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TEMPLARS ThoughtLab

Nigeria's Withholding Tax Regulations 2024 and Possible Conflict with Non-Discrimination Provisions in Double Taxation Treaties and Bilateral Investment Treaties

Introduction

In the realm of international taxation, two states often vie for the right to tax income from cross-border investments:

(i) The source state, where the income is generated; and
(ii) The residence state, where the income earner resides.

This dual claim can lead to double taxation where the same income is taxed twice. To address this, countries negotiate Double Taxation Treaties (*DTTs*) and Bilateral Investment Treaties (*BITs*) to promote trade, attract foreign investment and eliminate excessive tax burdens on their residents.

A cornerstone of DTTs are its non-discrimination provisions, which ensures fair treatment of taxpayers, regardless of their nationality or residence. Similarly, BITs often include clauses protecting foreign investors from discriminatory practices based on nationality. The overarching goal is clear- business enterprises from one contracting state should not face more onerous tax obligations than local residents of the source state.

Nigeria's recently issued Withholding Tax Regulations 2024 (*WHT Regulations or the 2024 Regulations*) impose different tax rates on residents and non-residents. This approach raises concerns about potential conflicts with non-discrimination provisions in DTTs and BITs that Nigeria has entered into with its treaty partners.

Tax Regulations

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This article discusses the intersection of the WHT Regulations and the non-discrimination clauses in Nigeria's tax and investment treaties. It also examines possible recourse for investors subjected to unfavourable tax treatment under these new regulations.

The Withholding Tax Framework and the 2024 WHT Regulations

Withholding Tax (WHT) serves as an advance payment of income tax on specific transactions, applied at varying rates depending on the nature of the transaction. In certain instances, WHT is deemed the final tax payable on a transaction. For example, WHT payable on dividends, interest, rent or royalty is the final tax on those transactions. Similarly, WHT on technical, professional, management and consultancy services is the final tax on such services.

Before the issuance of the 2024 Regulations, the applicable WHT rates for both resident and non-resident corporate and unincorporated entities were uniform. The 2024 Regulations, however, introduced a marked departure, prescribing higher rates for non-resident entities in many cases.

For instance, resident companies are taxed at 5% on commissions, while non-residents pay 10%. Similarly, directors' fees are taxed at 15% for residents and 20% for non-residents. Winnings from lotteries, gaming, and reality shows attract a 5% tax for residents but 15% for non-residents.

For businesses and individuals from treaty countries, the 2024 Regulations defer to the rates prescribed in applicable DTTs. However, this may not fully resolve the disparity in tax rates for non-residents from treaty countries. Many DTTs allocate taxing rights to the source country without prescribing specific rates for certain transactions, such as directors' fees, leaving domestic law to determine the rate. In these cases, source states may impose taxes that are more burdensome on non-residents than on residents.

To prevent such disparities, DTTs typically include non-discrimination provisions designed to ensure that individuals and entities from one contracting state are not taxed or subjected to more onerous requirements than local entities. The differential rates introduced by the 2024 Regulations may conflict with these provisions, raising concerns about their alignment with Nigeria's treaty obligations and their impact on foreign investment.

Non-Discrimination Provisions in DTTs and BITs

Most of the non-discrimination clauses in Nigeria's DTTs are standardized and typically appear uniformly across most agreements and are commonly found in Article 24 of the DTTs. The non-discrimination provisions generally provide that tax or taxation requirements imposed on nationals, permanent establishments or foreign owned companies of a treaty partner shall not be more burdensome or less favourable than those imposed on nationals, local enterprises or enterprises controlled by the citizens of the source country.

Non-Discrimination Provisions

Essentially, the provision prohibits discrimination on three key grounds- (i) nationality, (ii) permanent establishment and (iii) foreign ownership.

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Nationality related non-discrimination

This ground of non-discrimination emphasizes that nationals of a contracting state must not face taxation or tax-related requirements that is more burdensome than those imposed on nationals of the source state, provided both nationals are in comparable circumstances. This ensures equitable treatment for individuals and businesses regardless of nationality within the contracting states.

