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PROBLEMS IN TAXATION IN NIGERIA: A COMPARATIVE ANALYSIS

Being a Thesis Presented

by

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ABSTRACT

Working on a comparative basis, the objective here is to review certain aspects of Nigerian taxation. While the primary concern is with legal problems, an analysis of tax principles in the abstract is thought to be of limited value unless account is taken of the underlying economic problems which they are designed to regulate. Hence, wherever possible, legal principles are examined in the context of the country's programme for economic development and the role of foreign capital and technology in fulfilling that objective.

The introductory chapter sets out the aims of this thesis in more detail and emphasizes the inter-disciplinary approach. Also highlighted, are the division of taxing powers within the federal set up and the legal framework for economic activity.

Chapter Two, a thorough analysis of the charging provisions, establishes the essential philosophy behind the general scheme of taxation Subsequent discussion is based on two principles - liability on all "source" income and on "remittances."

In Chapter Three, problems relating to the taxation of business income are considered. Namely, the concept of "carrying on" business in Nigeria - the determination of taxable profits - accounting and related problems - allocation of income and expense between related entities - and the tax treatment of losses and a number of special trades (viz., shipping, insurance and the import and export trade).

Chapter Four deals with the taxation of employment and professional income. Some of the areas explored include valuation of benefits in kind - expenses - and the machinery for assessment and collection.

The tax treatment of investment income (i.e. interest, royalties and dividends) is reviewed in Chapter Five - especially as regards the "source principle and the inflow and outflow of foreign investments.

Nigeria's tax treaties are examined in Chapters Six, Seven and Eight. This takes place in the light of the OECD Draft Double Taxation Convention on Income and Capital. Cognisance is also taken of recent developments on the international scene.

A resumé of the principal findings and recommendations is offered in Chapter Nine.

Although considerable thought was given to the taxation of oil companies, material on this subject had to be dropped at the last minute because of the present confused state of the international oil industry and its direct influence on Nigeria's internal law. References in the text to our proposed chapter on Oil Company Taxation must, therefore, be disregarded. (Please see note at page 610 infra.)

This thesis states the law as at 30th September 1974.

A. A.

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ABBREVIATIONS

A.C.	Law Reports, Appeal Cases (U.K.).
All E.R.	Law Reports, All England Law Reports.
A.I.T.R.	Australia and New Zealand Income Tax Reports.
A.J.I.L.	American Journal of International Law.
A.L.J.	Australian Law Journal.
A.L.J.R.	Australian Law Journal Reports.
A.L.R.	Annotated Law Reports (Israel).
All N.L.R.	All Nigeria Law Reports.
A.S.C.L.	Annual Survey of Commonwealth Law.
B.I.F.D.	Bulletin for International Fiscal Documentation.
B.T.R.	British Tax Review.
B.Y.I.L.	British Yearbook of International Law.
Cahiers	Cahiers de Droit Fiscal International.
C.B.N.	Central Bank of Nigeria
Ch.D.	Law Reports, Chancery Division (U.K.).
C.G.T.D.	Capital Gains Tax Decree 1967, No. 44, 1967.
Cmd., Cmnd.	COMMAND Paper.
CITA	Companies Income Tax 1961, No. 2, 1961.
C.L.R.	Commonwealth Law Reports, Australia.
C.T.C.	Canadian Tax Cases.
D.L.R.	Dominion Law Reports, Canada.
D.T.C.	Dominion Tax Cases.
E.A.L.J.	East African Law Journal.
E.A.L.R.	East African Law Reports.
E.A.T.C.	East African Tax Cases.
F.S.C.	Law Reports, Federal Supre Court, Nigeria.
H.K.L.R.	Hong Kong Law Reports.
I.C.C.	International Chamber of Commerce.
I.C.L.Q.	International and Comparative Law Quarterly.
I.C.T.A.	Income and Corporation Taxes Act 1970, U.K.
I.T.J.	Indian Tax Journal.
ITMA	Income Tax Management Act 1961, No. 21, 1961.
I.T.R.	Indian Tax Reports.
J.W.T.L.	Journal of World Trade Law
K.B.	Law Reports, Kings Bench.
L.L.R.	Lagos High Court Law Reports.
L.R.B.G.	Reports of the Supreme Court (British Guiana).
M.N.R.	Minister of National Revenue (Canada).
N.L.C.D.	National Liberation Council Decree (Ghana).
N.L.R.	All Nigeria Law Reports.
N.Z.L.R.	New Zealand Law Journal.
N.Z.T.B.R.	New Zealand Tax Board Review.
OECD	Organisation for Economic Cooperation and Developmen
OPEC	Organisation of Petroleum Exporting Countries.
P.D.	Law Reports, Piskei Din, Israel.
Q.B.	Law Reports, Queen's Bench.
Q.B.D.	Law Reports, Queen's Bench Division.
S.A.L.R.	South African Law Reports.
S.A.T.C.	South African Tax Cases.
T.C.	Law Reports, Tax Cases (U.K.).
T.L.R.	Times Law Reports.
T.R.	Taxation Reports, U.K.
U.K.	United Kingdom.
UNCTAD	United Nations Conference on Trade and Development
W.A.C.A.	Law Reports, West African Court of Appeal.
W.L.R.	Weekly Law Reports, U.K.

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CHAPTER ONE

INTRODUCTION

I. PRELIMINARY REMARKS

Conceived initially as a study of Nigeria's tax treaties, the scope of this thesis has been enlarged in order to embrace other important and yet untreated aspects of the country's taxation. In the choice of subject-matter, we have been influenced by the following factors: (1) the need to present a logical argument; (2) the importance of breaking new grounds - thus avoiding a duplication of earlier efforts,[1] and above all, (3) the desire to relate our discussion to the contemporary issues facing Nigeria as an example of a developing country.

Conscious of the fact that taxation is essentially an instrument of fiscal policy as well as being a part of the general law, an interdisciplinary treatment of selected problems have been adopted. Whereas, other writers[1] have adhered strictly to an examination of tax principles, our discussion takes place in a much wider context. Wherever relevant, account is taken of the inter-relationship between the tax law and other branches of law; notably, the principles of

1. Particular notice has been of the works of these writers: S.O. Fashokun, Personal Taxation in Nigeria - unpublished Ph.D., 1971 (London); I.S.L. Agboola, Company Taxation in Nigeria, with special reference to the Anti-Avoidance Provisions and the Investment Incentives - unpublished Ph.D., 1968 (London); G.O. Orewa, Taxation in Western Nigeria - O.U.P. 1962; C.S. Ola, Income Tax Law and Practice in Nigeria - Heinneman, 1974.

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of conflicts of law, company law, commercial law, public international law and international economic law. In addition, due to the paucity of Nigerian authorities,[2] the subject-matter is treated on a comparative basis. Much reliance is placed on Commonwealth cases[3] in order to interpret or illustrate principles of local taxation.

In our analysis, two dominant themes emerge. Firstly, the question of how best to stimulate foreign investments, desirable trade and services, and the tax consequences of such activities. In other words, attention is focussed on the interaction of the national tax law with that of the foreign investor. Secondly, the internal workings of the present system as influenced by various social phenomena is examined. (i.e. illiteracy, social attitudes, cultural conflicts with statutory law, scarcity of skilled personnel, etc.)

A broad outline of the topics covered has been given in the ABSTRACT. These are spelt out in further detail in the introductory section of each chapter. What follows immediately is a brief outline of the Nigerian tax system as a necessary background to our subsequent discussion.

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2. Whereas, there are thousands of cases in other branches of law, until 1972 there were less than a dozen reported cases on Nigerian taxation. However, with the introduction of the Federal Revenue Court the picture is rapidly changing.

3. There is much similarity in the tax laws of most Commonwealth countries; evidence, perhaps, of their common legal heritage.

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II. THE NIGERIAN TAX SYSTEM: A PERSPECTIVE

A. Evolution and History

The origins and evolution of Nigeria's tax statutes are well documented.[4] For our purposes, it is sufficient to note that these were derived from a Colonial Tax Model prepared in the U.K. and subsequently introduced in the colonies and other overseas territories.

Shortly before the attainment of independence in 1960, the Raisman Commission recommended[5] the setting up of a study group, or more accurately that a special conference be convened attended by the representatives of all the governments of the Federation - the object of which was to draft a tax code adopted to the peculiar needs of the country.

Regrettably, the Commission's recommendation was not followed. What the country, therefore, has at present is a tax system too complex to be intelligible to the average citizen and with no other major objective save that of providing governmental revenue.[6] The suitability or otherwise of the present law in achieving its limited but yet important objective is our principle concern in this thesis.

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4. For example, see S.O. Fashokun, Personal Taxation in Nigeria - op. cit. Chapter 1, pages 1 - 136. The author traces the development of the taxation system from the pre-Lugard era (i.e. the indigenous system) to the introduction of modern statutes. See also Adedotun Philips, Nigeria's Companies Income Tax - In this article the author traces the evolution of the present Income Tax Act - (1968) Vol. 10, No. 3 Nigerian Journal of Economic and Social Studies, pp. 321 - 323.

5. Report of the Fiscal Commission: Nigeria - (1958), Cmnd. 481, page 21, para. 92. The Report was compiled by Jeremy Raisman and R.C. Tress.

6. Although the rates of taxes are progressive, the law does not aim at shifting wealth from the rich to the poor. There are no wealth or gifts taxes and no estate duty. However, there are specific statutes to attract foreign investors and to aid pioneer industries.

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B. Taxation and the Federal Set Up

The federal structure of Nigeria after 1954, and the need to provide sources of revenue for each of the governmental units led to a division of taxing authority between the Federal Government at the centre and the then Regional governments.[7] In accordance with the recommendations of the Raisman Commission,[8] and following the pre-independence pattern, the Federal Government is still vested with the tax authority in respect of the income and profits of companies.

Evidently, "the fundamental reason for making companies tax a Federal subject is the difficulty of dividing up the profits of companies which operate in the whole of Nigeria, so as to attribute particular parts of the profits to particular regions".[9] The position remains as true today as it was twenty years ago.[10]

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7. Now 'state' governments. Cf. States Creation Decree 1967 which divided the country into twelve political units called "states". For a more detailed account of the division of taxing powers within the Federation, see W.R. Cotter, "Taxation and Federalism in Nigeria" - (1964) B.T.R. 97. Even after 1967 the position remains very much the same.

8. Cmnd. 481 (1958) para. 99.

9. H.R. Hicks and Sydney Phillipson, Report of the Commission on Revenue Allocation (1951) para. 87.

10. Although this tax is centrally assessed and collected, it goes into the Distributable Pool Account of the Federation and is then shared out among the states according to a pre-determined formula. Several experiments have been made in the past as regards revenue allocation. Even today, the matter is far from settled. See recent statement of Federal Commission of Finance, "Government to Evolve New Revenue Allocation Formula - Daily Times (Nigeria) January 21st 1974, page 2.

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Jurisdiction over personal income has always been reserved to the states,[1] the Federal Government having only a limited authority in this field to provide uniform rules for the computation of tax and as regards the administration of the state tax laws.[2]

Apart from the above, it is important to note that the Federal Government is solely responsible for making laws for the purpose of:

(a) implementing any treaty, convention or agreement between the Federation and any other country ... with respect to taxes on income and profits;[3]

(b) securing uniform principles for the taxation of income and profits accruing to persons in Nigeria from countries other than Nigeria and of income and profits derived from Nigeria by persons outside Nigeria.[4]

The problems inherent in this type of constitutional arrangement are examined in the appropriate chapters, e.g. in Chapter Six as regards the double taxation agreements, and in Chapter Four as regards dividends.

C. The Principal Taxes and Enactments

Individuals and companies in Nigeria are liable to taxation on their

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1. s.76(4), 1963 Federal Constitution as amended. This position may however be changed in the near future. According to General Yakubu Gowan in his 1974/75 Budget speech - "the Supreme Military Council has approved in principle the introduction of a uniform system of personal income taxation throughout the country .... (involving) the same rates and similar personal reliefs and allowances ... (in order) to facilitate the mobility of high level manpower ... etc". - Daily Times (Nigeria) 2nd April, 1974

2. s.76(2) 1963 Constitution. The use of the "residence" criterion for avoiding internal double taxation where an individual's activity transcends state boundaries is discussed in Chapter IV.

3. Ibid. s.76(2)(a)

4. Ibid. s.76(2)(b).

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income and to a lesser extent on their capital gains.[5]

The liability of companies is regulated by the Companies Income Tax Act 1961, (No. 22) as amended by subsequent legislation and hereinafter referred to as CITA. The liability of individuals and partnerships on the other hand, is regulated by the state tax laws modelled on the Income Tax Management Act 1961, (No. 21) as amended by subsequent legislation and hereinafter referred to as ITMA. This latter enactment is a federal statute made in pursuance of that government's constitutional powers to provide uniform rules of taxation in the country.

The Capital Gains Tax Decree 1967 (No. 44 of 1967) as amended by subsequent legislation and hereinafter referred to as CGTD is applicable to all companies in Nigeria and to individuals and partnerships in Lagos and the Mid-West states.[6]

Companies engaged in the petroleum industry are assessed and taxed in accordance with the provision of the Petroleum Profits Tax Ordinance 1959, (No. 15 of 1959) as amended.

Other relevant statutes are referred to in the appropriate context.

D. Machinery for Assessment and Collection - Tax Avoidance and Evasion

Like several other countries, income tax assessment and collection is a major problem in Nigeria. As W. Arthur Lewis observed in 1966,

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5. Until recently companies were liable to a Super Tax in addition to income tax but the first mentioned tax has now been abolished by s.3 of the Finance (Miscellaneous Taxation Provisions) Decree 1972, No.47 of 1972.

6. s.46(3) CGTD. Note that the decree can only be applicable to matters of personal taxation if specifically adopted by a state just as the Mid-West and Lagos states have done.

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"the direct taxes on individuals (in Nigeria) can be doubled by better administration, reducing evasions, even without increases in rates".[7] This assertion which is probably true, is now generally recognised by the governments of the Federation.[8]

Wherever necessary in our discussion, the machinery for the assessment and collection of taxes is described and examined in outline. A fuller investigation of the problems in this area of taxation would merit a completely different study.[9]

II. <u>OTHER REMARKS</u>

Two recent events are likely to influence the development of the Nigerian tax law. While the newly introduced Federal Revenue Court[10] is likely to help in clarifying obscure aspects of the country's taxation, and is a clear manifestation of the government's resolve to get a maximum yield from direct taxation; the increasing revenue from oil[1] may relegate direct taxation to the background as a major source of governmental revenue in future.

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7. Part of mimeographed notes entitled "Reflections on Nigerian Growth" distributed during a seminar series at the University of Ibadan, Nov. 1966; Adedotun Philips in his article already cited highlighted the very low yield from direct company taxation.

8. For example, in May 1973 a National Conference on the problems and prospects of Income Tax Enforcement in Nigeria was held at the Ahmadu Bello University, Zaria.

9. For a helpful analysis of the situation see Milton C. Taylor, "The Relationship between Income Tax Administration and Income Tax Policy in Nigeria" - (1967) The Nigerian Journal of Economic and Social Studies, Vol. 9, No. 1, p. 203.

10. Established in 1973 by Federal Revenue Court Decree (No. 13 of 1973)

1. The Federal Government's revenue from the oil exploration industry was - 206.037 million for the first quarter of 1973, i.e. more than £100 million sterling. Figures from the Central Bank of Nigeria : Monthly Report, October 1973 at page 8.

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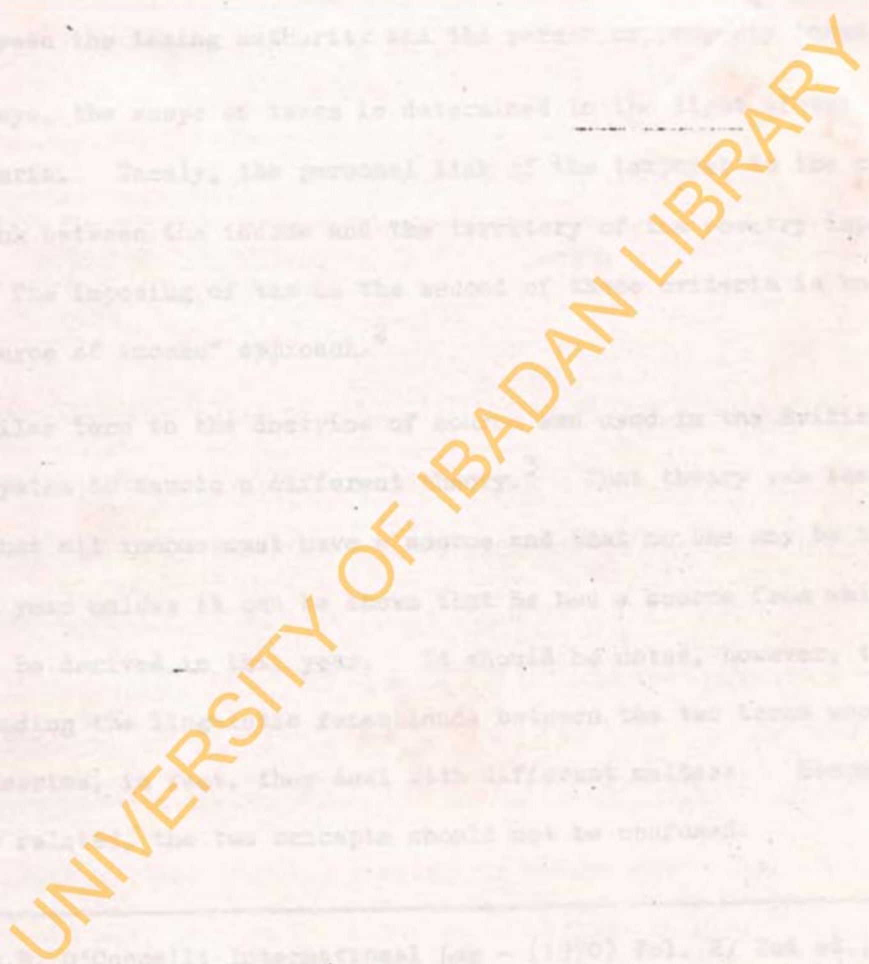
However, until that happens, direct taxation would continue to be an important subject.



CHAPTER TWO

IN SEARCH OF A TAX PHILOSOPHY

I. BASIS OF TAX LIABILITY IN GENERAL

Whereas, the right to levy taxes is an attribute of state sovereignty, and is in theory unrestricted,[1] for all practical purposes there must be a link between the taxing authority and the person or property taxed.

Nowadays, the scope of taxes is determined in the light of two well known criteria. Namely, the personal link of the taxpayer to the country, and the link between the income and the territory of the country imposing the tax. The imposing of tax on the second of these criteria is known as the "source of income" approach.[2]

A similar term to the doctrine of source was used in the British income tax system to denote a different theory.[3] That theory was based on the idea that all income must have a source and that no one may be taxed in a given year unless it can be shown that he had a source from which income could be derived in that year. It should be noted, however, that notwithstanding the linguistic resemblance between the two terms used for the two theories, in fact, they deal with different matters. Hence, apparently related, the two concepts should not be confused.

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1. Cf. D.P. O'Connell: International Law - (1970) Vol. 2, 2nd ed., page 715 et seq.

2. For a description of the "source" approach in one country, see Butterworth South Africa Income Tax Practice - edited by M.J. Wells, being a revised edition of - Law and Practice of South African Income Tax by I. Isaacs, W.D. Fielding and L. Lazar 1970, page 882, para. 572 et seq. See also Silke on South African Income Tax Law - by A.S. Silke 7th ed. Juta, 1972 at page 124 et seq.

3. Whiteman and Wheatcroft: Income Tax and Surtax - 1970, Butterworth, page 18, para. 1 - 28.

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Generally speaking, most tax systems do not adhere to one of the tests which have been mentioned above, but adopt elements of both. The English tax system for example, is based on the assumption that with certain exceptions, a domiciled resident of Great Britain is to be taxed on his income wherever derived,[4] and that a non-resident of the U.K. may be subject to tax if his income is derived from a source within the U.K.[5]

The objective of this chapter is to establish the basis of liability under the Nigerian law where tax is payable for each year of assessment upon income (or profits):

> "accruing in, derived from, brought into or received (in Nigeria) .... etc".[6]

I. LIABILITY TO NIGERIAN TAXATION: "INCOME ACCRUING IN, OR DERIVED FROM ...."

A. A "Source" Approach?

The terms "accruing in" and "derived from" are not defined in the Income Tax Acts and neither do we get much help in interpreting them from the jurisprudence of the Courts.

Historically, the provisions charging tax on income "accruing in" or "derived from" Nigeria seem to derive their origins from s.5 of the Model

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4. A non-domiciled resident is taxed on a remittance basis as regards his non-U.K. income. However, there are proposals in the 1974/75 Budget to make him liable on his world income if permanently resident in the U.K.

5. Sections 49 - 50 Income and Corporation Taxes Act 1970 (U.K.) - herein after referred to as ICTA 1970. Cf. Colquhoun v. Brooks [1889] A.C. Page 493.

6. s.4 ITMA; s.17 CITA, emphasis supplied. For a general discussion of the problems in this area of law see B.H. Rahim: "In Search of the True Meaning of 'Accrued in or Derived from'". (1971) Vol. 7, E.A.L.J. 258.

