trillion in earnings to tax havens, costing countries $245 billion in missed corporate tax [11].

2.3. Tax Havens

Tax havens are defined by OECD [12] as any country, jurisdiction, or territory that applies no or low nominal tax rates to non-residents (individuals or corporations) and whose laws or administration practices prevent the effective exchange of relevant information with other governments on taxpayers benefiting from low or no tax jurisdiction. In the tax haven jurisdiction, there is a lack of transparency and no requirement for substantive activity. Zoromé [13] went ahead to describe tax havens based on 3 distinct characteristics which are, Primary orientation towards non-residents, favourable regulatory environment (low supervisory requirement) and low/zero taxation scheme. All 3 characteristics collectively assessed, explains the approach tax havens use their sovereign legislative powers to maintain the secrecy of corporate financial activities, provide light regulation, and impose little or no tax on corporate income or profit to entice enterprises wanting to establish shell corporations to shift income from a high-tax jurisdiction to a tax haven to decrease the incidence tax on their business.

The tax justice network [14] further defines tax havens as countries that enact legislation to aid people, whether actual or legal, in avoiding regulatory obligations imposed on them in their principal location, *i.e.*, their origin country, jurisdiction or place of permanent establishment (the substance of economic transactions). The TJN highlighted that on principle the effect of secrecy was the telling factor in the establishment of a jurisdiction as a tax haven and therefore argued that established definitions of tax havens did not adequately address the fundamental issue of tax havens vis-a-vis profit shifting, as a whole which in this paper we agree and therefore, derive our definition of tax havens as a location that intentionally creates regulation for the primary benefit and use of those not resident in their geographical domain, with the intent of undermining the legislation or regulation of another jurisdiction, and that also creates a deliberate, legally backed veil of secrecy to ensure that those from outside the jurisdiction using its regulation cannot be identified as doing so. This definition aggregates both tax havens and offshore financial centres under one umbrella to give a holistic identification of the problem. Some examples of popular tax havens as listed by OECD [12] include Bermuda, Netherlands Luxembourg, Cayman Island, Singapore, Channel Island, Isle of Man, Ireland, Mauritius, Monaco Switzerland, and the Bahamas.

The occurrence of profit shifting has been recognised amongst international bodies like the OECD, UN and IMF as a critical issue affecting both developed and developing countries' tax administration with more emphasis on the developing countries, as rapid digitalisation, and competition for wealth due to globalization increases the complexity of profit shifting thus providing a huge conundrum for both local and international tax administration

It is important to note that tax havens aren't the only mechanism available to an entity for the purpose of moving profit out of a country, as the incidence of aggressive abuse of transfer pricing and financial structure cost reallocation can also be identified as a profit shifting mechanism. However, it is not discussed in this paper as they both are components of base erosion which is not treated in this paper.

2.4. Taxation and Tax Administration

Taxation continues to be an essential source of revenue for governments all over the world, as it provides governments with the financial resources they need to carry out and execute their electoral pledges. Some of these include but are not limited to, the development of jobs, the provision of social amenities, and the protection of lives and property. Several scholars have defined tax, but in the context of globalisation and profit shifting phenomena, we adopted the definition of tax as a compulsory levy contribution made by citizens to the state or even aliens subject to the jurisdiction of the government, for reasons of residence or property, and this contribution is for general or common use [15]. This definition so emphasizes that foreign entities (aliens) who are residents in a country or jurisdiction are compelled to pay tax liability because of their residency.

Tax administration refers to the tactics, ideas, and strategies utilized by any government to assure effective tax planning, mandatory tax levying, easy collection, and proper accounting and utilization of earned income [16] [17] [18] [19]. When the definitions of tax and tax administration are united, it sets the stage for the importance of tax administration style in countering globalisation and profit shifting challenges. Tax administration in Nigeria mirrors her federal systems in terms of the allocation of tax authority and obligations to each federal entity. Each unit is statutorily authorized to access and collect taxes within its legal jurisdiction without interfering with the authority of other units [20].

In terms of how to manage the phenomenon of globalisation and profit shifting, the federal section of the Nigerian tax administration, which is manned by the Federal inland revenue agency, is particularly worried. This is because FIRS oversees the collection of company income tax, which is the subject of profit shifting, demonstrating the direct interaction between foreign firms and FIRS in the context of taxation. The FIRS is charged with the job of harmonising best tax practices with Nigerian tax legislation to cater for new tax trends that arise because of the interaction between Nigeria as a tax jurisdiction and overseas corporations, *i.e.*, globalization.

3. Theoretical Perspective

This study's theoretical perspective is based on the view that every company's main economic goals are to reduce tax payments, increase profit, and increase the wealth of its owners. Every firm owes this legal obligation to its shareholders. As a result, corporations use a number of strategies to achieve these economic goals in order to promote their success as well as the interests of their shareholders [21]. Businesses' principal strategy of achieving economic goals is to avoid paying taxes by shifting their income or profit from high tax jurisdictions/countries to low or no tax jurisdictions/countries, as explained by the theory of shareholder wealth maximization.

The necessity for managers to maximize wealth develops a sequence of intentions, which are the motivating reason that affects multinational (foreign company) behaviour to engage in profit shifting. Ajzen [22] refers to this conduct as the planned behaviour theory. The ease with which such activities can be carried out guides a foreign entity's planned behaviour to shift profit. Adequate tax audit and proper mechanism to detect this malicious act would theoretically demotivate the need to shift profit, giving rise to the premise that without adequate deterrence, the act of tax evasion through profit shifting would continue to exist. The economic deterrence theory explains this point of view [3].