Ordinarily, treaty benefits under a DTT are available to residents of the contracting states.[1] However, the protection against nationality-based discrimination extends beyond residency. For example, if Country X and Country Y have a DTT, a national of Country X (Mr. A) residing outside both countries still qualifies for protection under the DTT. If Country Y imposes a more burdensome tax obligation on Mr. A, he can invoke the non-discrimination clause, as the critical factor is his nationality, not his residency.

In simple terms, a national of Country A cannot be subjected to more unfavourable taxation or tax-related treatment than a national of Country B under a DTT.

However, these non-discrimination provisions are not applied arbitrarily; they are limited to nationals who are in comparable circumstances. The DTTs themselves do not provide detailed guidance on what constitutes being in the "same circumstances". The Commentaries on the Articles of the OECD Model Tax Convention, however, suggests that the comparison should be based on fact and law[2]. For example, a partnership in country A and a telecoms company in country B would not qualify as being in the "same circumstances." Consequently, taxing them differently should not constitute discrimination.

PE related non-discrimination

The DTTs also address tax discrimination concerning Permanent Establishments (**PEs**) in source countries. They stipulate that the taxation imposed on a PE of a non-resident company in the source state should not be less favourable than the taxation applied to resident companies of the source country conducting the same activities.

This provision is unconcerned with the nationality of the owners of the PE; what matters is that the entity which owns the PE is resident in a treaty country and engaged in the same activity as entities incorporated in the source state. Its primary objective is to ensure that PEs are treated equitably, without discrimination, when compared to resident enterprises in the same sector. For instance, if a tower company incorporated in France establishes a representative office in Nigeria that qualifies as a PE under the Nigeria-France DTT, the French entity's PE in Nigeria must not be subjected to less favourable taxation than tower companies incorporated in Nigeria.

[1] Article 4 of the DTTs and FIRS Circular on Taxation of Non-residents.
[2] Commentary on OECD Model Tax Convention at page 333, paragraph 7.

Capital (Foreign Ownership)

By imposing a higher withholding tax rate on non-residents from a treaty country, Nigeria may have treated such non-residents less favourably than its own residents or nationals, thereby breaching the non-discrimination principle in the DTTs.

The 2024 Regulations impose a 2% WHT on resident companies providing co-location and telecoms tower services compared to the 5% imposed on non-resident companies engaged in the same activities. Similar disparities exist for companies involved in the construction of roads, bridges, buildings and power plants. Consequently, in the example above, the PE of the French entity may be subjected to a higher WHT rate simply because it is categorized as a non-resident company.

Additionally, the Federal Inland Revenue Service (FIRS) may need to clarify whether PEs of non-residents will be considered residents of Nigeria under the 2024 WHT Regulations. Such classification would subject them to the same (lower) tax rates applicable to resident companies, potentially addressing concerns about unequal treatment.

Capital (Foreign Ownership) related non-discrimination

In addition to the above protections against tax discrimination, DTTs protect companies incorporated in one contracting state that are partly or wholly owned by foreign non-residents of the other contracting state. Under this provision, a foreign-owned company incorporated under Nigerian law should not face more burdensome taxation or tax-related requirements than Nigerian-owned companies.

For instance, a foreign-owned oil and gas company incorporated in Nigeria should not be subject to more onerous tax obligations than Nigerian-owned oil and gas companies. Thus, if the Nigerian oil and gas company can deduct and carry forward losses, the foreign-owned oil company should not be precluded from deducting and carrying forward its losses as this would lead to more burdensome taxation on the foreign-owned company.

Like the above non-discrimination provisions in the DTT, some BITs signed by Nigeria and its treaty partners contain similar provisions. The Nigeria-Netherland BIT specifically provides that, each contracting party shall accord to nationals of the other contracting party who have investments in its territory, treatment not less favourable than that accorded to its own nationals with respect to taxes, fees, charges and fiscal deductions and exemptions.

Impact of the non-discrimination provisions on the Regulations and options open to affected investors

A higher WHT rate imposed by Nigeria on non-residents from a treaty country constitutes a breach of the non-discrimination provisions in the treaties. Central to DTTs is the principle that a country cannot impose more burdensome tax or taxation requirements on nationals or residents of a treaty country than on its own nationals or residents who are in similar circumstances. By imposing a higher withholding tax rate on non-residents from a treaty country, Nigeria may have treated such non-residents less favourably than its own residents or nationals, thereby breaching the non-discrimination principle in the DTTs.