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Ordinance prepared in England in 1922 by the Inter-Deparrmental Committee on income tax in the Colonies not possessing self government. Quite clearly, an indication that the notion of "source" is implicit in the terms "accruing in" and "derived from" which appear in the tax laws of several U.K. ex-colonies,[7] can be found in the explanatory comments of the fiscal Committee. They submitted that after careful consideration, they had come to the conclusion that the most appropriate scheme for the colonies generally, was one which imposed tax "upon income which either has its origin in the colony, or while having its origin outside is received in the colony".[8]

Be that as it may, it must be stressed that the Nigerian provisions do not speak of income "accruing in, or derived from a source ..... in Nigeria" as do parallel provisions in the tax legislation of some other territories within the Commonwealth; for instance, South Africa.[9]

The South African Income Tax Law adopts as its fundamental principle the test of the connection between the income and the territory of the country. In so doing, it probably resembles the Nigerian system, but unlike the Nigerian Law, the South African Income Tax Act 1962 contains an

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7. For example, see Ghana s.5, 47 (3), Income Tax Decree 1966. (N.L.C.D. 78)(as amended). Also India, Income Tax Act 1961 ss. 4,5, 9 and 10(7) (as amended).

   It is interesting to note that the original words are still used in the tax laws of many new countries even though they have parted ways economically with Britain for several years.

8. Cmd. 1788, page 5.

9. s.1(xi). Income Tax Act 1962, No. 58, of 1962. Note that South Africa was once within the Commonwealth.

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explicit reference to the source of income. That is, income is chargeable to tax in South Africa, if it is "derived from a source" located in the Republic of South Africa.[10] The personal circumstances of the taxpayer are a secondary issue.

The above may be contrasted with the income tax legislation in Colombia, which rests on the principle that the tax powers are confined to persons, property and business within its territory. Its concept of taxable income, is any income regardless of source, obtained by the taxpayer during they year - less the costs incurred in producing such receipts. In other words, the over-riding criterion is "enrichment" - that is, anything that adds to the taxpayer's wealth and, hence, to his taxing capacity, is a taxable receipt; unless, of course, it is expressly exempted from tax by law.[1]

Apart from the contention of one Israeli writer,[2] and the inferences from historical data, is there further evidence in support of our equating the Nigerian charging provisions to the "source" approach? What is the difference, if any, between the expression "accruing in" and "derived from"

10. For a discussion of the concept of "Gross income", see L. Lazar: "Income Tax Provisions which affect the foreign Investor in the Republic of South Africa". (1964) B.T.R. page 419 at 420-421.

1. Taxation in Colombia - World Tax Series (1964) at page 332. Harvard Law School publication.

2. A. Lapidoth, analysing similar provisions in Israeli tax laws, suggested that the intention of the Legislator in using these terms seem to have been that income is chargeable if was "created or arose" in Israel - "The Tests for the Determination of the Scope of Taxes: The territorial location of the object and the personal link of the taxpayer to the country" - (1969) Israel Law Review, Vol. 4, No. 3, p. 392 at 393.

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as used in the taxing statutes?

Even though there is language in at least one West African decision[3] which may be interpreted as a tacit recognition that a distinction exists between "derived from" and "accruing in",[4] this writer is of the opinion that the terms are synonymous. In this, we are supported by a number of Commonwealth authorities.

For example, according to Lord Davey in C.I.R. v. Kirk,[5]

> "their Lordships attach no special meaning to the word 'derived' which they treat as synonymous with 'arising' or 'accruing'".[6]

Also, in Esso Standard Eastern Inc. v. C.O.T.,[7] Duffus, P., had no difficulty in agreeing[8] with the trial judge that the expressions "accruing in" and "derived from " as used in the Kenyan Law[9] can be regarded as synonymous.

Without belabouring the point, for our purposes, the expressions

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3. Cf. Roper, J. in Karam v. C.I.R. [1948] 12 W.A.C.A. 331 at 337. See also Herbert Cox, C.J., in C.O.T. v. P. Co. Ltd. 1 E.A.T.C. 131 at 165 where he observed as follow; "I am inclined to the view that while it is clearly possible for 'derived' and 'arising and accruing' to be synonymous in certain cases, it may well be possible that be not so in all".

4. It may be observed that to identify these terms would appear to be in conflict with the principles of statutory construction whereby every word in a statute is presumed to have an independent meaning unless a contrary intent clearly appears.

5. [1900] A.C. 588.

6. Ibid., at p. 592

7. [1971] E.A.L.R. 127

8. Ibid., at p. 143

9. The charging provisions are in all material respects similar to the Nigerian Law.

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"accruing in" and "derived from" would be regarded as coterminous. Subsequently, they would be employed as alternatives - the use of one implying the use of the other.

To take our discussion one step further, what then do we understand by the expression "derived from" or "accruing in"?

The meaning of "derived from" has been the subject of litigation in two Nigerian cases concerning remuneration and employment. It has also been judicially considered in three East African cases; one involving director's salaries, another the source of a sales agent's commission and the third the source of interest income.

In Re Potter,[10] a case concerning the interpretation of charging provisions similar to the present Nigerian law, the petitioner, an employee of a shipping company in Nigeria, was assessed to income tax on a year's income including salary paid to him while on leave in England. He objected to the assessment, as his contract of service in Nigeria expired on his reaching Liverpool, and as he was paid salary on leave only under the following clause of his contract:-

> "(13) If after the expiration of the said term of twelve months or such subsequent period as aforesaid on the Coast, the Employee shall return to England and shall during such term have given full satisfaction to the company, and if the company agree to renew the engagement hereby entered into, the Employee shall be entitled to three months leave of absence to be computed from the date of his departure from the coast until the date of his sailing from Liverpool on his return and during which time the company shall pay him a salary at the rate of £41.18s.4d."[1]

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10. [1934] 11 N.L.R. 144
1. Op. cit., at page 144

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Carey, J.,had no difficulty in holding that the salary paid to the petitioner while on leave, was derived in respect of gains or profits from his employment and was, therefore, rightly included in the assessment for income tax.

In the rather scanty and unsatisfactory judgement in which not one single legal authority was cited, one finds it difficult to know the reasoning behind his Lordship's decision. Therefore, the judgement, though, in our opinion right,[2] cannot be much of a legal authority today. For example, did the learned judge specifically address himself to the question whether the provisions "accruing in" or "derived from" were synonymous? - and if so, whether these terms can be said to mean the same thing as the "source" of assessable income? Secondly, did the learned trial judge consider the various legal theories about the source of employment income - a matter examined by us at great length in another chapter, and on which there is much learning?[3]

The above decision may be compared, with another Nigerian case with fairly similar facts and concerning the interpretation of the charging provisions of the same Income Tax Ordinance. In the Matter of the Non-Native Income Tax Ordinance 1931, the petitioner, a bishop working in Nigeria, contended that he was assessed to pay income tax on salary received during a period of leave in England; that his salary was paid from a fund subscribed in England and not contributed to from Nigeria; and that his leave salary, being neither derived from nor received in Nigeria was not assessable to tax. The Crown on the other hand submitted that the leave salary was derived from employment in Nigeria and was, therefore, taxable.

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2. Why we consider it right would become clear when we discuss the "originating cause" of income and its place of location in the chapter on employment income.

3. Post., Chapter IV

4. [1931]5 W.A.C.A. 142

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The West African Court of Appeal, confirming the judgement of the Court below distinguished the present case from Potter's Case. The Court adopted the statement of the trial judge, where the latter said as follows:

> "with great respect to the decision in Potter's case, I am unable to apply it here. If the section read 'chargeable income derived from gains or profits from any vocation, employment etc. in Nigeria',[5] there is no doubt the petitioner's leave salary would be assessable. But these are not the words of the section. I do not think the words of the section 'derived from Nigeria in respect of gains or profits from any vocation etc.'[6] can bear that interpretation.
>
> As the section stands, I think a distinction must be drawn between the petitioner's case, and the cases for example, of a merchant or public servant in Nigeria, where the income derives from Nigeria in respect of the gains from his trade or vocation no matter where the recipient receives it".[7]

Finally, the Appeal Court concluded that were the words "derived from Nigeria" to be construed as meaning "derived from employment in Nigeria", one would be reading into the Ordinance words that were not there and which would materially affect the meaning.[8]

The ratio decidendi in this latter case is also difficult to comprehend

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5. Emphasis supplied.
6. Emphasis supplied.
7. [1939] 5 W.A.C.A. 142.
8. Ibid., at p. 143

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since the very brief judgement was in no way expository nor analytical and only Potter's case was cited.

However, two things are evident, neither did the Court consider whether or not "accruing in" or "derived from" mean the same thing, nor was any special attention paid to the fact that the "cause" of the leave salary being paid was the employment in Nigeria. A literal interpretation was preferred, thus equating the expression "derived from" to "got" or "obtained". Clearly, this is an approach which is not unreasonable.

It is in accord, for example, with the decision of the Supreme Court of Palestine in Palestine Discount Bank Ltd. v. Tel Aviv Assessing Officer,[9] where the court similarly rejected the contention that income was subject to tax if its source was in Palestine, stating that in order to adopt such interpretation, the phrase, namely, "derived from Palestine", in the tax Ordinance would have to be read as "derived from a source in Palestine". In this case, s.2 of the Palestine Income Tax Ordinance was interpreted by the Supreme Court as follows: - the term "accruing" the Court thought referred to sums which became payable to and was actually paid or credited to a person in Palestine, that "received" referred to sums actually received in Palestine; and "derived from" referred to sums received inside Palestine from outside Palestine.

Applying this interpretation to the facts of the Discount Bank Case, the Court decided that the bank was not chargeable in respect of certain sums of interest (credited to it and not received in Palestine) on foreign securities and deposits in foreign banks. The Court rejected the submission that the payments ought to be taxed since their source was in the activities of the Bank which was located in Palestine. Also interesting was the Court's attempt to draw a distinction between "accruing in" and "derived from" as we have indicated.

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9. [1947] A.L.R. 418; Lapidoth op. cit., page 394.

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On the other hand, Lapidoth has been quick to point out and rightly too, that the Supreme Court of Israel has preferred to interpret the words "accruing" or "derived from" as referring to the source of income, that is, income is taxable in Israel if it flows from a source situated in Israel. His conclusion is based on the following passage from the Supreme Court opinion in Assessing Officer v. Gross.[10]

> "As is well known, income is not taxable in Israel under s.5 of the Income Tax Ordinance unless it accrues in or is derived from Israel or is received there. Did these wages accrue in or were they derived from Israel? In order to answer this question we must ascertain the geographical location[1] of the source of the income".

Furthermore, in another case this same Court used the expression "having its source in Israel" as equivalent to accruing in or derived from Israel.[2] Basically, we do agree with the Supreme Court's views but have some strong reservation about the restriction of the source concept to its purely geographical meaning.

In an East African case referred to already, Esso Standard v. Comm. of Income Tax,[3] the Commissioner of Income Tax confirmed an assessment on the appellant, of income tax on interest received by it in respect of a loan. The loan agreement was made with a Kenya Company for the construction of a refinery at Mombassa and for working capital. The agreement was made in New York, the

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10. [1960]14 P.D. 668 at 690. A. Lapidoth op.cit. at page 395.

1. Emphasis supplied.

2. Assessing Officer Tel Aviv v. Giora Gordik International Promotions (1965) Ltd. (1) 23 P.D. 36.

3. [1971] E.A.L.R. 127.

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payment of the loan was made in New York in dollars, and all repayment of the loan was made in New York in dollars. The question was whether the interest on the loan accrued in, or was derived from Kenya. At the Court of Appeal, Duffus, the President of the Court, observed that although:

> "the word 'source' is not used in our Acts ..... the words 'income derived from Kenya' have the same meaning as the word 'source' ...... used in other legislations ...(that is) ...... such income as the taxpayer derives from Kenya ....
> The legislation in South Africa is different in that it defines 'gross income' as being the total amount received by a taxpayer from a source within the Union. Here, a similar reference would be to the income derived by the taxpayer from Kenya".[4]

The Court decided unanimously confirming the judgement of the trial judge that the source of income is the place from which it is derived and is a question of fact. That, the source of the interest was the contract made in New York, and that the location of that source was in New York. In other words, the interest neither accrued in nor was derived from Kenya.

The attitude of the courts in New Zealand have more or less been the same.[5] According to L. Lazar commenting on the case of Salmond Spraggon Ltd., there is no real distinction between "derived from New Zealand" and "derived from a source in New Zealand". In this author's view, the concept of derivation

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4. Ibid., at page 134
5. See L.R.C. v. N.V. Phillips [1955] N.Z.L.R. 868 at 874
6. [1968]10 A.L.T.R. 689.

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seems necessarily to imply a source.[7]

Thus far, we have outlined a trend in a few countries for the courts to adopt a source of income approach even where the words of the statute do not categorically provide so. But the big problem is that the word "source" has several possible meanings.[8] Therefore, whilst we endorse the attitude of the courts generally, we do not believe, as the Gross Case and others have tended to suggest, that the concept of source is restricted to the mere geographical source of the income. This is a matter which is discussed in much detail a little later. But in the meantime, to illustrate our point let us refer to the East African Case of Alfred Granville Ross v. R.[9] where Bacon, J.A., reading the judgement of the Court of Appeal expressed the central issue of the case succinctly, when he said that "the question was what was the source of the income concerned"?[10]

The emphasis here is on the word "what" which suggests a cause and effect relationship, rather than the simple geographical source were the question to be phrased differently as follows - "where was the source of the income concerned"?

The facts of the case were as follows: The appellant, a partner in a firm of commission agents, carrying on business in East Africa and England had

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7. (1969). Annual Survey of Commonwealth Law - Butterworth, at 237 referred to hereinafter as (A.S.C.L.).

8. Cf. C.I.R. v. Lever Bros. and Unilever Ltd. 14 S.A.T.C. 441 at page 448. See for example, E.W. Klimowsky - "The Source of Income in Municipal and International Taxation" - (1960) Vol. 14 BIFD page 66 et seq. The author in this article reviews the concept of the source of income which varied from country to country. In his opinion at p. 76 the source of income is composite and is made up of a qualitative and quantitative element which jointly and by their combined effect lead to the income itself.

9. [1957] E.A.T.C. 507.

10. Ibid., at p. 513.

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been convicted on a retrial, on thirty-five counts charging him with the making of false returns to evade tax. He was sentenced to one year's imprisonment and fines totalling £5,000. The substance of his appeal against conviction was that the firm's undeclared income was commission from overseas suppliers paid to, and retained by the U.K. office, and was not income derived from East Africa. The Court held that the firm procured its income from obtaining orders and it was open to the jury to find as a fact that the income in question was largely earned in and, therefore, derived from East Africa within the meaning of the Tax Ordinance.

After that brief digression we may return to the main theme of our discussion.

In a Southern Rhodesia case, there is further authority for the view that the correct and better understanding of the provisions of Nigerian tax law, is that income is liable to tax in Nigeria, if it has it source in Nigeria, - i.e. source either in a geographical, causal or other sense. This is as opposed to the findings in two Nigerian cases[1] where a different conclusion was arrived at based on a literal interpretation of the Ordinance. In Liquidator, Rhodesia Metal Ltd. v. Commissioner of Taxes,[2] their Lordships of the Privy Council appear to have accepted the view that the source of an income and the place of derivation are questions of fact - or perhaps of mixed fact and law.[3] And according to Sir Newham Worley, V.P., in a Tangayika case "there is no mystery in the words 'derived from', to say that a thing derives from a place is to say that it has its source in that place".[4]

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1. See In the Matter of the Non-Natives Income Tax Ordinance 5 W.A.C.A. 142 and Karam's Case.

2. [1940] A.C. 774 at pages 789 - 790.

3. Esso Standard Case, op. cit., at page 146 per Spry, V.P.

4. The Commissioner of Income Tax v. P. Co. Ltd & al. 1 E.A.T.C. 131 at page 164.

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Finally, one other reason why it is thought that an interpretation of the expressions "accruing in" and "derived from" as referring to the source of income is preferrable, is because it allows the Nigerian tax system which has very few domestic court decisions in this area to draw upon precedents from other countries where the source of income method is applied either because of an explicit reference to "source" in written law, or by way of analogy.

Alternatively, and better still, we submit that the Nigerian tax legislation should adopt a clear cut "source" approach instead of the use of words, which have to be interpreted by protracted legal reasoning in order to discover their true meaning.

While precedents in other countries could be helpful in the development of the Nigerian law it is essential to bear in mind the warning of their Lordships of the Privy Council in the Rhodesia Metal Case,[5] that decisions on the words of one statute are seldom of value in deciding on different words in another Statute. But presumably, where the words in different statutes are identical, judicial decisions on one should be strong persuasive authority in construing the others; especially, in jurisdictions with the same Common Law tradition. Theoretically too, a wide source concept is likely to yield more revenue to the State.

Is the source approach a panacea to all problems of legal interpretation as far as the charging provisions are concerned? Can it be

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5. Op.cit., at page 788

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said to be a means to an end, or an end itself? Straight away, there is a distinction which must be drawn as emerging from the decided cases, between a mere geographical source of income; the true or real source, based on a cause and effect relationship; and thirdly, a legal or deemed source according to statutory provisions.

B. Legal Meaning of Source - Application of Principle

The source approach is not trouble free, for just as the terms"accruing in" and "derived from" are not defined in Nigerian Law, neither does the South African nor the Australian law define "source". This is a consequence of the fact that the term cannot be exhaustively defined. Nevertheless, judicial authority is not lacking giving some ideas about its possible meaning. For example, in the appeal that reached the Privy Council already mentioned, in which the meaning of "source" in the Southern Rohodesia Income Tax Act was examined, Lord Atkin quoted with approval the view expressed by Ingram on South African tax law that:[6]

> "Source means not a legal concept, but something which a practical man would regard as the real source of income" and that "the ascertainment of the actual source, is a practical hard matter of fact".[7]

The above statement is only marginally helpful. Assuming that source

6. Liquidator Rhodesia Metal Ltd. v. Commissioner of Taxes [1940] A.C. 744 at 789. See also Nathan v. Federal Com. of Taxation [1918] 25 C.L.R. 183 at 189 - 190 where the same principle was stated.

7. Emphasis supplied.

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is not a legal concept, what does the so-called practical man regard as the real source of income? The Supreme Court of Israel has said that we must look at the "geographical location"[8] of the income while the West African Court with Roper, J., delivering the majority judgement, has held in Karam v. C.I.R.[9] that the words "accruing in" and "received in" imported a clear territorial limitation to the Gold Coast (now Ghana); and that the words "derived from" appear to be designed to meet, among other things, cases where profits arise from transactions carried out in that country. In that circumstance it was doubted whether the words can reasonably be held to apply to the case where a firm established in the Gold Coast carries out a business transaction in a country outside the Gold Coast, the profits in respect of which does not "accrue in" and are not "received" in the Gold Coast.

It is interesting to note the distinction which the Court attempted to draw between "accruing in" and "derived from".

The facts of the case so far as relevant were as follows: The appellant was a member of a firm of merchants carrying on business in the then Gold Coast. The same persons were also registered to carry on business in England, the English firm purchasing and shipping goods to the Gold Coast firm. During the war, some of the firm's goods were mistakenly shipped to Lagos where a ready market was found and the goods were sold at a handsome profit. The profit from the sale were partly remitted to the Gold Coast but the bulk of it remained in Nigeria. Nevertheless, the appellant was assessed to tax in respect of these profits on the

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8. See Gross Case, op. cit.

9. [1948] 12 W.A.C.A. 33 at 337.

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ground that it accrued to the firm in the Gold Coast.

Lucie Smith, C.J., in his minority judgement, reasoned that in a situation where the appellant ordered goods for delivery at Takoradi, which by some mischance were carried to Lagos, where seizing the opportunity for higher profit they were sold, the profits arising from the transaction were derived from the business activities carried on in the Gold Coast. Following San Paulo Railway v. Carter,[10] which is authority for the proposition that where a trade is wholly or partially carried on in a country the trader is liable to pay income tax on his trade, the learned Chief Justice held that the appellant was liable to Gold Coast income tax.[1] Roper, J., however, while purporting to follow the cannons of statutory interpretation in fiscal matters held in his majority judgement that to adopt the Chief Justice's view would be to strain the words of the Statute too severely against the taxpayer. He was of the opinion that in the absence of some express provision to the contrary:

> "the true meaning of s. 7 of the Ordinance, is that liability to pay income tax is limited in the geographical sense to transactions carried on in the Gold Coast and does not extend to transactions carried on outside it".[2]

In our opinion, the difference between the two judgements, is that

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10. [1895] Q.B. 580; [1896] A.C. 31; 65 L.J.Q.B. 161; 73 L.T. 528. 60 J.P. 84, 452; 12 T.L.R. 107. See also London Bank of Mexico and South America v. Apthorpe [1891] 2 Q.B. 378; 60 L.J.Q.B. 653; 65 L.T. 601.

1. Karam's Case, op. cit., at page 334

2. Ibid., at page 337

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while both appear to accept, at least tacitly, that income is chargeable to tax in the Gold Coast if it had its source in the Gold Coast, the Chief Justice was prepared to go further holding that the source of income was in the Gold Coast if the "cause", - in this case, the very existence of the partnerhip itself was in the Gold Coast. Whereas, on the other hand, McCarthy and Roper, J.J., restricted the taxpayer's liablity only to income having its "geographical source" within the Gold Coast.

Today, it would appear that the minority judgement is the one that is applicable to Nigeria in view of the fact that there is clear statutory provision to tax the profits of a company where the trading operations are carried on either wholly or partially in Nigeria and whether or not the company is a "Nigerian Company".[3]

In future, we believe that the concept of source must be given a wider meaning in Nigeria than in a mere geographical sense. The South African case of C.I.R. v. Lever Bros. and Unilever Ltd.[4] is in this respect very illuminating. Whilst it is not necessary to go into the somewhat complicated facts of the case, we wish to refer to the following relevant passage from the judgement of Watermeyer, C.J., which has been quoted with approval in several other cases.[5] His Lordship wrote as follows, that:

> "The word 'source' has several possible meanings. In this section it is used figuratively and when so used in

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3. s.5 ITMA; s. 17, 18(2) CITA. A "Nigerian Company" is one whose management and control are exercised in Nigeria.