Furthermore, profit shifting challenges are born out of the stratification and distinct gap created between those countries that consider themselves first world countries (developed) and third world countries (developing), which is a product of globalisation; this assertion conforms to the belief of the sceptical approach theory of globalisation. The sceptic's point of view is that as countries' interdependence grows because of globalization, there will be more rivalry for investment [23], thus small countries that lack economic might are compelled to engage in actions of making themselves appealing to foreign organizations and investment, thereby creating a scenario conducive to profit shifting by transforming themselves into tax havens.

4. Globalisation, Profit Shifting and Nigeria Tax Administration: Weaknesses and Challenges

One certain thing is that globalisation cannot be halted or stopped, as it is a phenomenon that transcends human control due to the fact that modern society and economic landscape are built on the interconnectedness and seamless interaction between different economies. This assertion also means that challenges associated with globalisation will exist alongside its benefits. The OECD recognised this issue and as such sorted out a system which will cater for the advent of such challenges, this led to the birth and formulation of the OECD action plan against base erosion and profit shifting. The action intended to guide against the rapid rise of digitalisation which made monitoring of movement of profit and capital ever more difficult. However, one can say the real intention was to ensure that capital and profit are kept within the European Union, therefore, protecting their tax base (Europe keeping the money within Europe).

The action plan recognised the need for international communities to come together and adopt a universal approach to reducing the incidence of profit shifting aided by digitalisation, but the action plan failed to consider operationality in the context of developing nations. Thus, the argument arises, of what benefit would it be to developing nations? This question is born out of the fact that developing countries would have a different outlook than developed countries as their need in terms of economic growth are different and thus a common-sense approach would require developing countries to adopt policies that would promote foreign investment *i.e.*, making themselves attractive through incentive (tax incentives) and adoption of the low tax regime. This was clearly stated by the UN chief of international tax cooperation, Michael Lennard in 2013, who identified that the OECD action plan was never designed to deal with issues faced by developing countries as developing countries would be more concerned with the need to attract foreign investment and taxation of the informal economy.

Nevertheless, Nigeria, a developing nation, joined the OECD action plan showing its readiness to face the challenges of profit shifting and digitalisation, but an investigation has shown that the Nigerian tax administration system is still inadequate in terms of infrastructure and policy implementation ability [24]. Some of the challenges faced by the Nigerian tax administration include:

Identification/Capturing taxable persons: The issue of a lack of a trustworthy, complete, and integrated suite of data to increase the rate of capture of prospective taxpayers outside the tax net or to follow persons within the tax net who have noticeably failed to comply. One feature that advanced tax administration systems share is the availability of a robust database management system that manages the details of all persons (companies or individuals, dead or alive), including date of birth, health profile, work profile, educational profile, and so on, regardless of whether he is a citizen, a resident, or anyone who has interacted with that country [24].

Tracking of hidden income: Tax officials have discovered instances of unidentified money earned by taxable individuals. Even though financial institutions are required to submit information, the reality is that the interface for information transmission between financial institutions and tax authorities might be significantly improved. With Nigeria's cashless policy fully implemented and the resulting integration of more taxpayers into the financial system, tax authorities have a tangible opportunity to track unidentifiable income by linking their systems with banking institutions; however, this remains a challenge for tax authorities in Nigeria [24].

Lack of clarity of tax jurisdiction: Even though there has been clarification constitutionally on the powers of each taxing unit there are instances of conflict amongst tax units which result in double taxation issues when different tax units tax the same taxable entity [25].

On the other hand, there is a need to recognise the effort made by the Nigerian tax administration system to keep up with global tax trends, this includes: Changes to the OECD Guidelines can be implemented immediately because Regulation 11 of the Nigerian transfer pricing regulations allows changes to the OECD Guidelines to be implemented automatically. Potential legislative and regulatory changes to incorporate additional ideas not included in the OECD Guidelines enhanced criticism of preferential tax regimes and tax incentives made available to Nigerian businesses to identify instances where they have been granted unlawful preferential tax regimes and tax incentives. This could include requests made to the local subsidiary (e.g., master file information) as well as demands made to the tax authorities at the Head Office (e.g., CbC reports) or non-resident affiliate via the Convention on Mutual Administrative Assistance in Tax Matters processes [26].

5. Conclusion

In conclusion, globalisation is a facet of modern society and cannot be overemphasised as it brings with it benefits and challenges, two of which are identified here as digitalisation which has a direct bearing on globalisation and profit shifting and it is onerous on the Nigerian tax administration to identify weaknesses in their system and rectify it in order to be able to profit from the opportunities available from globalisation and mitigate the risk associated with profit shifting.

6. Recommendation

It is recommended that Nigerian tax administrators should engage in a critical assessment of the Nigerian tax information technology and policy infrastructures put in place to assess the reliability and strength of these infrastructures and whether they can provide the necessary shock absorber to withstand global trends in international taxation.

7. Suggestions for Further Studies

1) This research only considered a conceptual approach to addressing globalisation and profit shifting challenges in the Nigerian tax administration system, an empirical analysis should be further carried out to ascertain the level at which profit shifting and globalisation policies affect the performance of the Nigerian tax system.

2) Further studies could investigate the issues of globalisation and profiting in the West African region and conduct a comparative analysis between Nigeria and other West African countries, *i.e.*, Ghana.

Conflicts of Interest

The authors declare no conflicts of interest.

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