This could potentially lead to claims for relief or compensation by investors from treaty countries who are disadvantaged compared to local entities. Such claims may render the WHT rates for non-residents from treaty countries inapplicable.

Affected investors may explore options under the treaty dispute resolution mechanism such as the Mutual Agreement Procedure (MAP). The DTTs allow taxpayers who believe that the actions of one or both contracting states result or will result in taxation inconsistent with the treaty to present their cases to the competent authority of their country of residence or the source state, irrespective of domestic remedies. However, in cases of non-discrimination based on nationality, the case must be submitted

Provisions on the Regulations

The taxpayer may proceed to appeal the ruling of the tax authority where it is dissatisfied with the ruling.

to the competent authority of the country where the taxpayer is a national. The case must be filed within three years from the first notification of the action leading to taxation, not in accordance with the DTT.[3] Taxpayers affected by the Regulations may therefore present their case to the relevant competent authority.

Alternatively, affected taxpayers may apply to the tax authority (FIRS) requesting an advance ruling on the issue of non-discrimination brought about by the 2024 Regulations. The taxpayer may proceed to appeal the ruling of the tax authority where it is dissatisfied with the ruling. This can be done by filing a suit at the Tax Appeal Tribunal (*the Tribunal*) challenging the ruling.

In addition, an affected taxpayer who receive a decision from the tax authority requiring payment of taxes under the 2024 Regulation, whether following an audit or otherwise, may proceed to file an action at the Tribunal challenging the decision of the tax authority on the grounds that the provisions of the 2024 Regulations conflict with the non-discrimination provisions of the DTT. Essentially, to trigger the local appeal process, affected taxpayers will need to receive a decision from the FIRS either by way of an advance ruling, or a demand notice.[4]

In some jurisdictions, tax tribunals and courts have upheld non-discrimination clauses in tax treaties where domestic law sought to impose more burdensome tax or tax-related requirements on businesses from a treaty country. For example, in a case that implicated the provisions of the United Kingdom (UK) and the United Sates of America (US) DTT, a US parent company with two subsidiaries in the UK was denied group taxation relief available to UK companies on the basis that the subsidiaries did not have a common corporate shareholder resident in the UK. The US parent challenged the decision of the tax authorities.

The tribunal agreed with the taxpayer and held that the subsidiaries had been subjected to more burdensome taxation when compared to the taxation of a purely UK group of companies. The Tribunal further found that the basis for the more burdensome taxation was that the UK subsidiaries were wholly or partly owned or controlled directly or indirectly by a US rather than a UK-resident parent company[5].

Taxpayers who may be affected by the law may proceed to trigger the dispute resolution mechanism under the DTTs, apply for an advance ruling from the FIRS and appeal same if dissatisfied with the ruling or file a suit to the Tribunal challenging the application of the 2024 Regulations based on the non-discrimination provisions of the DTT where the tax authority issues a decision that they are subject to the higher taxes.

[3] Article 25(1) of Nigeria's DTT with Belgium.
[4] Paragraph 13(1)(2) of the Fifth Schedule to the Federal Inland Revenue Service Establishment Act.
[5] HMRC v. FCE Bank Plc (2012) EWCA Civ 1290.

Conclusion

While domestic tax regulations are undoubtedly vital for Nigeria's fiscal policy and revenue generation, they must operate in harmony with the country's international obligations under its tax and investment treaties. These treaties, particularly their non-discrimination provisions, are designed to promote fairness and mutual respect in cross-border taxation. They protect residents and nationals of treaty countries from arbitrary or disproportionate tax burdens, ensuring that they are not treated less favourably than Nigeria's residents or nationals.

By adhering to these principles, Nigeria not only upholds its treaty commitments but also fosters an environment conducive to foreign investment and international trade. Aligning domestic tax policies with treaty obligations demonstrates Nigeria's commitment to the rule of law and the stability of its investment climate. Failure to honour these commitments risks undermining investor confidence and could lead to disputes or claims under the treaties. Therefore, a balanced approach that respects both fiscal needs and international obligations is essential for sustaining Nigeria's economic growth and its reputation as a reliable treaty partner.