4. [1946] S.A.T.C. 441.

5. For example, see Duffus, P., in the Esso Standard Case, op. cit., at page 144.

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relation to the receipt of money, one possible meaning is the originating cause[6] of the receipt of the money, another possible meaning, is the quarter from which the receipt is received.[7] A series of decisions of this court and the Judicial Committee of the Privy Council upon our income tax acts and upon similar acts elsewhere have dealt with the meaning of the word 'source', and the inference I think which should be drawn from these decisions is that the source of receipts, received as income, is not the quarter from where they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the quid pro quo which he gives in return for which he ~~gives~~ receives them. The work which he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages, and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or letting its use to someone else. Often the work is some combination of these."[8]

Similar to the above case, is C.I.R. v. Black[9] where it was held that the source of income is in South Africa if "the dominant, or main or sub-

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6. Emphasis supplied.

7. Emphasis supplied.

8. Op. cit., at page 449.

9. [1957] 21 S.A.T.C. 226.

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stantial or real or basic cause of the income is to be found there". In practice, this test is much wider and more subtle and difficult to apply than the simple geographical test of the source of income.

In C.O.T. Rhodesia v. R.[10] for example, under the will of the respondent's late husband, the residue of his estate was bequeathed to trustees who were required to realise the assets and were given power to invest the proceeds at their discretion and to vary the investments so made. They were further required to pay the respondent during her life time an annuity of £700. At the date of the will, the deceased was resident in Rhodesia, his will was made in conformity with Rhodesian law and probate was granted in Rhodesia. The trustees and the principal beneficiaries resided in Rhodesia. The question was whether income derived by the trustees by way of dividends from shares in United Kingdom and South African companies and admittedly received by them outside Rhodesia, had its "source" in Rhodesia and was liable to taxation there.

The Court held that the originating cause of the annuity was the deceased's trust (a Rhodesian trust) and that since it was created under that law, the source of the respondent's income was in Rhodesia. The term "source" was applied in relation to the location of the obligation to pay and not as regards the place from which the income was received.[1]

In another case, Transvaal Hide and Skin Merchants v. C.O.T. Botswana,[2]

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10. [1966] (2) S.A. 342; [1966] 28 T.C. 115. See Review of the case by L. Lazar (1966) Annual Survey of Commonwealth Law - Butterworth, Chapter on Taxation 483 at p. 526. See also the case of C.O.T. v. Parker [1966] Rhodesia Law Reports p. 144 which had very similar facts.

1. This decision is similar to that in the Esso Case and the Rhodesia Metals Case.

2. [1967] 29 S.A.T.C. 97 (C.A. Botswana) Roper, J., dissenting.

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the issue was the location of profits made by a company (which was domiciled and resident in the Republic of South Africa) from the sale of skins and hides which it purchased in Botswana from abattoirs there. Curing them through the knowledge, skill and work of its own servants at premises made available by the abattoirs, the company took the hides and skins to the Republic of South Africa where they were sold in fulfilment of specific orders and the purchase price was paid. The Collector of Income Taxes, Botswana, was upheld in his assessment of the income as arising in that country. In other words, the Court held that the profits were not realised at the place of sale, not being located there, but where the curing process had taken place. That process was essential to preserve the skins and hides which could not "travel" to the Republic in a raw state. Translated into non-technical terms,[3] what the Court had to do was to choose between the country where the skins and hides were cured, and where they were sold. In such a situation, the established test as pointed out is to seek the dominant (or main or substantial or real or basic) cause of the accrual of the income which is a question of fact.[4]

Certainly, the circumstances of this case were not purely purchase and sale but was more in line with the manufacture of goods in one country and the sale in another; or, the mining of minerals in one place and its sale elsewhere. In the instant case, the fact that the end product was money was not the dominant factor; that factor was the curing of skins and hides and the know-how to carry out the process.

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3. Apportionment between the two countries was inapplicable as no provision existed to that effect.

4. Liquidator, Rhodesia Metals Ltd. v. C.O.T. [1940] A.C. 774 at pages 789-790

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It is interesting to note that the reasoning in the above cases, is more or less in line with that of the minority judgement of Lucie-Smith, C.J., in Karam's Case. In that case, as we may recall, the majority judges seem to have been unduly concerned with the source of income in the strictly geographical sense, instead of giving more weight to the source of income in the causal sense, that is, where the originating cause is to be found - viz Ghana where the control and effective management of the partnership business was located.

One other matter of practical difficulty in adopting a "source" test is the apportionment of income between domestic and foreign sources where there is no dominant or single originating cause. This is necessary because "income can quite plainly be derived from more than one source even where the source is business".[5]

In the recent New Zealand case of Salmond Spraggon Ltd.[6] a right of apportionment was given where the source of royalty income was not exclusively in New Zealand.

As far as Nigeria is concerned, it is submitted that the law ought to be sufficiently flexible to allow apportionment. Surely, s.5 ITMA, and s.18(2) CITA which deal with the situation where a trade is only partly carried on in Nigeria, can be interpreted to that effect. However, the Nigerian case of Federal Board of Inland Revenue v. Aluminium Industries Akitichgeschischoff,[7] gives the impression that whilst the Revenue and the Nigerian courts are prepared to recognise that the originating cause of in-

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5. Rhodesia Metal Case, op. cit., at page 789.

6. [1968] 10 A.I.T.R. considered by L. Lazar in (1969) Annual Survey of Commonwealth Law - Butterworth page 232.

7. Suit No. SC/64/70 (unreported). Discussed at length in Chapter V.

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come may be located in more than one place, yet, they are unwilling to allow apportionment where income derived from Nigeria has more than one logical source.

Apportionment of taxable income between two tax jurisdictions, though desirable, may not always be easy to accomplish. In borderline cases, the hypothetical practical man of Lord Atkin would be in a real dilemma to determine the real source of income. In our opinion, and as L. Lazar[8] pointed out in his review of the Australian case of Federal Commissioner of Taxation v. Mitchum[9] the simple proportion of work done in a geographical area may not be a realistic or decisive test, in determining the sources of income and in resolving the problem of apportionment. Sometimes, a contract of work or employment may be concluded in one area and the work done in another; or the performance of ground work in one place, may result in the actual physical ar effective work being done elsewhere. The instant case was an appeal by the Commissioner from the decision of the Board of Review which had held that no part of the taxpayer's income (a U.S.A. resident) as a film actor, in respect of performances in Australia on behalf of a United States resident company was derived from a source in Australia.

In spite of a number of problems which have been highlighted, the whole picture is not so gloomy. This is because in most cases it is not difficult to decide whether or not a certain sum of income flows from a

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8. (1966) Annual Survey of Commonwealth Law - Butterworth page 527

9. [1966] A.L.R. 29. (H.C. of A.F.C.). In this case the court reviewed the case of Commissioner of Taxation v. French [1957] 98 C.L.R. 398 where salary paid to an engineer in respect of work done in New Zealand by a company resident in both Australia and New Zealand was held not to be derived from Australian sources, etc. This case does not lay down a rule of law that employment income must be regarded as derived from the place of performace of the work but simply emphasises the fact that each case must be decided on its own merits according to its peculiar facts.

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source within a country. But in the absence of a general exhaustive definition of the term "source", each case must be decided on its own facts. With regard to dividend income for example, it has been maintained in South Africa that the source of the income is the share of stock, and that the location of the share, is the place where it is registered.[10] As for income from interest, it has been held in East Africa and elsewhere that its source is the granting of the loan, and consequently, that the income derives from the place where the loan is granted.[1] The Nigerian Supreme Court recently arrived at the same conclusion.[2]

As we shall endeavour to show in subsequent chapters, it seems that the greatest difficulty in determining the source of income and its location, arises with regard to income from a "trade", "profession" or "employment".

Now let us consider the second arm of the charging provisions, that is, liability to tax on income "brought into, or received in Nigeria".

Is it essentially, the same as the U.K. "remittance rule"?

II. LIABILITY TO NIGERIAN TAX: "INCOME BROUGHT INTO OR RECEIVED...."

A. A Remittance Rule?

So far, we have seen that income is chargeable to tax in Nigeria

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10. See the South African decision of Boyd v. C.I.R. (3) S.A. 525 (A.D. 17 S.A.T.C. 366: quoted by Silke, op. cit., Chapter on the Meaning of "source' etc.

1. See Silke ibid., and cases cited therein. Also Esso Standard Inc. v. C.I.R. [1971] E.A.L.R. 127.

2. Cf. Fed. Board of Revenue v. Aluminium Industries, op. cit.

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if its source is there. In addition, income, though having its source abroad, may be chargeable to Nigerian tax if "brought into" or "received in Nigeria".[3] The only persons exempted from this rule are non-residents who come to the country, staying for a period of less than 183 days in all.[4] But when precisely is income "brought into" or "received" in Nigeria?

The question whether or not income is "received" or "brought into" Nigeria has either never arisen in practice, or else if it has, has been settled by the Revenue before reaching the courts. This is the only reasonable explanation we can offer for the lack of Nigerian case law on this point.

In another country where the problem has arisen, it has been decided that reference to income "received" in East Africa concerns income which accrued or was derived abroad and which was received in East Africa.[5] In other words, liability on a foreign source income is on a "remittance basis".

On that authority, it would seem that the Nigerian law is quite similar to the U.K. law. In that country, the law provides that certain income of foreign source will be taxed in the United Kingdom only if received there.[6] The meaning of this basis of taxation known as the

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3. See s.4 ITMA, s.17 CITA

4. Note the residence test in s.3(2) ITMA and in Schedule 3 ITMA Income Exempted item (x).

5. Cf. B.W. v. C.O.T. 4 E.A.T.C. 225. The East African provisions are similar to the Nigerian law.

6. This basis for imposing tax is provided for in English income tax law in respect of certain types of income chargeable under Schedule D Cases IV and V; certain types of employment income taxable under Schedule E, and until lately certain short term capital gains taxable under Schedule D Case VII.

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remittance rule, has been dealt with extensively in English case law. And to those cases the Nigerian Courts may have to turn for guidance in interpreting the expression "income brought into, or received in Nigeria".

B. Legal Meaning of a Remittance - Deemed Remittance?

In considering what is a remittance, two situations must be distinguished; firstly, when the income is received in the country by someone other than the owner of the income; secondly, when the owner himself receives it. For example, it has been held in Carter v. Sharon[7] that income received by a taxpayer abroad which he effectively alienates there, but which is subsequently brought to the United Kingdom by the recipient, does not give rise to any charge to tax.[8] But where the income has not been so alienated, it is clear that the rule does not require that the income must be received physically by the person chargeable. It is sufficient for tax liability as in Timpson's Executors v. Yerbury,[9] if it is still technically the taxpayer's income when it arrives in the United Kingdom. Thus, if the taxpayer pays his butcher in the country with money from abroad, it is nevertheless regarded as his income when the butcher reeeives it.[10]

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7. [1936] 20 T.C. 229

8. This point has been expressly left open by the Court of Appeal in the Timpson's Case.

9. [1936] 1 K.B. 645; 20 T.C. 155

10. See Lord Denning in Thomson v. Moyse [1961] A.C. 967 at 1003; 9 T.C. at 340.

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In the case of gifts by cheques or drafts drawn on the instructions of a resident in the United Kingdom by his agent abroad on a foreign account in favour of donees in the United Kingdom, the test is whether the cheque or draft was revocable when it arrived in the United Kingdom by the law of the country from which it was sent. If it was so revocable, then it was regarded as income of the donor received by him in the United Kingdom.

Much difficulty has arisen in cases where the taxpayer has obtained the benefit, in the United Kingdom of income from abroad without it being directly transferred to him. For instance, in Thomson v. Moyse,[1] a resident of the United Kingdom who drew in the United Kingdom, a cheque on his American bank account, which contained income taxable on a remittance basis, and sold that cheque to a United Kingdom bank in London, was held by the House of Lords to be taxable on the proceeds of the cheque. It wss argued by the taxpayer that no part of his income was ever remited. Indeed, that may be true, for no money may have crossed the Atlantic at all because when the bank sent the cheque to New York for collection where they were credited with the money. The House of Lords, however, unanimously decided that where a customer employs a banker to collect by means of a foreign cheque money abroad which is part of his income, the sum which the customer receives in this country is a sum "received" within the meaning of Cases IV and V of Schedule D, and that it is immaterial that no money was ever brought into this country in the course of, or in connection with the transaction.

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1. [1961] A.C. 967; 39 T.C. 29. See also Schioler v. Westminster Bank Ltd [1970] T.R. 167. In this case a claim for damages was based on liability for tax resulting from a Guernsey bank sending Guernsey remittances from Malaysia to London for conversion from Malaysian dollars into sterling. Previously, the remittances had been sent in sterling direct to Guernsey.

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Also relevant in the context of our present disuussion is the case of Harmel v. Wright.[2] In that case, the taxpayer an employee of a South African company working and resident[3] in the United Kingdom devised a scheme whereby his salary was remitted to the United Kingdom in form of a loan from a foreign company.

The scheme involved the application of a major part of his salary each year to the purchase of shares in a South African company under his control. The company lent the money received to a second South African company in which he held no shares. That company then lent the money it received to him in the U.K. The loans received by him were interest free and payable on demand.

The taxpayer was assessed to income tax under Schedule E for the years 1962-3 to 1964-5 in amounts which included the sums received by him in the United Kingdom by way of loans.

Dismissing the taxpayer's appeal from the Special Commissioners, it was held by Templeman, J., in the Chancery division that since it was possible to trace the loans through from the money used to purchase shares in the South African company to the money received by the taxpayer in the United Kingdom, the money received in the United Kingdom had been derived from the application of the taxpayer's income in South Africa, and accordingly were emoluments received in the United Kingdom for the purposes of the Income Tax Act.

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2. [1974] 1 W.L.R. 325

3. The taxpayer retained his South African domicile. In other words, he was not liable to U.K tax on his "world income", but only on his U.K source income and on "remittances".

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The above case may be compared with two other cases in which the "receipt" of income was at issue.

In Schioler v. National Westminster Bank Ltd.[4] a claim for damages was based on liability for tax resulting from a Guernsey Bank sending remittances from Malaysia to London for conversion from Malaysian dollars into sterling. The United Kingdom Revenue assessed the taxpayer, (a Danish national domiciled in Denmark but resident in England) to tax on the grounds that his Malaysian income had been remitted to the U.K.

Mocatta, J., in the Queen's Bench Division held that the defendants (i.e. the bank) had implied authority and a contractual duty to credit the plantiff's account with dividends received by them on her behalf and were bound to discharge that duty with reasonable care; but that in the absence of express instructions to them they were not negligent and did not exceed their implied authority in sending the dividend warrant to England for realisation. In his Lordship's opinion, to hold that the defendants were negligent in acting as they did without first consulting the plaintiff or her accountant because of possible tax repercussions would be to place an impossible and unreasonable burden on banks generally.[5]

In the opinion of this writer, the judgement in this case was unduly hard on the taxpayer especially since the Bank had acted contrary to her interests. Apart from that, however, this case illustrates the highly technical nature of the "remittance rule".

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4. [1970] 3 W.L.R. 68

5. Ibid., at page 75

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Equally intriguing is the decision of the Supreme Court of India in C.I.T. Bombay South v. Ogale Glass Works Ltd.[6] in which the concept of "received" income was considered. In that case, the taxpayer was a limited liability company incorporated and carrying on business in Aundh which in those days was an Indian state outside British India. It was accordingly a non-resident company for the purposes of the Indian Income Tax Act.

The taxpayer was a manufacturer of lanterns and other glasswares at its works in Aundh State. In the relevant accounting years the taxpayer secured some contracts for the supply of lanterns and other glasswares to the Government of India. The price of the goods supplied under the contracts were paid by cheques drawn on the Reserve Bank of India, Bombay. The cheques used to be received by the taxpayer in Aundh and cashed through its bank at Bombay.

The taxpayer being a non-resident company, its liability to British Indian income tax depended upon its receipt of income within British India. In the course of the proceedings for assessment to income tax the taxpayer contended that its profits on the sales "accrued" and were "received" in the Aundh State where it received the payment by the receipt of the cheques.

Reversing the decision of the High Court,the Supreme Court of India held that the posting of the cheques in Delhi amounted to a payment and that the taxpayer was accordingly in receipt of taxable income within British India.[7]

In many cases where the question arises whether or not income has been remitted, the answer must depend on whether the sum remitted can be identified

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6. This case is reported in (1954) Vol. 8 BIFD p. 270.

7. Alternatively, it could probably have been argued that a proportion of the taxpayer's gross profits arose from the act of "sale" within British India.

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as income or as representing the proceeds of income. In other words, for tax liability, we have to examine the nature of the taxpayer's interest under the foreign transaction and the character of that interest as capital or income under the local law. For example, a distribution of shares in pursuance of a "partial liquidation" of a Maryland (U.S.A.) company under that local law, was held in Rae v. Lazard Investment Co. Ltd.[8] not to be income liable to U.K. tax. As Lord Pearce stated inter alia:

> "By the law of Maryland, this Maryland corporation has made a distribution of capital. In the hands of the shareholder the distribution is received as capital and not income......[9]

Similarly, in Courtaulds Investment v. Fleming[10] a return of capital by an Italian company was held not to be income for the purposes of Schedule D, Case V. In all these cases, the test applied was whether the local law treated the receipt as one of capital; if it did, then the payment was not assessable to income tax.

Relevant too in the context of our present discussion is the problem of vested and non-vested income. In the U.K., a domiciled and resident taxpayer is liable on his world income whether or not remitted to that country. Difficulties, therefore, arise when he becomes vested (i.e. according to U.K. law) with foreign income which is not remitted.

In Baker v. Archer-Shee[1] the House of Lords held that a domiciled benefi-

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8. [1963] 41 T.C. page 125

9. Ibid., at p. 131

10. [1969] T.R. 345; see also Inchyra v. Jennings 1926 2 All E.R. 714; I.R.C. v. Reid's Trustees 1949 A.C. 361; Lawson v. Rolfe 1969 T.R. 537

1. [1927] A.C. 844

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ciary under a New York trust was liable to U.K. taxation. This was on the assumption that the laws of New York and the U.K. were the same. But in Garland v. Archer-Shee[2] the same taxpayer proved that under the law of New York the income under a trust is vested in the trustees and that the beneficiary only has a right in equity to compel the trustees to discharge their duties.

Relating the above specifically to Nigeria, we are of the opinion that the Nigerians provisions are not concerned with the taxpayer's foreign income and whether or not it has vested in him. For purposes of liability, there must be an actual or deemed remittance of income into Nigeria.

From the foregoing discussion, it is evident that liability to tax on a remittance basis, or as under the Nigerian law, on "income brought into or received in Nigeria", potentially involves complex problems of administration. With no evidence of a tangible inflow of overseas income, it would appear that in the case of Nigeria, the effect of these provisions have been nugatory. Surely, it cannot be seriously argued that there are no Nigerian residents bringing into or receiving income in Nigeria from foreign sources. Where tax is charged on a remittances or similar basis, it is quite possible to avoid liability without much effort or risk. What prevents a U.K. taxpayer deriving income from Nigeria and a Nigerian taxpayer deriving income from the U.K. from doing a deal avoiding any actual transfer or remittance of funds? For example, A, a Nigerian taxpayer with U.K. income can pay it over to B in the U.K. where the latter is resident, while B, deriving income from Nigeria gives the equivalent to A resident in Nigeria. Or, as regards professional or employment income, it may be possible for a Nigerian resident to be paid abroad for work

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2. [1931] A.C. 212

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done in Nigeria and for him to remit the same to the country by unorthodox means.[3]

Another favourite scheme to avoid (or evade) tax liability was as follows: Where the taxpayer derives income from abroad, he does not transfer it to the country but proceeds to borrow a similar sum from somebody abroad and it is this second sum which because of legal technicality is not "income", that is repatriated. The debt is repaid by transferring to the creditor the income derived abroad.[4]

In the U.K. this loophole was closed by section 24 of the English Finance Act 1953 (now S. 122(4), (7) of the English Income and Corporation Taxes Act 1970. This statutory provision aimed at tax avoidance has no counterpart in the Nigerian Income Tax Acts. But it should be remembered that questions of this kind, have not yet reached the courts in Nigeria, and if they ever arise, the Revenue may try to invoke the general anti-avoidance provisions of the law. However, it would seem that the strict legislation concerning foreign exchange control in force in the country has discouraged taxpayers with foreign source income from remitting such income into Nigeria.

In our opinion, it should theoretically be more beneficial to the country if instead of a remittance basis, tax was charge on global income wherever it may have arisen, and whether or not, remitted to Nigeria.

But such an approach is thought to be futile for a number of reasons. Firstly, how does the Revenue find out those residents deriving income from foreign sources without resorting to a process of witch-hunting or arbitrary assessment? The dangers inherent in any method adopted have to be stressed considering that in Nigeria the majority of the people are self-employed and

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3. There is very strong suspicion that a lot of this goes on all the time.

4. For example, see I.R.C. v. Gordon [1952] A.C. 552, 33 T.C. Contra Harmel v. Wright op.cit.

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that their activities are less well documented than in other countries. Secondly, attempt to tax foreign source income creates problems of double taxation.

In view of these, it is submitted that with a tax exemption or lower rate of tax on foreign source income, there is a greater chance that taxpayers would repatriate their money into Nigeria. What the country endures under the present law is the worst of two worlds. Not only have the charging provisions failed to provide governmental revenue in form of taxes on foreign source income, they have probably deterred people from bringing home their funds where they would have been willing to do so.

IV. CONCLUSION

From the foregoing discussion, we have seen that until presently, the Nigerian courts have had very few opportunities to consider the charging provisions under the Tax Acts.

The meaning of the words "income accruing (in), or "derived from" was dealt with by the Onitsha High Court in Potter's Case; and by the West African Court of Appeal in the Matter of Non-Natives Income Tax Ordinance 1931. Regrettably, however, in these two cases the judgements of the courts were sketchy and generally unsatisfactory. No great elucidation of principles emerged.

For example, in the latter of the two cases the Court preferred to interpret those words literarily and rejected the idea that they really referred to the "source" of the income. In Karam's case, another West African Court of

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Appeal decision, the majority judges while accepting the idea that the words refer to the "source" of income, were not ready to extend this concept beyond its purely geographical meaning. The Chief Justice on the other hand, took cognisance of the reality of the situation by extending his concept of "source" to the "originating cause" and its place of location. This, we submit, is the better view and is perhaps the view which the Supreme Court of Nigeria would adopt were it to be faced with this issue today.

The term "received or brought into Nigeria" has not yet been the subject of thorough consideration by the courts. When the question of the term's meaning does come up, it seems a reasonable guess that the court will interpret the term in the light of English case law on similar questions relating to the "remittance rule".

In conclusion, we wish to re-echo what has been stated above already - that the Nigerian tax law appears to adopt as its basic principles, liability to tax on source income, and liability on a remittance basis, while embodying elements of the personal contact principle. Although these provisions appear good, nevertheless a charge to tax on source income ought to be couched in very clear language. (i.e. indicating that the word "source" is used in its geographical, causal, literal or other sense).

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CHAPTER THREE

TAXATION OF TRADING OR BUSINESS INCOME

I. INTRODUCTION

Very often not all the incidents of a business transaction (e.g. the negotiation of the contract, its execution, passage of title etc.) take place within the territorial limits of one country or its taxing jurisdiction. In this chapter, we examine the problems which arise when some aspect of the activity which generates trading or business income occurs outside Nigeria; especially, where the entities engaged in these commercial transactions are alien or non-resident. Since trading or business income is potentially the largest source of governmental revenue, the significance of our enquiry is self-evident.[1]

From our discussion above, it was noted that the Nigerian Law seeks to tax all income brought into, or having its "source" in Nigeria, except in instances where a specific exemption is granted by the law.[2] In other words, any trading or business income having its source or deemed source in Nigeria, or which have been remitted into the country is liable to tax.

It is perhaps necessary to emphasize from the start that this chapter is not very much concerned with the routine computation of business income and assessment to tax,[3] where no foreign or complex issues are involved.

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1. i.e. apart from the revenue from Oil and Customs duties.
2. s.4 ITMA; s.17 CITA.
3. For a general discussion of the computation of business income in Nigeria, see S.O. Fashokun, op. cit. Chapter IV; C.S. Ola, op. cit. Chapter 5.

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In discussing the various aspects of the taxation of business or trading income, it is assumed that the general income tax law applies without treaty modifications (e.g. either in respect of the foreign income of residents, or the Nigerian source income of non-residents). In short, the question of double taxation (dealt with subsequently) is largely ignored.

Some of the major issues considered in this chapter are as follows: (1) The meaning of "trading" or "business" income and the legal framework for economic activity in Nigeria. (2) The applicable tests for determining when an individual or company is "trading" or "doing business" in the country. (3) Thirdly, we examine the accountancy and other related problems of computation of assessable profits; and in particular, the criteria for the allocation of items of income and expense between related corporations in different states and the transfer of losses between entities under common control. (4) Finally, an attempt is made to highlight the difficulties of taxing the gains or profits of a number of special trades e.g. petty-trading, the import and export trade, insurance, shipping and airways business and foreign exchange profits or losses.

A. What is a "Trading" or "Business" Income?

The Nigerian law seeks to tax the "profits or gains"[4] derived from the country in respect of any trade or business for whatever period of time such trade or business may have been carried on or exercised.[5] The question is, how correct is it to assume that the expression "profits or gains" mean the same thing as "income" derived from any business or trade?

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4. Emphasis supplied.

5. s.4 ITMA; s. 17 CITA

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The U.K. Royal Commission having categorically stated that the tax code treats the words "income", "profits" and "gains" as in effect interchangeable,[6] it would seem too, that on a proper understanding of the Nigerian tax law, the expression "profits or gains" as used therein, and the word "income", are coterminous. But that not withstanding, what must be remembered is that legal terms and expressions are not immutable.[7] For example, in the U.K., similar words to those under review have been recently used in a different and highly technical sense.[8]

Attention may now be turned to the ascertainment of the legal meaning of the words "trade" or "business", and to explore any possible distinction between the two words as used in the Nigerian Code. In Commissioner for Inland Revenue v. Epstein,[9] a South African case, strenuous attempts were made to distinguish between the two terms, but the Court was not impressed. In rejecting the submissions of counsel, Centilivres, C.J. noted:

> "that lengthy argument was addressed to (the Court) on behalf of the respondent on the source of income from business and on the source of income from trade, the contention being that within the category of 'business' there exists the narrower connotation of 'trade' i.e., a type of business in which there is the prime element of purchase and sale of commodities".[10]

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6. Cmnd. 9474 para. 36 page 10.

7. See Lord Atkin in Liquidator Rhodesia Metals Ltd. v. C.O.T. [1940] A.C. 774 at 788. "Decision on the words of one statute are seldom of value in deciding on different words in another statute". See also Ikpeazu, J., in Aderawo's Timber Trading Co. Ltd. v. Federal Board of Inland Revenue [1966] L.L. R. 195 at p. 206.

8. See Finance Act 1965 s. 19(2)

9. [1954] (3) S.A.L.R. 689.

10. Ibid., at page 695.

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In the opinion of the learned Chief Justice, these distinctions may be appropriate in interpreting English Income Tax legislation but would be out of place in construing the definition of "gross income" in s.7 of the South African Act (No. 31 of 1941) which definition makes no mention of "business" or "trade".

Unlike the South African Law, the Nigerian Code employs the two words under consideration. The real trouble is that like most other jurisdictions, the Nigerian Income Tax Acts do not define a "trade" or "business". Following a number of authorities, however, it is clear that "trade" is within the term "business" and that "business" is a wider term not synonymous with "trade" and meaning practically anything which is an occupation as distinguished from leisure.[1] Comparing the English and Nigerian tax law, it can be argued that the latter which employs both the terms "trade" and "business" is more extensive than the former, which seeks to tax only the profits or gains from a "trade .... or adventure in the nature of trade".[2] This point was, at least, tacitly recognised by Sowemimo, J., in Arbico v. Federal Board of Inland Revenue.[3] In their application, however, it is doubtful whether the U.K. and Nigerian laws would yield results which are materially different in any given set of circumstances.

For our purposes, it is considered that income from a trade or business is essentially income from the same specie of activity. In

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1. Smith v. Anderson [1880] Ch. D 247 at 257. Jessel, M.R., pointed out at page 259 that "business" is a word of large and indefinite import, having a more extensive signification than "trade". See also Halsbury's Laws of England, 3rd ed., Vol. 38 page 10.

2. i.e. comparing Nigeria's s.4 ITMA, s.17 CITA with U.K. Tax Management Act 1970 s. 118 (1); and s.109(2) ICTA 1970.

3. [1966] 2 All N.L.R. 303 at page 305.

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our discussion, therefore, the use of one term implies the use of the other.

Under the Nigerian law, a trade would perhaps include "trade, manufacture, adventure or concern in the nature of trade", that is, if we follow the circuitous definition adopted in the U.K. This defintion, needless to say, is unhelpful.

Turning as usual to case law for guidance, we find that despite the large number of cases which have been decided, no simple definition of trade has emerged which can be comprehensively stated in a few propositions A multitude of incidents are taken into account but no one decisive test has been found. Furthermore, bearing in mind that "different business operations may give rise to different taxing results" only rarely can one case be a precedent for another.[4]

Recognising that the word "trade" denotes an elusive concept,[5] and that the inference of "trade" or "no trade" remains a question of fact, it must nevertheless be pointed out that what the statute means by trade in a question of law.[6] So that, where a court is satisfied that the only reasonable conclusion it could come to from the "case stated" contradicts the conclusion of the Commissioners than the latter must have mis-

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4. Rhodesia Metals Case, op. cit. Lord Atkin at page. 788.

5. D. de M. Carey, "Trade - the Elusive Concept" (1972) B.T.R.6.

6. Edwards v. Bairstow [1960] A.C. 14; 36 T.C. 207; See particularly, Lord Simmonds [1956] A.C. 14 at p. 30, and 36 T.C. 207 at 224.

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directed themselves in law and their findings will be set aside.[7]

In the last twenty years or so, the courts have been guided by the so-called six "badges" of trade as recognised by the U.K. Royal Commission in their final Report.[8]

In most cases, there would hardly be any difficulty in deciding whether or not "trading" has taken place. Difficulties arise in the less obvious instances. Take for example profits from an isolated transaction and payments for "not trading".

It has been held in C.O.T. v. Bapoo,[9] and East African case, that a single transaction may in East Africa be a "business" the profits derived from which is taxable. This was a case in which the taxpayer realised a profit on breaking up a wrecked ship which he had purchased originally to have repaired, and selling off the odd bits and pieces. The decision is similar to the U.K. case of I.R.C. v. Fraser[10] where the respondent, a woodcutter, was held to be "trading" having realised a profit from an isolated whisky deal. "Trading" was also held to have taken place in Rutledge v. I.R.C.[1] where the subject matter of the transaction was one million rolls of toilet paper on which a substantial profit was made on a resale. Several other examples may be cited

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7. Note Lord Reid's dictum in his dissenting speech in Griffiths v. J.P. Harrison (Watford) Ltd. [1962] 2 W.L.R. 909 at 919 "the question is not whether the Commissioners were wrong, but whether their decision was unreasonable.

8. Cmnd. 9474, pages 39 - 40, para. 116. Listed as follows. (a) the subject matter of the transaction; (b) the length of the period of ownership, (c) the frequency of number of similar transactions by the same person, (d) supplementary work on or in connection with the property realised, (e) the circumstances that were responsible for the realisation, (f) motive.

9. [1958] E.A.L.R. 223.

10. 24 T.C. 498.

1. 14 T.C. 490. cf. Whiteman and Wheatcroft paras. 5 - 10 to 5 - 40 where the authors discussed what is a "trade" and what is "an adventure in the nature of trade".

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from different jurisdictions.[2]

The above notwithstanding, it is doubtful whether under the Nigerian law an isolated transaction ought to be regarded as constituting a "trade" or "business", considering that the law seeks to tax the:

> "profits or gains from any trade or business etc....... for whatever period of time such trade[3] or business may have been carried on or exercised".

Because of the few Nigerian tax cases on these provisions, it is believed that their true legal import has not been finally determined.[4]

A number of authorities suggest that the words "to exercise a trade or business" imply that the trade or business must be habitually or systematically exercised and that they do not apply to isolated transactions. For example, in a recent Nigerian case,[5] counsel for the appellant stressed that the words "carried on" in s.17 of the Companies Income Tax Act 1961, implies a continuous activity. And A.S. Silke in his work on South African tax law has stated that "carrying on business" usually involves a series of activities on the part of the taxpayer while conceding that single transactions could be so regarded.[6]

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2. E.g. M.N.R. v. Taylor [1956] C.T.C. 189; 56 D.T.C. 1125. In this Canadian case some negative and positive propositions were enunciated which may be compared with the so-called "badges of trade" listed in the U.K. Royal Commission Report 1955. See also the Indian case of Janki Ram Bahadur Ram v. C.I.T. [1965] 2 I.T.J. 230 S.C. 1898.

3. s.4 ITMA; s. 17 CITA. Emphasis supplied.

4. As a matter of fact, this writer has only been able to single case on this point, i.e. Arbico's Case.

5. See Aderawos Timber Trading Co. Ltd. v. Federal Board of Inland Revenue [1966] L.L.R. 195 at 206. The arguments of Chief Rotimi Williams Q.C.

6. Op. cit., at page

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The trend in the courts of the common law countries has been to regard the profits of isolated transactions as trading income[7] where the activities in question bear any of the six so-called "badges" of trade.[8] This trend is likely to persist and is probably justifiable where the profits involved are large and if there is no capital gains tax legislation to catch them.[9]

Particular difficulties arise where the question is whether a receipt constitutes the profits of a trade or an accretion to capital. In the Nigerian case of Arbico Ltd. v. Federal Board of Inland Revenue,[10] a company formed *inter alia* for the purposes of building and selling property, developed a block of flats for the accommodation of its own staff. Subsequently, it sold this block. It was held that the profit was taxable. Whilst we concede that one single transaction could be a "trade" or "business" giving rise to a trading or business income, it is believed that this is a borderline case bearing in mind that the property had originally been acquired for the taxpayer's own purposes. One writer has, in fact, argued that the facts of this case were such as to have tilted the balance in the taxpayer's favour.[1] Perhaps, what must be stressed here is that "accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would rise in value".[2]

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7. See L. Lazar (1966) A.S.C.L. at page 552 discussing the question of "Adventure or concern in the nature of trade" in Canada; and at page 557 on "Venture in the nature of trade in India".

8. Cmnd. 9474, para. 116. U.K. Royal Commission Report.

9. The Nigerian Capital Gains Tax Decree 1967 is applicable only in some parts of the country.

10. [1966] 2 All N.L.R. 303; (1966) L.L.R. 223.

1. S.M. Cretney (1971) A.S.C.L. page 265 at 285.

2. Per Lord Buckmaster in Lemming v. Jones 15 T.C. 333 at 337.

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The above case may be contrasted with the New Zealand case of City Motor Services. Ltd. v. I.R.C.[3] In that case, certain costs of alterations and additions to the taxpayer petrol service station were paid by the Mobil Company and did not appear in the taxpayer's trading records. The Mobil Company supervised the work to ensure that its products were properly handled, and included work which the taxpayer did not require for its business. The taxpayer, as was the common practice, had decided to deal only in one brand of petrol and oil products, and had chosen Mobil who had offered it a loan at interest, but unsecured, to conduct its business. The taxpayer's principal business was the exploitation of a motor vehicle franchise.

The Commissioner included as income in the taxpayer's return an amount equal to the amount paid by Mobil on additions and renovations to the taxpayer's premises. The taxpayer, dissatisfied with its assessment, requested the Commissioner to state a case for the opinion of the Supreme Court.

Henry, J., upheld the taxpayer's objection - that the gain to the taxpayer was of a capital nature and so did not form part of the taxpayer's assessable income.

Commenting on the meaning of the words "profits or gains derived from any business" his Lordship made it clear[4] that the words do not alter the essential differences between capital items and income items, though they may well tip the scale in any borderline case into the income area. According to his Lordship, the essence is that the profits or gains must be derived from "the business" with the consequence that if the item is not proved to be capital it might well be caught up by the charging section.

At this juncture, what ought to be emphasized again is that the ultimate

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3. 10 A.I.T.R. p. 585. For a review of this case see L. Lazar (1969) A.S.C.L. at page 238.

4. Ibid., at page 588.

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question of "trade" or "no trade" is one of law to be answered in the light of all the circumstances which it is reasonable to be taken into account, the weight to be given to a particular circumstance to depend rather on common sense than on strict application of any legal principle.[5]

Assuming that our reasoning thus far is correct, what is the tax treatment under the Nigerian law of payments for "not trading"? Are these sufficiently analogous to "trading" or "business" income to be taxable; or, are such payments outside the scope of the charging provisions? The real point is this: if receipts from "trading" or "doing business" (positive acts) are taxable, can receipts from "not trading" or "not doing business" (negative acts) be equally taxable?

Not many cases have been decided in Nigeria or elsewhere on this question. In order to deal with the problem, however, it would seem that the approach adopted in the U.K. in Higgs v. Oliver[6] is the correct one.

In that case, a well known actor made an agreement with a film company by which in consideration of £15,000 he agreed not to act in, or produce or direct any film anywhere for a period of 12 months, except for the company. The object of the agreement was to protect the exploitation of a film which he had produced for that company and in which he had acted the principal role under an earlier agreement with them.

The sum of £15,000 was included in his assessment to income tax as part of his income from his "vocation" as an actor under Case II of Schedule D to the

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5. Per Lord Reid in Regent Oil Co., Ltd. v. Strick [1966] A.C. 295 at 313, approving Van den Berghs Ltd. v. Clark [1935] A.C.431 at 438-439 (Lord MacMillan).

6. [1952] Ch. 311. See also Beak v. Robson [1943] A.C. 352; Hose v. Warwick 27 T.C. 459.

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Income Tax Act 1918. The Commissioners for the special purposes of the Income Tax Acts discharged the Assessment, holding that the £15,000 did not come to the taxpayer from the "exercise" of his "vocation", but from refraining from carrying on that vocation.

The Court of Appeal considered that the whole question was one of mixed fact and law. It confirmed the decision of the Special Commissioners and held that the sum which the taxpayer received was outside the formula "profits or gains arising or accruing" "from" the taxpayer's "profession" or "vocation" as an actor and, hence, was not taxable under Case II of Schedule D of the Income Tax Act 1918.

According to Lord Evershed, M.R., profits or gains in order to be taxable must:

> "'arise or accrue from a profession' in the sense that it arises from the exercise of a profession".[7]

On that analogy, it is submitted that payments for "not trading" (i.e. for restrictive covenants) are not taxable under the provisions of the Nigeria law.

One important specie of payments must be distinguished from payments for "not trading". What may be noted here is that sums of money received in the course of carrying on a trade but not as a result of the trade as it was contemplated that it should be carried on in the normal course of events may, nevertheless, be taxable. Several cases of this kind arose in the U.K. out of the restrictions placed upon trading companies during the first World War.

7. [1952] Ch. 311 at p. 316.

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For example, there was the case of I.R.C. v. Newcastle Brewries Ltd.,[8] where rum produced by a brewery company was requisitioned by the Admiralty and compensation paid; there were also cases where contracts for shipbuilding were cancelled;[9] and so on. In all these cases, it was decided by the courts that the sums paid by way of compensation were taxable.

If according to our submissions payments for "not trading" are not taxable in the hands of the recipient, what is the tax treatment of such sums from the point of view of the payor?

For an answer, we may refer to the Privy Council decision in C.O.T. v. Nchanga Consolidated Copper Mines Ltd.[10] where it was held that the payment by one company of a group to another to cease production for one year was an "operating cost" and, hence, an allowable deduction. According to the Court, what the payor company bought was the right to have the payee company out of production for 12 months. In that regard, the money expended had no true analogy with the expenditure for the purpose of acquiring a business or the benefit of a long term or enduring contract. In other words, the money in question was a revenue expense as distinct from a capital expenditure.

One important inference may be drawn from both the Olivier and Nchanga cases. To wit, that the Revenue may have the worst of two worlds. This is so because a payee may not be taxable since the sum he receives is not of an income nature not being derived from the "exercise" of his "trade" "business" or "profession". At the same time, a payor may be allowed to deduct the kind

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8. 12 T.C. 927

9. E.g. Short Brothers Ltd. v. I.R.C. 12 T.C. 955

10. [1964] A.C. 948 (P.C.) Decision from the Federal Supreme Court of Rhodesia and Nyasaland. Contra Associated Portland Cement Manufactures v. C.I.R. 27 T.C. 103, where it was held that payments by a company to retiring directors in consideration for worldwide covenants by them not to compete with the company after retirement were of a capital nature and, hence, not deductible.

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of sums under consideration being of a revenue character incurred in the production of income.

In our opinion, there is a strong case for the Nigerian provisions to be amended so that payments for "not trading" are deemed to be income in the hands of the recipients.

In the U.K., it has been the taxpayers who for many years have denied that their activities constituted a "trade" while the Revenue has been concerned to establish that they did. The activities of dividend-strippers[1] in recent years have led to these roles being reversed, the taxpayer being concerned to argue that his dividend-stripping transaction involves a "loss" in a "trade" entitling him to tax relief. The Revenue on the other hand, being forced to assert that the activity is not trading in stocks and shares but, rather, "the planning and execution of a raid on the treasury using the technicalities of revenue law and company law as the necessary weapons".[2] The difficulty here is due to the fact that it is not essential to the carrying on of a trade that those engaged in it should desire to make a profit[3] and because the component elements in the dividend-stripping operation are all such as have (taken in isolation) the indicia of a trading operation. The real issue often is whether viewed as a whole, the transaction can be regarded as genuine or not.

According to S.M. Cretney, dividend-stripping is a good example of the kind of tax evasion which is only satisfactorily dealt with by legislation as has been done in the United Kingdom.[4] But in countries like Nigeria, such

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1. Dividend stripping is a term applied to a device by which a financial concern obtains control of a company, having accumulated profits by purchase of the company's shares, arranges for the profit to be distributed to the concern by way of dividend, shows a loss on the subsequent sale of the shares of the company and obtains a repayment of the tax deemed to have been deducted in arriving at the figure of profits distributed as dividends.

2. Per Lord Donovan in Lupton v. F.A. and A. B. Ltd [1971] 3 W.L.R. 670 at page 688-9.

3. Per Lord Coleridge in I.R.C. v. Incorporated Council of Law Reporting [1888] 22 Q.B.D. 279 at p. 293.

4. S.M. Cretney, op. cit. at page 288.

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ingenous raids on the treasury can still be executed except, perhaps, if caught by the general anti-avoidance provisions of the law.[5]

From the foregoing discussion it could seem that there would be perpetual difficulty in determing what is, or what is not, a trade for the purposes of taxation. One can only hope that the Revenue and the Courts in Nigeria would be able to recognise a "trade" when they see it, or "an adventure in the nature of trade" - even though, all may be hard pressed to define it.

Up till the present, no writer has suggested that the concept of "trade" or "business" per se, when used in relation to commercial activities in developed countries is materially different from its use in relation to analogous activities in developing countries. It is, therefore, assumed that the concept of "trade" or "business" is universal. Be that as it may, it is considered apt to point out here that in places like Africa where the joint stock phenomenon is a comparatively recent thing, much trade is still carried on by nomads, pedlars itinerant merchants and other assorted variety of persons.

To return to our main theme, we wish to state clearly that what is important is not an enquiry into what constitutes a trading or business activity as such. Rather, our task is to find out when exactly the "source" or the "originating cause" of trading or business income is located or deemed to be located within Nigeria so as to render such receipts liable to local taxation. Evidently, where all the incidents of the transaction take place within the territory of Nigeria, and if all the entities involved are resident, there would hardly be any doubt that the income thus derived is liable to Nigerian tax.

On the other hand, where some of the incidents of the transaction take place outside Nigeria, difficulties may arise in determining the precise source o

5. S.14 ITMA; s.25 CITA dealing with artificial transactions.

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location of the profit. There may be need for apportionment between two or more possible sources with all the problems inherent in such apportionment. Take for example, the thousands of itinerant merchants trading all along West Africa. Can it not be said that these persons are deriving trading income from every country in which they sell their wares - the temporary duration of their stay in any one country not-withstanding?

The crux of the matter is this: when exactly is a trade or business carried on within Nigeria for tax purposes by an individual? Or, stated differently, what tests are applicable to determine "trade" or "no trade" within Nigeria? Without suggesting possible answers here, it is considered appropriate first, to examine another related question, that is, the legal framework for economic activity in the country.

B. Legal Framework for Economic Activity

The taxation of business or trading income cannot be effectively examined either within a purely domestic context or in its wider international law setting without a little understanding of the legal framework for such activities. Also, this is important as regards Nigeria, because of the recent economic and political trends in the country.

An individual may carry on business in Nigeria in four main legal forms.[6] Either as a sole proprietor, through an agent of other commercial representative, by entering into a partnership or by establishing a company.

Until lately, there were few restrictions on the activities of foreigners, but with the Nigerian Enterprises Promotion Decree 1972, aliens are now completely barred from participating in twenty-two kinds of commercial activities while being partially barred from participating in thirty-three others.[7]

6. As explained below.

7. s.1 Nigerian Enterprises Promotion Decree 1972.

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Although this Decree discriminates against foreigners, such economic discrimination is a kind familiar in most other countries.[8] But that notwithstanding, what must be emphasized is that within the sphere of activity in which they are allowed in Nigeria, aliens do enjoy a "standard of national treatment" in fiscal and other matters.[9]

(i) The Sole Proprietor

The whole idea of joint stock trading is a comparatively recent phenomenon in Africa where most business activities are still conducted on a one-man basis. One basic fact is that at any given point of time, it is difficult to know who is a trader and who is not. It is probably correct to state that to some degree every Nigerian is a businessman or trader. For example, there have been instances where clerical officers gave up their jobs temporarily in order to take part in the buying and selling of cocoa at the harvest season.

Under this heading of one "man businesses" come petty traders and the like, to whom we have already alluded. They remain a potent economic force in Nigeria, exerting a tremendous impact on intra-African trade generally. The other problems connected with this relatively unsophisticated medium of trading e.g., its intermittent and migratory character, little or no documentation of transactions etc., are considered in due course.

(ii) Commercial Representatives[10]

The tax liability of commercial representatives or their principals is generally determined according to the kind of responsibility entrusted to them and their degree of authority. For reasons of convenience it is not considered

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8. The trend today is towards a greater restriction of the rights of aliens to participate in the economic life of host countries.

9. Cf. G.W. Schwarzenberger "Principles and Standards of International Economic Law" (1966) Recaeil de Cours. Academie de droit.

10. Discussed more fully in Chapters 6, 7 and 8 on Double Taxation.

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appropriate here to venture into the legal distinctions between "agents", "brokers", "factors", "general commission agents" and the like, as this is something which is better discussed within the concept of "permanent establishment" and double taxation in general.

(iii) Partnerships

Under the Nigerian law, a partnership is not regarded as a legal entity. For tax purposes the partners are regarded as individuals even though there is a partnership deed and the parties may carry on business under a business name.[1] This type of economic legal framework does not normally give rise to problems except where some of the activities are conducted partly within Nigeria and partly elsewhere or where some of the partners are non resident.

(iv) Companies[2]

These are becoming the most important medium of doing business in Nigeria, due to the well known advantages of joint stock undertakings.

The Companies Decree 1968 was an attempt to revolutionise the organisation of corporate business in Nigeria. Under Part X of the Decree, all foreign companies[3] are deemed to have become automatically incorporated in

1. For a discussion of the taxation of partnerships see C.S. Ola, Income Tax Law and Practice in Nigeria, op. cit.

2. There are four types of ecompanies under the Nigerian law: public companies private companies, companies limited by guarantee and unlimited companies. See sections 1, 28, Companies Decree 1968.

3. A foreign company is defined in s.368 of the Decree as (i) a company before the commencement of this Decree incorporated outside Nigeria, and having on the commencement thereof an established place of business in Nigeria; (ii) a company before or after the commencement of this Decree incorporated outside Nigeria, and having the intention of carrying on business in Nigeria on or after such commencement.

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Nigeria as separate and distinct entities from the parent companies overseas, that is, to the extent of their operations in Nigeria.

According to Adesanya and Oloyede, the experiment is "unique and has no known parallel elsewhere".[4] True, but its novelty is proof of nothing, as it appears that the legislation may actually have far more reaching consequences than its authors intended. Moreover, it is regretable that this attempt to alter the company law has not been matched by a simultaneous effort to re-appraise the country's tax laws, even though it is evident that they are inter-related in their application.

Despite the fact that the revenue laws suggest the contrary, the impression one gathers from the Companies Decree itself is that after 1968, there is only one kind of corporate entity in Nigeria. For instance, the marginal note of s.369 (admittedly not part of the Decree) summarises the provisions of that section as follows: "the conversion of foreign companies already established into domestic companies";[5] while the note to s.370 indicates that the section makes it compulsory for a "foreign company to be incorporated as a domestic company before commencing business".[6]

With the new law, can it be said that for tax purposes no foreign company carries on business in Nigeria today without being incorporated? More important still, is it the intention of the new Decree to make all incorporated companies automatically "resident" in Nigeria for tax purposes?

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4. Business Law in Nigeria - 1972, (Evans) at p. 247

5. Emphasis supplied.

6. Emphasis supplied.

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These are vital matters on which the Decree is silent.[7]

It is interesting to note that because of the new Decree several Nigerian writers have concluded that there is now only one kind of corporate entity known to the Nigerian law, i.e. the "Nigerian company".[8] But it is doubtful whether they are right. It may seem a small point not worth pursuing, except for the fact that the Nigerian tax law accords a preferential treatment to the so-called "non-Nigerian companies".

In our opinion, no matter what the 1968 Companies Decree may have done, or was intended to do, foreign companies cannot be "converted" into "domestic companies" short of an expropriation. This is so, particularly, since the Decree itself allows the shareholders' rights to remain unaltered.[9]

The true legal import of the enactment, we submit, is to incorporate the foreign companies as foreign subsidiaries in Nigeria. Except for the provision to file separate accounts, different from that of the group or parent company, the change in the status quo has been more apparent than real. Our view is probably correct since there is nothing in the law compelling companies to have resident or indigenous directors, or for compulsory local participation in their equities as is the case elsewhere.[10]

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7. Note that tax liability depends on the "residence" of corporations among other things and that a company is resident where its "management and control" resides. See G.C. Cheshire and P.M. North - Cheshire's Private International Law 8th ed., (1970) page 184. These are matters to be further considered subsequently.

8. J.O. Orojo - Guide to Company Law and Practice in Nigeria (1970) pages 2, 28; Adesanya and Oloyede op. cit. at page 247- 248. The authors were not categorical either way. A.A. Ani Company Taxation - Seminar Paper presented at the Accountants' Conference at the University of Lagos on 7th September, 1971.

9. s.369(1)(d) Companies Decree 1968.

10. The position is now somewhat modified as a result of the provisions of Nigerian Enterprises Promotion Decree 1972.

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The basic tax problems remain, namely, how to effectively tax the profits of interconnected, foreign or related enterprises operating in Nigeria whether as branches or subsidiaries.

Under the Tax Acts, the profits of a "Nigerian Company" (i.e. one managed and controlled in Nigeria),[1] is deemed to accrue in Nigeria, wherever arising even if not brought into or received in Nigeria.[2] In other words, there is a charge to tax on its global income. On the other hand, the profits of a "non-Nigerian" company from a trade or business are treated as derived from Nigeria only to the extent that they are not attributable to operations outside Nigeria.[3]

Were we to adopt the suggestion that after 1968 all companies incorporated in Nigeria are now Nigerian companies, then under the tax laws, they would all be technically liable to tax on their global income, wherever derived from, and whether or not brought into Nigeria. But this cannot be so because the Decree does not make it compulsory for companies incorporated in Nigeria to exercise their "management and control" in Nigeria thus making them coming "resident" in the country for tax purposes.

For all practical purposes what must be emphasised is that liability to Nigerian tax is on all "source" income and on remittances. In that regard, therefore, the question of the residence of companies is not of fundamental importance.

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1. s.2 ITMA; s.2 CITA. Definition sections.
2. s.18(1) CITA
3. s.18(2) CITA. Note that a non-Nigerian company is nowhere defined.

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II. LIABILITY TO NIGERIAN TAX

A. General Principles: Trading or Carrying on Business in Nigeria

Whilst it is simple enough to state that any trading or business income, the source of which is Nigeria is liable to Nigerian tax, precisely when or under what circumstances an individual or company is carrying on a trade or business in Nigeria may not always be clear. What tests are applicable? Consider for example, the situation where a non-resident does business within the country through an agent, or where a company is incorporated in Nigeria specifically for the purpose of doing business overseas. Should the mere fact of incorporation be sufficient *per se*, to attract liability where the commercial activities of a company take place entirely outside Nigeria and whether or not the profits are repatriated? Several difficulties arise, where a company's activity overseas is of a cursory, auxillary or preparatory character hence the "permanent establishment" clause in double treaties.[4]

In the absence of treaty provisions three problems arise. Firstly, whether or not a trade has been carried on in Nigeria. Secondly, assuming that that is the case, whether there is someone within Nigeria who can be assessed on the profits in question - for an assessment on a non-resident will normally be of little effect or nothing more than an empty gesture of sovereignty unless the tax due can be collected.[5] Thirdly, the basis on which that assessment should be made.[6]

There are no procedure or tests laid down in the Nigerian Income Tax Law to determine when a trade or business is carried on in the country,

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4. E.g. Article V OECD Model Convention. 1963.

5. See A.R. Albrecht: "Taxation of Aliens in International Law" (1952) BYIL

6. Whiteman and Wheatcroft pages 229-237; para. 5/58 to 5/70.

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although the Act recognises that often the trading activities of a resident or non-resident may take place partly in Nigeria and partly elsewhere.[7] Again the jurisprudence of the Nigerian courts is of little help, for as indicated in the previous chapters, income tax cases appear not to arise in the country, or if they do, never seem to reach the courts or get reported. With less than a dozen cases in forty years,[8] one wonders whether the Revenue has been applying the law.[9] However, in such few cases that have arisen, the attitude of the Nigerian courts have been to follow English precedents while recognising that the Nigerian law which is in several respects similar to the U.K. law is nevertheless different.[10]

Having adopted a "source" approach as its basic philosophy, to determine whether or not "trading" has taken place "within" Nigeria it is necessary to identify the location of the dominant, or real or substantial cause of trading income. This proposition is easier stated than applied since there is no universal criterion for isolating the "real or dominant" cause of trading income.

Three tests have been applied by common law countries to determine "trading" or "carrying on business" for tax purposes. Firstly, the place of the contract, secondly the situs of control, and thirdly the "activities"

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7. E.g. s.5A ITMA; s.30A CITA (as amended).

8. Starting with Re Potter in 1931 to the Alumaco Case decided in 1970. The position is likely to change soon with the establishment of the Federal Revenue Court.

9. S.O. Fashokun noted the paucity of Nigerian tax cases but attributed it to the poverty of the people and the use of administrative remedies. J.E.A. Mills commenting on the Ghana position observed that the lack of income tax cases is due to the shortage of lawyers in the Income Tax department. There is clearly some truth in both assertions.

10. See Ikpeazu, J., in Aderawo's Timber Trading Co. Ltd. v. Federal Board of Inland Revenue. [1966] L.L.R 195 at 202

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test. Analysis of these tests involves difficult problems of conflicts of law.

B. Place of the Contract Test

Where the incidents of a business transaction transcend the taxing jurisdiction of two or more countries, the attitude of the English courts have been to regard the place where the business was concluded as the most important criterion for the location of a trading activity and, hence, the taxable income.[1] This is so, particularly, where the transaction involves the sale and purchase of goods. In that country, there is a broad distinction between trading "with" a country and trading "within" a country - a distinction well expressed by Lord Herschell in Grainger & Son v. Gough[2] where his Lordship noted inter-alia that:

> "many merchants and manufacturers export their goods to all parts of the world, yet ..... no one would dream of saying that they exercise or carry on their trade in every country in which their goods find customers ...."[3]

The above decision shows that to a certain extent the question of a non-resident trading in England depends on whether or not the contracts of sale were made in the country or abroad. This was a case where a French wine merchant and champagne manufacturer employed an English agent to obtain orders

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1. Wilcock v. Pinto & Co. 9 T.C. at p. 133; Sully v. A-C 2 T.C.149; Nelson Anderson & Co. v. Collins [1928] A.C. 34.

2. [1896] A.C. 325; 3 T.C. 462.

3. Ibid., A.C. 335; 336; at pp. 467-468.

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in England. Any orders, however, had to be transmitted to France for acceptance, which took place when the wine was sent by the foreign principal to England. It was held that the French wine firm was not trading in England because "no contract was ever made by the appellants on behalf of the French company. All that they did was to transmit orders received and until (they) had agreed to comply or complied with them, there was no contract".[4]

The fact that the place where the contract is made may not always be a realistic test is recognised by the English courts and stated by Atkins, L.J., in Greenwood v. F.L. Smidth & Co.[5] as follows:

> "The contracts in this case were made abroad. But I am not prepared to hold that this test is decisive.
>
> I can imagine cases where the contract of re-sale is made abroad, and yet the manufacture of the goods, some negotiation of the terms and complete execution of the contract take place here under such circumstances that the trade was in truth exercised here. I think the question is, where do the operations take place from which the profits in substance arise".

The above case involved Danish cement manufacturers with offices in London who were held by the courts not to be trading in the U.K. because all the contracts of sale were made in Copenhagen.[6]

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4. Ibid., A.C. 333; T.C. at p. 465. Note also the case of MacLaine v. Ecott 1926 A.C. 424 at 432; 10 T.C. 481 at - where Viscount Cave, L.C., stated that a "trade is exercised or carried on at the place where the contracts are made".

5. 8 T.C. 193 at 204.

6. Similarly, in Firestone Tyre and Rubber Co. v. Llewellin, 1957 T.R. 19 Lord Radcliffe noted that place of sale may not be the determining factor always.

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The United States courts have established as the exclusive test for determining where a sale is made, the place where the legal ownership changes. The decision in U.S. v. Balanowski[7] reasserts the passage of title doctrine [8] as the applicable test in determining in the case of international sale of goods whether or not the resulting income is taxable in the United States. The main issue here was whether an Argentine partnership was engaged in a trade or business in the U.S. so as to render it taxable there on income derived from the sale and purchase of personal property within the U.S.

Of much more relevance to developing countries like Nigeria, is the taxation of profits arising from the purchase of goods in one country and their resale in another country. What is the source of profit in this situation? In Commissioner of Tax v. D. and W. Murray Ltd.[9] one of the questions at issue was whether the whole of the profits arising from the purchase of goods by the head office of a company in England and their resale by a branch in Western Australia were made in Western Australia. The company contended that because of the skill and judgement exercised by head office in England in selecting the goods, and because of the discounts allowed to the company for prompt payment there and the rebates obtained by head office in respect of insurance and freight on such goods, that part of the profit arising from the purchase and sale of the goods was attributable to the business operations in England.

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7. 236 Fnd. 298 (2nd. Cir. 1956), (131 F. Supp. 898 S.D.N.Y. 1955).

8. R. Baker and M.R. Meek "Tax Problems of Doing Business Abroad: Some Practical Considerations" - (1957) Wisconsin Law Review p. 75 at pp 90-100. Here the authors discussed the background to the Passage of Title Test.

9. 3 A.L.J. 192.

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The High Court held that the case was governed by the principle laid down in Sully v. Attorney-General and that the profits derived from the purchase and sale of the goods were made wholly in Western Australia. The case of Sully v. Attorney-General was one in which it was held that where an American firm habitually purchased goods in England and shipped them to America for resale at a profit, the profits were not taxable in England.

The decision of the High Court of Australia when compared with its decisions in the cases of Federal Commissioner of Taxation v. Berger and Sons Ltd.[10] and Michell v. Federal Commissioner of Taxation[1] indicates that the place where the profit is made depends largely on what is the real essence of the business and the locality in which the business is carried on. Thus, where a business depends for its profits on the sale of goods which are acquired for resale the essence of the business is "the selling of the goods" and the profits are made wholly where the sales are effected. If on the other hand, the business depends for its profits on the manufacture or treatment of the goods and their resale as in Berger's case, the essence of the business is "manufacturing and selling goods" and the profits are apportionable as between the place in which the manufacturing is carried on and the place where the sales are affected.

Two observations must be made here. Since parties can fix the place of completion of purchase and sale or the time and place of change of legal

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10. 39 C.L.R. 468. It was held in this case that where the profits of a taxpayer's business include profits which are attributable to sales to customers outside the Commonwealth, the question of what portion of the profits attributable to such sales is derived directly or indirectly from sources in Australia is a question of fact, and the Commissioner of Taxation is not entitled to apply to all such cases the same rigid formula.

1. [1928] A.L.R. 25.

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ownership, little weight should be given to these criteria in order to establish "presence" for tax purposes. An international approach to the problem is the best solution. For example, an International Sales Agreement which determines where ownership passes in all cases where parties adopt the conventional form of Agreement would be very helpful to determine "carrying on business" in a particular country for tax purposes.

In cases of purchase of goods abroad and their sale in Nigeria, the Murray decision if followed could lead to a number of undesirable consequences e.g. making more non-residents technically liable to Nigerian tax, creating complex problems of assessment and collection etc. Some of these issues are considered subsequently.

C. The Situs of Control or the "Control" Test

To state that a person can carry on business in more than one place at a time is, perhaps, axiometic. The place where the taxpayer resides is no criterion as to where he carries on business, for just as a company resident in one country can carry on business in another, so also can a person employ an agent to conduct his business elsewhere on his behalf under an arrangement such that the principal himself is regarded as carrying on business at the place where the agent acts for him. In view of this, and as indicated earlier on, the English courts adopt another criterion to determine whether or not a trade is exercised or carried on in a particular country. This is known as the situs of control test.[2]

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1. Under the U.K. law, residence is the basis of liability for income tax. A company is regarded by the law as resident in the country where the centre of control exists, i.e. where the seat and directing power of the affairs of the company are located.

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It is now settled law following the judgement of the House of Lords in the San Paulo (Brazilian) Railway Co. Ltd. v. Carter and other cases[3] that where a trade is carried on either wholly in the U.K., or partly within and partly outside it, and profits accrue therefrom to a person or corporation resident in the United Kingdom, the assessment for income tax falls under Case I and not Case V of Schedule D. The significance of this is that tax is computed upon the full amount of the balance of the profits or gains of the trade since the taxpayer is regarded as trading "in" the United Kingdom rather than computation upon the actual sums received in that country from investment overseas.

Lord Halsbury, L.C., in the instant case, while agreeing with the opinion expressed by Cockburn, C.J., in Sully v. Attorney-General that "it is probably a question of fact where the trade is carried on", went on to explain that this phrase must be understood in different senses. Accordingly,

> "it may mean where the goods in respect of which trading is carried on are conveyed, made, bought or sold; or speaking of land, where it is cultivated or used for any other purpose of profit. That makes the locality of the goods or the land which are the subject of the trade to be in a certain sense the place where the trade is carried on, because it is the place where the things corporeally exist or are dealt with.

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3. [1896] A.C. 31. The test of control was laid down by the Exchequer Division in Cesena Sulphur Co. v. Nicholson [1876] 1 Ex.D. 428, a decision which has been repeatedly approved and followed. E.g. see De Beers Consolidated Mines v. Howe [1906] A.C.455; American Thread Co. Ltd. v. Joyce [1913] 108 L.T. 353.

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"But there is another sense in which the conduct and management, the head and brain of the trading adventure are situated in a place different from that in which the corporeal subjects of the trading can be found".[4]

It may be recalled here that all that the House of Lords had to decide in the San Paulo Railway Case, was whether a company with a head office in London from which the board of directors governed the operations of the company in Brazil did not exercise a business in England. It was not in doubt that the profits and income were to some extent earned in Brazil, what was not so obvious was whether the sums in question could also be held to have been earned in the United Kingdom. Relying on the "situs of control test", the House in a unanimous decision held that a trade was exercised in the U.K. and that any profits derived therefrom was liable to that country's tax. In the words of the Lord Chancellor,

"the person who governs the whole commercial adventure the person who decides what shall be done in respect of the adventure, what capital shall be invested in the adventure, on what terms the adventure shall be carried on, in short, the person who in the strictest sense, makes the profit by his skill or industry, however distant may be the field of his adventure is the person who is trading".[5]

Lord Davey put it slightly differently, distinguishing first, the present case from Colquhoun v. Brooks.[6] His Lordship observed that since:

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4. Ibid., at p. 38.

5. Ibid., at page 38-39.

6. [1889] 14 Appeal Cases 493. Note also Lord Parker of Waddington in Mitchell v. Egyptian Hotels Ltd., [1915] A.C. 1022 at 1037 - "Where the brain which controls the operation from which the profits arise is in this country, the trade or business is at any rate partly carried on in this country."

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"the direction and supreme control of the appellant's company's business is vested in the board of directors in London, who appoint the agents and officials abroad ..... etc. The business is, therefore, in very truth carried on in and from the United Kingdom, although the actual operations of the company are in Brazil, and in that sense the business is also carried on in that country".[7]

Whilst it may be quite easy to determine whether or not the management of a business is exercised in a place, the control test which is not statutorily defined is much more difficult to apply. This is a result of the fact that the word "control" may be used in different senses.

As far as companies are concerned, the fact that shareholding control and direct control are two different concepts was clearly expressed in Gramophone and Typewriter Co. Ltd. v. Stanley[1] where Fletcher Moulton, L.J., stated inter-alia that:

"the control of individual corporators is something entirely different from the management of the business itself. Nor is the principle less true when the shareholding of the individual corporator is so large that he is able to override the wishes of the other corporators".[2]

Similarly, in Kodak Ltd. v. Clark[3] where 98% of the shares of an American Company were held by a company resident in the U.K., and the remaining 2% of

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7. [1896] A.C. 31 at page 42-43. See also Lord Esher, M.R., in the London Bank of Mexico and South America Ltd. v. Apthorpe [1819] 2 Q.B. 378 at page 382.

1 [1908] 2 K.B. 89.

2. Ibid., at page 98

3. [1903] 1 K.B. 505; 4 T.C. 549; See M.A. Pickering " The Concept of Control in Company and Tax Law", LL.M. Thesis 1962.

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the shares were owned by independent shareholders, the court held that the business of the American company was not the business of the company resident in England as its control was only shareholding control.

The above may be contrasted with the Canadian law. The Supreme Court of that country considered the concept of "control" in M.N.R. v. Aaron's Ladies Appa.el Ltd.[4] in which it referred with approval to the remarks of Hall, J., in the Court below[5] to the following effect: That "control" meant de jure control[6], namely, "the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of votes in the election of a Board of Directors".

A number of difficulties connected with the control test may be highlighted.

Firstly, what is the position where a company is in fact controlled in a place, not necessarily where according to its constitution it ought to be controlled?

On the authority of Unit Construction Co. Ltd. v. Bullock,[7] such a company is deemed to be resident (i.e. carrying on a trade) in England for tax purposes; the fact that control is exercised in the U.K. in breach of its memorandum and articles of association notwithstanding. The case in question was one where an overseas subsidiary company was held to be resident in England as a result of the control exercised over its affairs by its parent company which

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4. [1967] 60 D.L.R. (2nd) 448. See L. Lazar (1968) Annual Survey at page 596 "Control and Associated Companies".

5. Subnorm M.N.R. v. Dworkin Furs Pembroke Ltd 60 D.L.R. 2nd. page 450.

6. Butterfields Ltd. v. M.N.R. [1965] 1 Ex. C.R. at 302-303.

7. [1960] A.C. 351.

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was resident in England.

In its application much more problematic is the situation where "control" is split between two different persons in different locations.

A natural inference from our discussion thus far is that the "central control and management of a company" cannot at the same time abide in two or more different and separate places. Nevertheless, the matter cannot be dismissed in this summary though sensible fashion without considering two more leading cases, Swedish Central Railway v. Thompson[8] and Egyptian Delta Land and Investment Co. v. Todd.[9] In each of these cases the company was an investment company, i.e. of a passive or static nature, not engaged in active trading operations, but interested solely in the receipt of money arising abroad. In each, the question was whether the company was liable, as being resident in England, for income tax upon such money. There were certain similarities in the facts of each case.

In the Swedish Railway Case, the company was incorporated in England in 1870 with the object of constructing and running a railway in Sweden. Its registered office was in London. In 1900 it leased the railway to a traffic company for 50 years at an annual rent of £33,000 payable in England. In the same year, the articles of association were altered so as to remove the control and management to Sweden, and after that time the general meetings of the directors were held at Stockholm. Dividends were declared there and no profits were transmitted to England except in the shape of dividends due to the English shareholders. On the other hand, a committee which met regularly was established in London to deal with share transfers, to draft and attach

8. [1925] A.C. 495

9. [1929]A.C. 1.

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the seal to share certificates and to sign cheques on the London banking account. The secretary resided in London and it was there that the annual accounts were made up and audited.

In the Egyptian Delta Land Case, the company was incorporated in England in 1904 for the purpose of acquiring and disposing of any land served by the Egyptian Delta Railways Ltd. Since 1907 the business had been controlled, managed and directed entirely in Cairo. The secretary-general, all the directors, the seal, share register, books and bank account were in Cairo.

In order to satisfy the requirements of the Companies Act, there was a registered office in London where the necessary lists and registers were kept. This office did not consist of a separate room. All that the company did was to employ a Mr. Horne, who carried on the business of secretary of public companies to keep the necessary documents and to post the name of the company on the door of his office.

The Crown claimed income tax in respect of interest accruing from mortgages and leases made in Egypt.

It was held by the House of Lords in the Swedish case that the company was resident both in England and in Sweden;[9a] in the Egyptian Case that the company was resident only in Egypt.

These two decisions confuse rather than enlighten the law. It is clear, of course, that the business done in England was of far more substantial character in the Swedish than the Egyptian case. It is also clear that the

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9a. It is doubtful whether the House of Lords was right in holding that the company was resident in Sweden. Surely, whether or not a company is resident in Sweden is a matter to be decided by Swedish courts according to Swedish law.

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contention of the Crown in the Egyptian Case, that a company is inevitably resident in the country where it has been incorporated and where its registered office is situated, was untenable, for if this were so the decisions in the Cesena type of case would have been put upon that short and simple ground. Nevertheless, how is the decision in the Swedish case to be reconciled with the rule established by the House of Lords, that a company resides where its real business is carried on and that the real business is carried on where the central control and management abide?

It can scarcely be said, as Pollock, M.R., said that the central control test is not the only test.[10] If words mean anything, there is a natural reluctance to accept the statement of Lord Cave that "the central control and management of a company may be divided".[1] Again, it is difficult to resist the conclusion that Lord Summer, in explaining away the Swedish decision by the remark that the business done in London was a little less important than that transacted in Sweden, virtually repudiated the principle of central control. Nevertheless, the joint effect of the Swedish and Egyptian decisions seems to be that if the control is so evenly divided between two or more countries so as to preclude the possibility of identifying one place of central control, then the company must be regarded as resident in each country in which to a substantial degree control is in fact exercised.[2]

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10. Swedish Central Railway Co. v. Thompson [1924] 2 K.B. 255 at p. 265

1. Ibid., [1925] A.C. 495 at 501

2. See the remarks of Lord Simonds and Lord Radcliffe in Unit Construction Co. Ltd. v. Bullock [1960] A.C. 351 at pp. 360-1; 367-369.
   It may be noted as a matter of interest that in most civil law countries a corporation is localised for conflicts as well as for many other at its "seat", i.e. in the place where the central control and management is exercised. See Ernst Rabel: Conflict of Laws: A Comparative Study. Vol. 2, 1947 at p. 29.

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It should be pointed out at this juncture that in all reported cases, it becomes a question of importance whether although a power of control existed it was exercised so as to constitute a "carrying on" of business in a country. A case in point here is Colquhoun v. Brooks,[3] where it was held that a partner resident in England whose firm traded exclusively in Australia was not trading in England because he did not exercise control in England over the partnership's activities abroad. This case may be contrasted with Ogilvie v. Kitton [4] where a Canadian business was held to be partly carried on in England because the taxpayer who was resident in England was vested with the control and management of the business, the fact that he rarely exercised his control was immaterial.

Whilst it is doubtful whether a sole owner of a foreign business having exclusive power of control over it, if resident in England, can sucessfully maintain that he did not carry on business in that country, the same analogy does not apply to companies. Thus, in Kodak Ltd. v. Clark[5] where a British company owned 98% of the shares of an American company, the court maintained that the two companies were two distinct legal entities and the business of the American company was held not to be partly carried on in the U.K., even though, the shareholding control was in the U.K.

Bearing in mind all that have been said, how suitable is the English "control" test for determining whether or not a trade is carried on or exercised in Nigeria?

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3. [1889] 14 App. Cas. p. 493

4. 5 T.C. 338. Note also the case of Malayan Shipping Co. Ltd. v. Federal Commissioner of Taxation (Australia) 20 A.L.J. page 27 to which we shall refer presently.

5. [1903] K.B. 505.

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It would appear that the "control" test can only be suitable in Nigeria in so far as it can be reconciled with the fundamental philosophy of Nigerian tax law, that is, taxation on Nigerian source income. Therefore, if the originating cause of a trading income is the "control" exercised within Nigeria, then, such income is chargeable to Nigerian tax, the place of residence or the nationality of the taxpayer being secondary issues. This is not the same as in the U.K. where the fact of residence which might depend on a mere technicality must first be proved; and then the existence of the power of control as well as its exercise or potential exercise within the U.K. What must be stressed is that "control" as one of the possible <u>indicia</u> to determine "carrying on business" in that country, means <u>de facto</u> exercise of control in Nigeria as distinct from the formal right to exercise such control, or the possibility of its exercise sometime in the future.[6]

Our submission is that the concept of "control" under the Nigerian law denotes an activity, or the originating cause directly responsible for the creation or accrual of trading income. In this sense, it is very much akin to yet another test applied in some common law countries; namely, the "activities" test.

D. <u>The "Activities" Test</u>:

In countries where taxation on source income has been adopted either explicitly or implicitly, it would seem that the "activities" test is the

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6. Upon our analysis it would appear that the West African court of Appeal decision in <u>C.I.R.</u> v. <u>Karam</u> should have gone the other way.

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most realistic criterion for determining whether or not a trade is carried on in the country for tax purposes. Not least, of course, among its advantages is the fact that it is less easy to manipulate than any other test.

The "activities test" as it should be understood is very well illustrated by the leading South African case of C.I.R. v. Epstein.[7] In that case, the taxpayer who was resident in Johannesburg where he carried on business as agent for foreign firms was associated in business with a partnership known as Hendriksse and Company, which carried on business in Argentina. The business was conducted in the following manner: (a) Hendriksse and Co. solicited orders from persons in Argentina for the sale of asbestos to the latter. (b) Upon receipt by them of such an order, Hendriske and Co. cabled the taxpayer informing him of the particular type of asbestos required and instructing him as to which South African producer he had to approach with a view to obtaining the asbestos and what price he had to offer. (c) The taxpayer then approached the South African producer and informed Henriksse and Co. of his inquiries wh then proceeded in its own name to conclude in the Argentine a sale of the asbestos with the person who placed the order. (d) Hendriksse and Co. thereafter instructed the taxpayer to conclude in his own name a contract with the South African producer for the purchase of the asbestos. (e) When this contract had been concluded the purchaser in the Argentine opened a letter of credit in favour of the taxpayer and payable at a bank in South Africa. Thereafter, the taxpayer shipped the asbestos direct to the purchaser in the Argentine.

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7. [1954] (3) S.A.L.R. 689.

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Out of the transactions with Hendriskse and Co., the taxpayer derived certain profits from the partnership in respect of the 1946 and 1947 tax years. The profits represented the difference between the amounts for which the asbestos had been sold in the Argentine and the amounts paid to the South African producer in respect of the purchase price of the asbestos. The profits were divided equally between the parties. The question for decision was whether the taxpayer's share of the profits accrued from a source in South Africa. Centilivres, C.J., had no doubt at all that the respondent's profits in connection with his dealings in asbestos were received from a source within the Union since he rendered no services and spent no money outside the Union in connection with his association with Hendriskse and Co., and since he used his own bank account in the Union for the purposes of financing the transactions in respect of the asbestos.[8]

In concluding his judgement, the learned Chief Justice articulated the "activities test" when he stated that:

> "In taxing the respondent, the legislature looks at his activities and ascertains whether those activities were exercised within the Union, and if they were, then he is liable in respect of any profits resulting from such activities".[9]

Very similar to Epstein's Case and also involving the source of an agent's commission is the East African Court of Appeal decision in A.G. Ross v. R.[10] In that case, Bacon, J.A., reading the judgement of

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8. Ibid., at page 699.
9. Ibid., at page 699.
10. [1957] E.A.L.R. 507

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the Court quoted with approval a passage from the judgement of the trial judge below as follows:

> "the point really is, where did the partnership substantially carry on business which earned the commission?[1] Was it in England where the agency agreements were made with the manufacturers, and where the manufacturers accepted orders from East Africa; and where Elliot and Co. Ltd., carried on some accounting and office work for the partnership and received payments of the commission? Or, was it East Africa, where the head office of the partnership was situated; where the accused canvassed for the orders that earned the commission and generally kept the manufacturer's name before prospective customers;[2] and where the bulk of the expenses charged against the partnership in the partnership accounts was incurred?[3]

Confirming the judgement below, the Court of Appeal maintained that the functions performed in Birmingham in relation to particular orders and shipments were all subsidiary to the appellant's operations in East Africa which were the real source of the firm's earnings. The point is that where commission agents are canvassing, collecting orders and nursing their market in territory A, but sending the orders to territory B for acceptance by the suppliers it cannot be argued that it is territory B, and not A which as a matter of law should be regarded as the source from which the agent's profits are derived.

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1. Emphasis supplied.
2. Emphasis supplied.
3. [1957] E.A.L.R. 507 at 513.

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As a contrast to the two cases cited and endorsing the validity of the activities test, we refer to a case decided by the Special Court in South Africa.[4] The facts were that a company which was registered and had its head office in the Union conducted producing operations <u>wholly outside</u> the country. The produce won by these operations was shipped from the place where these operations were carried on direct to Europe, where it was sold by a representative of the company who had power to complete contracts by sale. It was held that the profits made on the sale of the produce in London was derived from the business operations outside the Union. But the Court would probably have come to a contrary decision where the carrying out of the transaction overseas is so linked with the general business of the taxpayer in the Republic so as to be an integral and inseparable part of it. Whether this is so or not is a question of fact depending on each particular case.

In relation to the above, and to illustrate the difficulties of applying the "activities test", it is apt to refer to the Southern Rhodesia case of <u>Mufulira Copper Mines Ltd</u>. v. <u>C.O.T</u>.[5] The issue which arose in this case was the location of the profits realised by the taxpayer from the purchase and sale of securities in London. The material facts were as follows:

The appellant company, whose main activity was the mining, smelting and refining of copper in the Federation (i.e. Rhodesia and Nyasaland as it then was) and whose head office and control were at all relevant times

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4. I.T.C. 81; 3 S.A.T.C. 136.

5. [1958] Rhodesia and Nyasaland Law Reports page 336.

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in the Federation, had from time to time funds in London which it did not immediately require to use for its mining activities and it was its practice to cause to be invested temporarily in London some of these funds in purchase there of United Kingdom Government securities with the object of re-selling them there at a profit.

The overall control of these investments was exercised from the Federation, but the actual transactions of buying and selling were conducted on the Appellant's behalf by agents in London, and the securities, when acquired, were registered in the name of a nominee in London.

In respect of each of the years of assessment ending respectively on March 31st 1954, and March 31st 1955, the applicant disclosed in its returns for assessment certain profits from the sales of these securities, which the Commissioner included in the Appellant's taxable income in respect of those fiscal years, on the ground that these profits were received by or accrued to the Appellant from a source within the Federation.

Murray, C.J., giving the judgement of the Court decided inter-alia that upon the facts it appeared that the Appellant, having made certain profits from its activities in the Federation, had proceeded to make subsequent profits in London by a separate activity conducted there, and that although the investigations and deliberations in the Federation which preceded the issue to its London agents of instructions to buy or sell the securities concerned doubtless constituted a causa sine qua non, it was the actual making of the investments in London and their sale there which was predominantly the effective cause, and so, the source of the profits concerned. Accordingly, the profits were received or accrued from a source outside the Federation.

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The above decision, which is probably correct, might easily have gone the other way. The main problem in this case was whether the source of the profits in dispute was attributable to the deliberations and decisions made in the Federation to carry on in London through agents in London certain forms of business activity, rather than the actual carrying into effect of those decisions in London in the particular circumstances of this case.

In the opinion of the learned C.J., to "regard these investigations and deliberations .... as the 'originating cause' of the taxpayer's income may involve the consequences that in every instance the location of consideration and decision (i.e. control) must be the local source of the income, no matter what activities take place elsewhere".

This writer agrees, for the reported cases do not lay this down as a conclusive and universal test. Each case must depend on its own facts. Clearly, where several acts done in several places are responsible for the accrual of income difficulties must often arise in determining which one of these is the originating cause of the income. Problems are likely to arise too where the carrying out of a transaction overseas is so linked with the taxpayer's business in a country, so as to be an integral and inseparable part of it.

E. <u>Multiple Tests - a solution for Nigeria?</u>

As has already been mentioned, there is no provision in the tax Acts for determining when exactly in law a trade or business is exercised in Nigeria. If the Revenue and the courts choose to follow the U.K. tax laws,

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the markedly different economic situations in the two countries must be kept in mind. In other words, provisions which are useful in the United Kingdom may be unworkable under local conditions.

What really matters as far as Nigeria is concerned is that the wider and more embracing the concept of "carrying on business in Nigeria", the larger the number of potential taxpayers, and ultimately the reeenue derived. Whether this idea has been sufficiently grasped in high quarters is a matter of conjecture.

It is believed that a doctrinaire approach to the problem is unsuitable. With the infinite variety of business transactions, we do not advocate a universal test, but rather, a combination of several tests consistent with the underlying philosophy of Nigerian tax law - i.e. taxation of Nigerian source income. The Canadian solution to the problem is strongly recommended. In that country, the concept of "carrying on business in Canada" has a case law meaning familiar in the United Kingdom which is further extended by statute. The statutory section expands the definition in Grainger v. Gough[6] and Greenwood v. Smith,[7] both in the activities which are embraced and in the place of performance. Thus it is provided in s. 139(7) of the Canadian Income Tax Act 1952 (as amended) that:

"Where in a taxation year, a non-resident person (a) produced, grew, mined, created, manufactured, fabricated, improved,

6. [1896] A.C. 325

7. [1922] A.C. 417; J.M. MacIntyre - "Tax Problems for United Kingdom Companies Doing Business in Canada". (1968) B.T.R. 306 at 310 et. seq.

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packed, preserved or constructed in whole or in part, anything in Canada whether or not he exported that thing without selling it prior to exportation, or (b) solicited orders or offers anything for sale in Canada through an agent or servant whether the contract or transaction was to be completed inside or outside Canada or partly in and partly outside Canada, he shall be deemed for the purposes of this Act to have been carrying on business in Canada in that year".

As we understand it, the Canadian statutory provision is more or less an "activities test" which extends the tax law to cover two distinct situations. Firstly, where the non-resident himself engages in any profit making activity part of which takes place within Canada; and on the other hand, where he is acting through an agent whatever the legal status of such agent. Having adopted the place of the contract test as in Grainger v. Gough, and the "activities test" in general, it is evident that Canada employs a multiplicity of tests in order to bring more transactions and more persons under its tax jurisdiction.

It is interesting to note that despite the fact that the concept of "carrying on business in Canada", and the particular application of s.139(7) are of the utmost importance to exporters of goods and services, there has been surprisingly little litigation from which to derive guidance as to their meaning. But the few cases that have arisen are indicative of their true import.

One problem area is the extent to which the principal is considered to be doing business in Canada because of the activities of his agent. In the case of sale, section 139(7) is very clear, what is not so obvious, however, is whether a sale which would have been a capital sale and not taxable in the hands of a resident is made a "business" by this section in the case of a non-resident. Unfortunately, the two cases on this point Thea Corporation v. M.N.R.[8] and Ross

8. [1967] D.T.C. 175; [1967] Tax A.B.C. 206. This case involved real estate transaction within Canada by an agent acting on behalf of a non-resident.

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v. M.N.R.[9] were cases in which the transactions would have been taxable anyway even for residents so the question is still open for a non-resident who offers his Canadian house for sale through a Canadian agent. To levy tax in this situation would seem unfair, but tax statutes are not open to arguments of equity or fairness.

A recent decision of the Exchequer Court points to some other problems. In United Geophysical Company of Canada v. M.N.R.[10] the court held that a subsidiary is not necessarily an agent of its parent, and so does not necessarily involve its parent into carrying on business in Canada. This decision puts the Canadian law on the same footing vis-à-vis Nigeria, where the activities of an incorporated subsidiary company are deemed to be different from that of the parent company - one not being regarded as an agent of the other.[1] Furthermore, whereas the Nigerian law is rather uncertain, in Canada, service payments by the subsidiary to the parent are deemed to constitute "doing business" in Canada since the parent company is supposed to render the services in Canada.

We submit that in developing countries where foreign subsidiaries operate whether incorporated locally or not, rental income from machinery or service payments to the parent company should be sufficient to make the parent company

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9. [1967] D.T.C. 421; [1967] Tax A.B.C. 594. This case involved dealings in securities by an agent in Canada acting on behalf of a non-resident.

10. [1961] D.T.C. 1099; [1961] Exch. 284.

1. Nigeria's 1968 Companies Decree ss. 369, 370, making incorporation in Nigeria compulsory. Note also Ghana's Companies Code S.303(3)(b) which provides that the fact that a body corporate has a subsidiary which is incorporated, resident and carrying on business in Ghana, whether through an established place of business or otherwise, shall not of itself constitute the place of business of that body corporate.

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liable to local taxation as deriving business income from the country. Alternatively, such moneys could be classified under royalty payments and taxed as such at the country of source.[2]

As a supplement to the Canadian approach recommended, it is advocated that Nigeria should adopt the Australian "control" test as one of the multiplicity of tests for determining "carrying on business" in Nigeria. The position is well illustrated by the case of Malayan Shipping Co. Ltd. v. Federal Commissioner of Taxation (Australia).[3] The company in that case had been assessed upon the basis that it was a resident of Australia within that portion of the definition of "resident" in s.6 of the Income Tax Assessment Act 1936, which defined resident to mean a company which, not being incorporated in Australia carried on business in Australia and had either its "central management and control" in Australia, or its "voting power" controlled by shareholders who were resident in Australia.

The company's tax liability arose because the sole proprietor of a company incorporated in Singapore resided in Australia during the relevant tax years. This case is the exact opposite of Kodak v. Clarke noted earlier on; and in a sense can be said to have been decided on the basis of the "activities" test.

To conclude our discussion on the concept of carrying on business, we would like to relate briefly special difficulties which arise where a company's

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2. Note our discussion in Chapters V and VII.

3. 20 A.L.J. p. 27. Note the similarity of this case to the cases decided in England e.g., The San Paulo Railway Case: De Beers Consolidated v. Howe etc.

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activity is of a cursory, auxillary or preparatory character. In other words, what is the minimum degree of commercial activity that must take place before a "trade" is deemed to have been carried on? The Nigerian law is silent on this crucial point, whereas in Ghana an attempt is made to deal with this matter. In that country, a non-resident person is not deemed to be carrying on a trade or business in Ghana by reason of the mere supplying of goods and services to Ghana if his activities are carried on entirely outside the country;[4] or, if he has no "established place of business" in Ghana. The expression "established place of business" is defined as a "branch, management share transfer or registration office, factory, mine, or other fixed place of business but does not include an agency unless the agent has and habitually exercises, a general authority to negotiate and conclude contracts on behalf of the body corporate or maintains a stock of merchandise belonging to that body corporate from which he regularly fills orders on its behalf. A body corporate is not deemed to have an established place of business in Ghana merely because it carries on dealings in Ghana through a bona fide broker or general commission agent acting in the ordinary course of his business as such.[5]

As would emerge subsequently, this solution is similar to that adopted in double taxation agreements generally. But since no cases have yet arisen on their interpretation it is not clear how actually significant they are in practice.

In the case of isolated transactions the general law should apply as

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4. (1966) Ghana Income Tax Decree s.6(1)(a).

5. s.303 (3) Ghana Companies Code 1963.

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discussed in Section 1 of this chapter.[6] To make the position very clear, however, it should be provided categorically in the tax code that a non-resident deriving income from an isolated transaction of a trading character shall be held liable to tax as having carried on a trade in Nigeria.[7]

It is obvious that all the criteria hitherto discussed cannot be satisfactorily applied to every kind of trading or business activity in order to determine "tax presence". The tests applicable to some special trades e.g. shipping and airways business, insurance and re-insurance, the export and import trade etc. have been deliberately omitted here as it is believed that they are better considered within another context.

I. DETERMINATION OF PROFITS - ACCOUNTING AND RELATED PROBLEMS

Thus far, various problems relating to the taxation of trading or business income have been examined, and in particular the concept of a trading or business income, the criteria for determining "tax presence" in Nigeria etc. This section is devoted to the computation of taxable profits. The approach remains the same, that is, to highlight the major issues especially those relating to matters not yet sufficiently dealt with by other Nigerian writers.[8]

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6. i.e. on the question of "trade" or "no trade". It may be noted that the line between an isolated transaction and a "cursory activity" may not be all that clear.

7. Jamaica appears to have taken a similar steps. See s.5(2)(3) Jamaica Income Tax Act 1954 as amended.

8. The commencement and discontinuance of trades; the basis periods and a number of other issues have been sufficiently dealt with by other Nigerian writers. E.g. see C.S. Ola: Income Tax Law and Practice in Nigeria.

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A. The Basic Rule as supplemented by good Accounting Practice

A taxpayer earning business income in Nigeria pays Nigerian tax on gross Nigerian source income less Nigerian source expenses. In order to arrive at the appropriate taxable profit the Income Tax Acts provide a list of allowable and non-allowable expenditure.[9] Since these rules are not nearly detailed enough, over the years the courts have been obliged to rely on "good accounting practice" to fill in gaps where the statutory rules are silent.

However, because words like "profit" have no single objective meaning, we immediately find ourselves in a predicament. Experience has shown that "good accounting practice" in many instances is an illusion because accountants are as divergent and subjective in their views and methods as psychiatrists or economists. Also, we know as a fact that there is no universally accepted system of accounting and that there are, perhaps, as many systems as there are countries.[10]

Strictly speaking, there is nothing in the Nigerian law compelling companies to compute their taxable profits according to recognised principles of accounting, except by an extended view of s.140 of the Companies Decree which requires that proper books of account be kept and stipulates that proper books are only deemed to have been kept where the books give a

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9. Sections 27, 28 CITA; ss. 17, 18 ITMA.

10. See The Times (London) December 7th, 1972. "EEC Problem for Accountants". In this article Sir Henry Benson, senior partner in the firm of Cooper Bros., pointed out that the accountancy standards and procedures in Europe are different from, and in some cases lower than the U.K's and that within the EEC countries standards varied widely.

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"true and fair view" of the companies affairs and help to explain its transactions.[1]

It is interesting to note that unlike many other countries, doing business in Nigeria does not imply the use of Nigerian accountants or accountants who are resident in the country.[2] Foreign subsidiaries incorporated in Nigeria may have their accounts audited by the same accounting firm employed by their parent company overseas. This gives room for wide variations in standards depending on whether the accounts are prepared in Tokyo, London, New York or Amsterdam;[3] and would seem to make nonsense of the concept of "separate and distinct entities" between subsidiaries and parent companies as envisaged in the 1968 Companies Decree. Furthermore, the use of foreign based accounting firms by Nigerian companies suggests the ipso facto acceptance of the accounting practice of several overseas countries. While such a situation may not be objectionable per se, what is definitely objectionable is the unjustifiable and unnecessary strain on the Nigerian Revenue in trying to grasp the so-called "good accounting practice" of diverse oversea countries.

Some would probably justify the use of foreigners on the ground that there is a shortage of locally based accountants. That was probably the case twenty years ago, but whether this is still so is very much doubtful.

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1. The concept of "true and fair view" is discussed presently.
2. Compare the position with Sweden where all companies have to use Swedish accountants. See J. Muten: "Tax Problems of Doing Business in Scandinavia" - (1968) B.T.R. 291 at 300.
3. The recent attempts to harmonise the accounting standards within the EEC may be noted here. See John Plender: "Agreement on EEC Accounting Principles" - The Times, London April 10, 1973.

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The compulsory use of locally based accountants would undoubtedly enhance the understanding of the business machinations of multinational, corporations.[4] To allow these entities to engage oversea based accountants is a great mistake, the full implications of which have not yet dawned on the Nigerian authorities.

To illustrate how vague and elusive this concept of "good accounting practice" can be, and how difficult it is to apply let us look at a few decided cases.[5]

In the Australian case of J. Rowe and Son Pty Ltd. v. C.O.T.[6] a store in Toowamba opened a credit sales service for the supply of household goods. The customer signed an undertaking to pay for the goods over a period of years and the price included a service charge calculated at 11% on the cost price of the goods. The taxpayer argued that the only item to be brought into his trading account, should be actual receipts in any year. The Court did not hesitate in rejecting this approach on the basis that it would give a result totally at variance with the true

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4. Little is publicly known about the activities of multinational companies. But they are generally believed to conduct their affairs to the detriment of host states. The EEC, for example, is seeking ways to put multinational companies under tighter surveillance, and so narrow their scope for avoiding or reducing taxation in Europe. See Clyde J. Farnsworth: "EEC Tax Watch on Multinationals" - The Times, July 25th, 1973.

5. For a discussion of some of the problems in this area of law see Robert Burgess: "Revenue Law and Accountancy Practice"- (1972) B.T.R. 308. See also S.T. Crump: "Accounting Profits and Tax Profits" - (1959) B.T.R. 323.

6. [1971] 45 A.L.J.R. 21 affirmed by the full Court in [1971] 45 A.L.J.R. 428. See also FINCON (Construction)Ltd. v. I.R.C. (1970) N.Z.L.R. 469.

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profitability of the enterprise. In reality, as soon as the sale was made, the price was earned. Some discount could be allowed for the fact that the debts owing might not all be realised, but the proper valuation would be their worth to the company, not the value which they would fetch in the open market. The Court accepted that more sophisticated accounting techniques based on the concept of an "emerging profit" might produce a more accurate result, but doubted whether this was feasible. It concluded that in any case it was for the taxpayer to produce accounts in the form he wished to sustain.

What is significant about the above case, is that the Court while recognising that there are substantial differences between the English and Australian tax laws, nevertheless thought the differences were scarcely relevant to the questions of accounting and business procedure.

Apart from the test of good accounting practice articulated by the courts, it would appear that this is not the only test because an accounting principle adopted in computing gross profits, though sound, may yet be rejected. In B.S.C. Footwear Ltd. v. Ridgeway[7] for example, the sole question in a case which finally divided the House of Lords three to two, was the method which the taxpayer should adopt for valuing his stock at the end of an accounting period. The traditional method which has been adopted for this purpose is "cost or market value whichever is the less". The taxpayer had for more than 30 years adopted a more sophisticated technique which was thought to give a better picture of the company's financial position by fairly allocating profits and losses to different periods. This was, in essence, to value the stock at the price which the

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7. [1971] 2 W.L.R. 1313. For a review of this case see H.F. Bessemer Clark (1971) B.T.R. 318.

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company would have been prepared to pay for it at the close of the accounting year given the price at which they then anticipated being able to sell it; which might be substantially less than cost.

The taxpayer had 790 retail outlets for their shoe selling business, and they thus bought very large amount of stock. Changes in fashion or even vagaries of the weather might make these difficult to sell, save at special sale prices. The method of discounting the anticipated retail price by the company's normal retail mark up was disallowed by the House of Lords even though it was of long standing, gave a fair picture of the company's business, had been adopted on the advice of eminent accountants and would not result over the years in producing lower overall profit figures for tax purposes. It was con eded that the onus was on the Crown to show that the accounting method was wrong but the Court held that this burden had been discharged. It took the view that the company's method was artificial and unreal, and might result in tax liability being deferred even if not evaded. The favoured method for calculating profit for tax purposes was to value the stock at the price which can be obtained in the retail market taking into account salesmen's commission on each sale.

To further illustrate the point, we may refer to the case of Chancery Lane Safe Deposit and Offices Co. Ltd. v. I.R.C.[8] the facts of which were as follows: The taxpayer company borrowed huge sums on mortgage from 1954 to 1957, reaching £650,000 in 1957. On the advice of its auditors it charged a certain proportion of the mortgage interest payments to capital in the accounts. During the years in question there were profits

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8. [1966] A.C. 85. See also Regent Oil Co. v. Strick [1965] 3 W.L.R 636.

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out of which that portion of interest might have been paid. The company was assessed to tax for the years 1954-1955 to 1958-1959 inclusive under s.170 of the Income Tax Act, 1952, on the ground that the portion of interest that was debited to capital account was in fact paid out of capital and not out of profits and gains brought into charge to tax. The company appealed to the Special Commissioners, claiming that these sums had been paid out of taxed income, although charged to capital in the accounts.

It was held by the House of Lords, (Lord Reid and Lord Upjohn dissenting), that the company having of its own free choice made a deliberate attribution having practical effects of the sum in question to capital, was precluded from subsequently making an inconsistent attribution and could not treat a payment actually made out of capital as notionally made out of income; accordingly, it was liable to tax under s.170 of the Act.

While the correct principle of commercial accountancy was rejected in the above two cases, it was expressly accepted in Odeon Associated Theatres Ltd. v. Jones.[9]

In that case, the main question at issue was whether or not certain sums spent on "deferred repairs" could be properly treated as revenue. The facts were that during the last war Odeon acquired a number of cinemas, among them the "Regal" in Marble Arch. During the war years because of restrictions then in force, it had been impossible to spend more than minimal sums to keep cinemas in repair. So, at the time of the purchase, January 1945, the Regal was somewhat run down and in need of repair. In

9. [1971] 1 W.L.R. 442.

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each year from 1945 to 1959 Odeon spent substantial sums of money on repairs and renewals. Some of this money was charged in their accounts as revenue expenditure spent on current repairs and renewals; other sums spent during this period were charged in the accounts as revenue expenditure made in respect of deferred repairs and renewals. The reason for this distinction was that Odeon wished to take the benefit of s.37 of the Finance Act 1946 which provided that sums spent on deferred repairs could be credited against liability to excess profits tax.

The Revenue contended that these latter sums were capital and, therefore, not allowable. Odeon claimed that they were properly so made and that as such they were properly allowable revenue expenses.

Allowing the taxpayer's appeal from the decision of the Special Commissioners, Pennycuick, V.C., held inter-alia that since the expenditure was referrable to revenue account according to the correct principles of commercial accountancy, and since there was no contrary authority it was deductible.

To continue our discussion on the concept of good commercial accounting practice, it ought to be emphasized that not always is a point of law at issue. (i.e. whether an item is to be credited to revenue or capital). Often, the sole task of the court may be to choose between two competing figures produced by two competing accountancy techniques.

In order to impeach a particular system the Revenue must do two things.[1] First, they must establish that the method used by the taxpayer has defects and that the results of these defects is that the accounts

1. See Robert Burgess, op. cit., at page 317.

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present an inaccurate picture for the purposes of income taxation. As Lord Pearson said in the B.S.C. Footwear case:

> "In order to do this I think that the Inland Revenue must show that the system is likely to produce (results) which are seriously and substantially incorrect and thereby cause a distortion of the assessment of the profits and gains for the year. If this is the effect of the system, the taxpayer cannot succeed ...."[2]

Secondly, the Revenue must provide an alternative and "show that their method is, if not the right one, at least a better one".[3]

If nothing else, the cases discussed thus far show that it is usually possible for honest and skilled men to produce widely different calculations of profit from the same trading figures depending on the purpose for which the calculation is required. In tax cases, the taxpayer normally benefits by showing a low profit, therefore, it is not surprising if figures are produced which show a lower profit than would quite properly have been produced had the taxpayer been concerned to sell his shareholding or resist a take-over bid. The essential point to note is that accounts must be drawn up in a way which is not only accurate, but also fair and reasonable. And the Courts must be prepared to rule on that issue in the light of the sometimes divergent interests of shareholders and the Revenue.

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2. Op. cit., at page 1331
3. Per Viscount Dilhorne [1971] 2 W.L.R. p. 1313 at page 1328.

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B. The Concept of "True and Fair Accounts"

The Nigerian law requires that a "Profit and Loss" account or an income and expenditure account, as well as a Balance Sheet be produced at intervals for the benefit of the members of the company.[4] These documents are required to give a "true and fair view" of the profit or loss of the company for the corresponding period in question.[5]

Similarly, group accounts must give a "true and fair view" of the state of affairs and the profit and loss of a company and its subsidiaries.[6] All accounts are required to fulfil the same detailed requirements spelt out in Schedule 8 of the Decree,[7] and as far as possible it is expected that a holding company and its subsidiary would have the same financial year.[8] The parent-subsidiary relationship referred to here is one in which both companies are incorporated in Nigeria, something which must not be confused with the more important situation where only the foreign subsidiary is incorporated or vice versa.

A critical analysis of the words "true and fair" show that unless the words are given an adequate interpretation, the accounts of companies may represent a set of figures which have some meaning to those who were

4. s.141(1); s.141(2) Cos. Decree 1968.

5. s.142(1); " " "

6. s.145(1); " " "

7. s.142(2) Cos. Decree 1968.

8. s.146(1) Cos. Decree 1968.

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party to the preparation of the accounts but to no one else. Historically, when the words "true and fair" were first introduced, a literal or almost literal meaning was given to them. However, it will appear that today a technical interpretation has been adopted by accountants which does not allow the investor, shareholder or the Revenue to gain an accurate insight into the affairs of a company.[9]

The primary purpose of the annual accounts of a business is to present information to the proprietors showing how their funds have been utilized and the profits derived from such use. But it has long been accepted in accountancy practice that a balance sheet prepared for this purpose is an historical record and not a statement of current worth.[10] Much to our regret, the courts have been reluctant to interfere,[1] with the result that we are left to the mercy of the accountant who has been given full reign to prepare company accounts in accordance with what the law imagines are well "defined rules of accountancy" aimed at representing the "true and fair", or correct state of affairs of a company. Indeed, so much latitude have been given to accountants that Buckley, J., once stated inter alia that:

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9. R. Bart: "True and Fair Accounts" (1970) A.L.J. 54. See also A.A. Berle Jr., and Frederick S. Fisher Jr: "Elements of the Law of Business Accounting" 32 Columbia L.R. 573.

10. This is the view of the Institute of Chartered Accountants of England and Wales as endorsed by the Jenkins Committee Cmnd. 1749 para. 333 and the Cohen Committee before it. Cmnd. 6659 p. 54, 55. For a proposed modification of the orthodox view. See "The Times" London, January 17th, 1973. The Accounting Standards Steering Committee has proposed to "establish a standard method for calculating the effect of changes in the purchasing power of money on conventional historical cost accounting. etc. etc."

1. The courts will intervene, however, where an accountant has taken a mistaken view of the Law. e.g. in Peter Merchant Ltd. v. Stedford (1948) 30 T.C. 496; Owen v. Southern Railway of Peru [1957] A.C. 334; 36 T.C. 602. Lord MacNaughten in Davey v. Corey [1901] A.C. 477 at p. 488.

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"If a balance sheet be so worded as to show that there is an undisclosed asset (e.g. a secret reserve) the existence of which makes the financial position better than shown, such a balance sheet will not in my judgement, be necessarily inconsistent with the Acts of Parliament. Assets are often, by reasons of prudence, estimated, and stated to be estimated, at less than their probable real value. The purpose of the balance sheet is primarily to show that the financial position of the company is as good as there stated, and not to show that it is not or may not be better."[2]

The implication of the above is that accounts are not necessarily to show the true position of a company; and that all that is required is that a company is not worse off than shown. Luckily, the view taken by Buckley, J., was subjected to criticism in R. v. Klysant[3] and "overruled" by the Cohen Committee.[4]

The objections urged against undisclosed reserves can be summarised as follows: If assets are under-valued or liabilities overstated, the balance sheet does not present a true picture of the state of the company's affairs; the balance of profit disclosed as available for dividends is diminished and the market value of the shares may accordingly be lower than it might otherwise be. The creation, existence, or the use of

2. Newton v. Birmingham Small Arms Co. Ltd [1906] 2 Ch. 378 at 387.

3. [1932] K.B. 442.

4. Paragraph 101 pp. 56 - 57.

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reserves known only to the directors may place them in an invidious position when buying or selling shares. On the other hand, if there is no detailed disclosure in the profit and loss account, undisclosed reserves accumulated in past periods may be used to swell the profits in years when the company is faring badly and the shareholders may be misled into thinking that the company is making profit when such is not the case. Where there is an impeding expropriation, therefore, there is always a lot of controversy about what the actual value of a company's assets are, particularly, in the oil industry.

To say the least, we agree with R. Baxt[5] and others who suggest that there is no reason why the accounts of a company should not reflect its true position.[6] The requirement of the balance sheet which appear in the relevant schedules of Companies Acts are not exhaustive enough. This is probably why the common law countries have tacitly allowed the accounting profession to lay down its own rules for the purposes of the Acts. That the profession has failed to present any set of rules which may be referred to as "generally accepted accounting principles" is not open to much doubt. The phrase "generally accepted accounting principles", it is submitted, is an empty one. But whether the courts or legislators are prepared to allow these "principles" to remain as "law" is a matter to be seen in due course.

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5. Op. cit., at page 550. Only recently John Plender has suggested that only a government inspired change can alter the situation, and that to expect the Accounting profession to produce a more meaningful system of financial reporting from within is wishful thinking. Cf. "The Times" London January 17th 1973.

6. Except where tax policy decides otherwise.

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From our foregoing discussion certain conclusions emerge. Firstly, the need for a harmonisation of accounting concepts and procedures as a part of any process of economic integration;[7] and, in particular, in double taxation agreements etc. Secondly, the mistake already alluded to of allowing foreign subsidiaries in Nigeria to employ oversea based accountants. Above all, the very worthless and misleading nature of company accounts generally.

C. Computation without records: An African Dilemma

In developing countries like Nigeria, the task of profit computation is rendered even more difficult by a number of social factors. For example, illiteracy, lack of proper business organisations etc. In this section certain aspects of the problem are examined.

Whereas, all companies incorporated in Nigeria are legally bound to keep proper books of accounts[8] the activities of the majority of individual traders are hardly documented. This is due partly to the migratory or seasonal nature of their trade, and partly to the illiteracy and lack of expertise by the traders themselves. Generally speaking, no proper books of accounts are kept and there are no clear-cut commencement or termination of trading activities by petty traders and the like because of the often intermittent nature of such activities.[9]

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7. In this regard, some progress has been made towards international co-operation. Cf. E. Kenneth Wright (President of the Institute of Chartered Accountants in England and Wales): "Towards World Standard of Accounting" - The Times (U.K.) 5th July 1973.

8. s. 140(1). Companies Decree 1968. Note that proper books of accounts are deemed to have been kept only if the records are such as to give a "true and fair" view of the state of the company's affairs and help to explain its transactions.

9. For Income Tax Purposes, there is usually a Basis Period. See Part IV. ITMA "Ascertainment of Assessable Income"

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The Nigerian authorities have been at pains for years in an endeavour to determine the volume and exact nature of trade between Nigeria and her neighbouring countries. The exercise has not been very successful due to a large number of factors peculiar to Africa. Firstly, traders are difficult to identify because every African is potentially one. To understand the position, just imagine a situation where the houses in a town are unnumbered or if numbered, are done in a haphazard manner without any logical sequence. Or, consider the position where the movement of persons across frontiers are not properly recorded. Under these conditions it is clearly difficult to keep track of any trading or business activity done.

The issue is further complicated by the fact that where an individual is liable to Nigerian tax on his Nigerian source income, it is left to the Revenue authorities of his place of residence to actually assess and collect the tax.[10] This provision, ostensibly to prevent internal double taxation in a federal set up, is exploited by African merchants who come into Nigeria. They are able to evade tax because of a technicality of the law since they would probably have no identifiable place of residence in any of the twelve states of the Federation.

The other point we wish to make is that in countries where people make little use of banking facilities and do not bother to claim capital allowances or loss relief, it is very difficult to determine their taxable income with any degree of accuracy. Because of the magnitude of the problem,

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10. s.76(2) 1963 Constitution reserves the right of personal taxation to the States. Note ITMA Schedule 3 for rules on the determination of Residence.

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a public call has recently been made on Nigerian traders to adopt an accounting system. Professor Tugbiyele believes that it may, in fact, be necessary for the Federal Government to decree that all small scale business-men in Nigeria must adopt a basic accounting system. The authorities could help, it is argued, by printing simple accounting forms for free distribution or at a nominal fee.[1]

The crux of the matter is that in a country like Nigeria where the vast majority of people are self-employed, there is no requirement in law making it mandatory for a trader to keep books of accounts in English or any other language. What then must the Revenue rely on except something which has been euphemistically described as a "best of judgement assessement" - a notoriously arbitrary and sometimes oppressive method of taxation.[2] Without reliable information on individual business activities in general, it is our view that wage and salary earners as well as other government employees who must pay tax under the P.A.Y.E. system bear an unproportionate share of the tax burden. Looking at the matter from another angle, the plight of a student of Nigerian Income Tax Law in circumstances where even the Revenue is lacking in much reliable data can be appreciated.

Although a procedure is set out in the Income Tax Acts for the computation of profits[3] without proper records, the truth is that it is impossible to "compute" taxable income in any meaningful sense of that

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1. Daily Times (Nigeria) November 13th 1972.

2. See Ihekwoaba v. C.O.T. [1958] Vol. III page 67. F.S.C. This Nigerian case shows that the onus of proving that the assessment is excessive is on the taxpayer.

3. s.17, s.18 ITMA 1961; s.27, s.28 CITA.

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word without adequate data.

To cite just one example, if there are no records, what is to be done in the Sharkey v. Wernher[4] situation where the taxpayer uses up his stock for domestic purposes as tends to happen often in countries like Nigeria?

Conscious of this fact, the Revenue is empowered to make an assessment on such "fair and reasonable percentage" of the turnover of a trade or business as the Board may determine[5] - and in the case of a non-Nigerian company, on such "fair and reasonable percentage of that part of its turnover attributable to the operations carried on in Nigeria".[6] But these provisions, we submit, are unhelpful for two reasons. Firstly, how can the Revenue determine the turnover of a business where there are no records? Secondly, how is the difficulty inherent in determining what is a "fair and reasonable percentage" to be resolved? These problems become more complex in the case of a non-resident taxpayer.

The Ceylonese case of J.A.P. Zebedee Fernando and Co. v. C.I.R.[7] helps to illustrate the position. In that case, certain non-resident manufacturers of dried fish were chargeable to tax on the importation of such fish by local wholesalers into Ceylon who disposed of their goods

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4. [1955] 3 W.L.R. 671; This case establishes that where a taxpayer has appropriated part of his trading stock for domestic purposes the stock used is to be valued at its current realisable value. i.e. in the computation of taxable profits. For a review of this case see H.C. Edey: "Valuation of Stock in Trade for Income Tax Purposes"- (1956) B.T.R. 23 especially at p. 34.

5. s.30 A(1) (a) CITA as amended; s.5(A) ITMA as amended.

6. s.30 A(1) (b) CITA as amended; s.5(A) ITMA as amended.

7. [1964] 66 New Law Reports (S.C.) p. 256. For a review of this case see L. Lazar (1966) Annual Survey of Commonwealth Law, p. 532.

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to retailers. The problem which arose related to the ascertainment of the taxable amount since the wholesalers, agents of the non-resident consignors carrying on business in Ceylon, failed to produce any accounts of the business done by them for their non-resident principals. The assessor in the present case made an assessment of the profits derived from Ceylon by the non-resident consignors for whom the assessee acted as agents fixing the profits at 7 per cent of the turnover for the year of assessment 1954-1955 and at 10 per cent for the following two years of assessment.[8] This basis was appealed by the assessee[9] on the ground that evidence of the rate of commission paid to an agent could not be used as a basis of measure of the profits of a "merchant" contemplated in the enabling provision for such assessment;[10] this referred to the profits reasonably to be expected to be made by a"merchant" selling the property in question by wholesale as the ceiling for the amount of profit assessed.

The Court held that "merchant" in its ordinary meaning, and bearing in mind its use in other provisions[1] could not be interpreted to mean "non-resident merchant", and accordingly rejected the Revenue's submission. The practical consequence was that just as the power of the Commissioner

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8. Income Tax Ordinance (Cap. 242) s.34 (1) s.37. The profits were fixed at 5 per cent for the years before 1954-1955.

9. The present case was representative of fire such cases.

10. Income Tax Ord. (Cap. 243) s.34(1), provides in circumstances such as the present for the profits arising to be deemed to be derived by the non-resident person from business transacted by him in Ceylon and the person there who acts on his behalf is deemed to be his agent for all purposes. The proviso enacts (2.2.56) that in taxing a non-resident manufacturer of goods in Ceylon the profits shall "be deemed to be not more than the profits which might reasonably be expected to be made by a merchant selling the property by wholesale".

1. Ibid., s.36(3)

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to estimate the income of the assessee whose returns were not accepted was fettered (i) by the limitation that he only had power to estimate when a person had furnished a return of income, (ii) by the ceiling imposed (as in the present case) on the profits which might reasonably be supposed to be made by a merchant selling the property by wholesale; similarly, his wide powers in computing the profits of a non-resident person carrying on business in Ceylon whose accounts could not be readily ascertained (i.e. by computing the profits at a fair percentage of turnover) was limited by the same upper ceiling referred to. The Commissioner was obliged to act on a statement of profits made by the merchants for the period in question (since the correctness of this had not been questioned) as a basis for estimating the profits of the non-resident merchants. The Court also emphasised the fact that the percentages referred to for the various years which had obviously been stated in advance had influenced the view regarding the percentage rate for each year of assessment. The Commissioner's power was limited to that of fixing taxes for a particular period under consideration.

In our opinion, as long as proper records are not available, the computation of business profits would always be a mere estimation. Looking at it historically, John F. Due was partially right when he asserted that the "traditional Colonial Income Tax modelled on the U.K. and originally intended for Europeans in the African countries is unnecessarily complicated as compared for example, to the U.S. tax for the African environment".[2]

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2. Cf "Income Taxation in Tropical Africa" (1962) B.T.R. 225 at page 369

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Actually, what is called for is a legal requirement compelling all traders to keep books of account; the use of simplified returns and standard deductions, as well as other measures to make the task of filing and checking returns easier.

D. Mechanics of Profit Adjustment

For income tax purposes all companies must submit the following documents to the Inland Revenue. A balance sheet, the trading profit and loss account, the Capital Allowances Schedule and the company's own income tax computation. From these it is seen whether the company has made a "net profit" or sustained a "net loss". But the "net profit" of a company and its "statutory income" are two different things. Since it is on the latter that tax is levied, the former must, therefore, be scrutinised and adjusted in order to arrive at the latter. This process of adjustment is necessary for two reasons: (a) Firstly, in the preparation of business accounts, accountants take into consideration the fact that capital is consumed in producing income thus necessitating an appropriation for depreciation. Under the tax Acts, however, depreciation is not an allowable item as it is taken care of by the Capital Allowances Schedule. (b) Secondly, certain peculiar "expenses" or "application of income" allowed by accountants in pursuance of their so-called "good accounting practice" are, in actual fact, contrary to the provisions of the tax Acts.

The general proposition is that deductions allowable in ascertaining the income or loss of an individual, or the profit or loss of any company are restricted to outgoings and expenses which are "wholly, exclusively and necessarily" incurred during the year of assessment for the purposes

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of obtaining income.[3]

From the above, two conclusions come to mind. Firstly, that the proper interpretation of the expression "wholly, exclusively and necessarily" incurred is of fundamental importance as much else depends on it. Secondly, that the most significant item in the preparation of the profit and loss account are "expenses".

On a purely domestic level, the expression "wholly, exclusively and necessarily" has been the subject of countless judicial decisions in several tax jurisdictions.[4] To these, the Nigerian courts would likely turn for guidance. Interesting as some of these cases are, they show how strict, arbitrary and inflexible the rule is. This is especially true in the case of the United Kingdom where no sum is allowed as an expense incurred in the production of income once there is a duality of purpose.[5]

On a higher level of abstraction, and of much more relevance to our study, are the criteria for the allocation of items of income and expense between related corporations in different states who are not parties to a tax convention.[6] The precise example we have in mind are the parent-subsidiary relationships of foreign companies who dominate the Nigerian economy. The issues are more fully considered subsequently.

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3. s.17(1) ITMA; s.27 CITA as amended by s.5(1), (2) of the Income Tax (Amendme t) Decree 1966 No. 65 of 1966.

4. E.g. <u>Bentleys, Stokes and Lowless</u> v. <u>Beeson</u> [1952] 33 T.C.491 (C.A.); <u>Norman</u> v. <u>Golder</u> [1944] 26 T.C. 293 (C.A.); <u>Prince</u> v. <u>Mapp</u> [1969] 46 T.C. 169.

5. For an analysis of these provisions in relation to the Nigerian law see Chapter IV.

6. The allocation of items of profits and expense between corporations in different states which are party to a tax treaty are considered in Chapter VII.

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The mechanics of profit adjustment involves a series of "add backs" and "deductions".[7] In other words, adding back to the net profits shown per account ~~any~~ expenses which have been debited before arriving at the profits but which are specifically disallowed by the Acts, as well as certain other classes of expenditure normally met with in conducting a business or exercising a trade. The latter category of expenses disallowed include expenses which are not "wholly, exclusively and necessarily incurred for the purposes of the business; losses which are not connected with, or arising out of the trade or business; expenses or losses of a capital nature which may have been charged in the profits and loss account as a matter of prudence e.g. improvements to premises or plants etc. Also disallowable are ostensible expenses which are in reality an application of profits. For example, income tax paid in another jurisdiction has been held in Bookers Demerara Sugar Estates Ltd. v. C.O.T.[8] to be an appropriation of profits, and not a charge in arriving at the profits. In that case, the appellant was a company incorporated in England and registered in the then Colony of Guiana. The question was whether income tax payable in the U.K. was a deductible expense for the purpose of the colony tax. The Court rejected the appellants contention on the grounds that U.K. income tax was not an expenditure laid out by the appellants for the purposes of earning profits.

Also to be added back to the net profit are all transfers to reserves (whether or not made against anticipated losses); voluntary gifts; dividends and sums apportioned to the proprietors of the business etc.

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7. i.e. in accordance with a statutory list of allowable and non-allowable expenditure.

8. [1955] L.R.B.G. 166.

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On the other hand, certain items of income which have been credited in the accounts may be deducted from the net profits. For example, items of income which have been specifically exempted from income tax by virtue of the Third Schedule of ITMA of s.26 of CITA. These include interests on Post Office Savings Account, or interest on other government securities; dividends which are categorically exempt from tax; (e.g. Pioneer dividends and dividends from Petroleum Companies). Also deductible from the net profits are items which are not taxable at all (i.e. Capital receipts and profits or gains not derived from a trade or business).

Usually, in the adjustment of accounts for income tax purposes the taxpayer may charge revenue to capital or vice versa as the case may be. But a taxpayer, is not permitted to claim for income tax purposes, that a payment it has made is an income as opposed to a capital payment if it has clearly asserted in its company accounts that the payment was of a capital nature. In B.W. Nobes and Co. Ltd. v. I.R.C.[9] the taxpayer company had set off, in its company accounts, certain annual payments made by it under a share transaction agreement against capital receipts of identical amounts in each instance. It claimed that was entitled to adjust its accounts for income tax purposes so that the annual payments were set off against taxed profits. The company had also distributed dividends out of its trading profits broadly equivalent in amount to such profits. Under company law, the carry forward on the profit and loss account each year was not sufficient to enable both the dividends and annual payments to be made out of profits and revenue reserves but under that law the annual payments could be properly

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9. [1965] 1 W.L.R. 229 (C.A.); Decision affirmed by the House of Lords [1966] 1 W.L.R. 111

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debited to capital account. The Court of Appeal reversing the decision of Plowman, J., in the High Court, upheld the Revenue's contention that once the company had clearly asserted that the payments were made out of capital, it could not thereafter claim that for tax purposes they were income payments.

What must be emphasized is that the Nobes Case illustrates an important principle of public election which binds the taxpayer in preparing his tax accounts from company accounts.

The process of profit adjustment is complete only when the "total profits"[10] of an individual or company are determined. Since a taxpayer may derive income from several sources, these have to be summed up in order to arrive at his total profits. For example, a company whose main business is wholesale trading may also own property from which it receives rent. If the two or more operations are unconnected, they may be regarded as separate sources for the purposes of ascertaining his total profits. Briefly then, the total profits of a company for a year of assessment consists of the total assessable profits from all sources for that year; plus any balancing charge arising from the disposal of assets; less any capital allowances claimed; and taking into account any claims for losses.

As a background to Section IV, we now wish to comment on a hitherto unused provision of the Companies Income Tax Act 1961 which could be of the utmost importance. viz The Scrutineer Committee.

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10. s.31 CITA; s. 21(1) ITMA.

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E. Scrutiny of Accounts

In anticipation of incompleteness of submitted company accounts, the Act provides that there shall be established one or more Scrutineer Committees for the purposes of making recommendations in relation to the assessment of profits of companies and to claimsfor losses by companies.[1] The criteria for membership of this Committee is that the appointee shall "have had experience and shown capacity in the management of a substantial trade or business or the exercise of a profession in Nigeria".[2] Once a Scrutineer Committee is established, the Board of Inland Revenue cannot make any tax assessment on a company without the consent of the Committee. It is, therefore, obliged to prepare a list of companies and to indicate the amount of the assessable profits which it proposes to include in the computation of the total profits of such companies for the purposes of making any tax assessment.[3]

The duty of the Scrutineer Commit ee as the name implies is to dissect and scrutinise accounts. And in order to accomplish this, it is vested with wide powers.[4] With respect to the proposed amount of assessable profits shown against the name of any company on the list produced at its meeting, the Committee may inquire of its secretary, inter-alia, the nature of the source and the period over which such profits arose; whether the proposed amount was estimated either in the absence of a return, statement, or account, or upon the rejection thereof as unsatisfactory; or was estimated or computed having regard to any such returns, statement or account.[5] The Secretary is further obliged to furnish at the chairman's

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1. s.9(1) CITA.
2. s.9(3)(a) CITA.
3. s.10 CITA.
4. s.11(3) CITA.
5. s.11(4)(a) CITA.

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request any return, statement, account or other document received by the Revenue in connection with the determination of such profits; and if considered necessary to inform the Committee of the assessable profits of a particular company for the three preceding years.[6]

The important point to note is that if after making the above inquiries and using its local or general knowledge of a particular company or of any trade or business, the Committee is of the opinion that the proposed amount of assessment is insufficient, the chairman shall at such meeting record in writing against the proposed amount the revised amount which the Committee recommends and the reasons for such recommendation.[7] Subject to the usual right of appeal, the Revenue must comply.

Where any company has incurred a loss, before the amount of the loss is admitted or determined, the Committee must scrutinise the amount of assessable profits. (Calling for books, statements etc.).[8]

Having outlined the position above, a few observations may be made. Firstly, that the provision for a Scrutineer Committee is one of those numerous instances in which Nigeria has a good law which is not put into effect. Why for example has a Scrutineer Committee not been set up? The second point we wish to make is that were such a Committee to be established in future, the present laid down criteria for membership must be reconsidered. It is believed that a man who has "had experience and shown capacity in the management of a substantial trade or business or in

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6. s.11(4)(b)(i)(ii) CITA.
7. s.11(4)(c) CITA.
8. s.13 CITA.

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the exercise of a profession in Nigeria" may yet be totally unacquainted with the intricacies of international business, the complex operations of multinational corporations, and the technicalities of the tax law.

What is clearly needed is the use of accomplished experts. In other words, the appointment of accountants, economists, lawyers and other similarly skilled men on Scrutineer Committees. It must be accepted that taxation is a highly specialised subject and that the best "Scrutineers" of company accounts prepared by accountants are the accountants themselves.

The third point we wish to highlight is the _modus operandi_ of the Scrutineer Committee as prescribed by law. How exactly is this Committee to make or revise an assessment using its "local or general knowledge" of a particular company or trade? If the papers submitted do not reveal the whole truth about a company, how is the Committee to obtain further information? Can it be by hearsay evidence or the use of informants, spies etc.? What is the position when the activities of a company transcends several tax jurisdictions? Without appearing to be cynical can it not be said that the procedure to be adopted by the Scrutineer Committee is analogous to the so-called "best of judgement assessment"?[9] At the present stage of Nigeria's economic development a much more sophisticated approach would be required.

Fourthly, what are the rights of the taxpayer before the Scrutineer Committee to know the allegations against him; to make representations, to be represented by accountants, lawyers etc.? Apart from a general

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9. This is a rough and ready method of assessment adopted sometimes by the Revenue when proper records are lacking.

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right of appeal to the Commissioners and to the High Court, the law is silent on these important matters.

In these circumstances, our submission is that the taxpayer must be given the opportunity to explain his transactions when his books are being examined by a Scrutineer Committee prior to the making of an actual assessment. To be given the right to appeal only when an assessment has been made is unfair.

One area in which the scrutiny of accounts is a must, is the allocation of income and expense between related entities under common control. Such is the importance of the subject that it formed part of the agenda of the 25th Congress of the International Fiscal Association held in Washington in 1971.[10] The next section looks in more detail at the issues involved.

DETERMINATION OF PROFITS - ALLOCATION OF INCOME AND EXPENSE BETWEEN RELATED ENTITIES

The discussion here is in terms of a parent corporation and a subsidiary assumed to be resident in different countries hereinafter referred to as the parent's country and the subsidiary's country. That is, Nigeria and an overseas country as the case may be. The tax involved referred to as "income tax" must be understood to cover corporation tax,

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10. Cf. Stanley S. Surrey and David R. Tillinghast: "Criteria for the allocation of items of Income and Expense Between Related Corporations in different states, Whether or Not Parties to a Tax Convention". Cahiers de Droit Fiscal International (1971) Vol. LVI (b) General Report page 1/1 et seq.

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super tax or profits tax usually applicable under income tax law and to some extent withholding taxes imposed on various payments to foreign entities.

A. Why Rules of Allocation?

The economic stakes for tax systems and tax authorities make rules of allocation necessary. Where for example, the parent's country has a relatively high income tax (say 50%) and the subsidiary's country a much lower rate (say 20%), the differential in rates can be a temptation for the parent corporation to lodge in the subsidiary corporation income arising from the activities of the two corporations. This can happen when the parent sells goods to the subsidiary for a resale by the latter, which retains a larger share of the profit with the idea of securing a tax advantage for the related entities. An overall tax saving on the transaction results if two conditions exist; first, if the parent's country does not concurrently tax income of the subsidiary when earned (and most tax systems do not), and secondly if either (i) the parent's country does not tax dividends or other payments to the parent from the subsidiary, or (ii) the subsidiary has a use for the income it receives either on its own operations or as an investment in operating companies which it controls and thus will not return it as a dividend or other taxable payment to the parent.

The real question is, will this temptation be acted upon by companies engaged in international business?

If tax systems permitted such companies to arrange their inter-company

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transactions to take advantage of the differential in tax rates, experience has shown that in many cases companies would respond to the situation, and achieve the tax saving. Income like water flows to areas of lower taxation. In theory, therefore, the country with the higher rate will lose revenue, and the country with the lower rate will gain. But since transactions may flow from parent to subsidiaries, from subsidiaries to parent, or between subsidiaries, there cannot be any general assumption as to which country - parent's or subsidiary's - will be the ultimate loser.

There are, of course, a variety of situations in which other factors may exert a stronger and contrary pull to the attraction of tax rates. An example that comes to mind is the presence of losses in one country against which international profits can be offset. Examples of non-tax considerations are the effect of exchange controls, monetary or governmental instability in a particular country, a desire to satisfy the national economic aspirations of a given country and a variety of other commercial considerations.

As international business grows in volume and concentration and among larger enterprises, would the tax authorities around the world be content to allow the executives of these enterprises to allocate the revenue of the countries touched by their operations? Most countries recognise the economic stakes and their tax systems provide their tax authorities with powers to examine international transactions so as to protect the country's revenue. Modern tax treaties too provide for such examination.[1]

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1. For a detailed discussion of the various methods of profit allocation under the tax treaties see Chapter VII.

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Looking at the other side of the coin, the problem faced by the taxpayer in a situation where each country can assert its own tax sovereignty and stipulate its own rules of allocation must be acknowledged. Often, the taxpayer has to comply with rules of allocation which are not well articulated. If the Revenue of one country applies its rules of allocation to change the international division of profit arising under the taxpayer's arrangement of a transaction, the immediate dilemma facing the taxpayer is whether the tax authorities of the other country will recognise the allocation so as to permit the latter country's portion of the transaction to be recast in a complementary manner. This is crucial because rules of allocation between countries may vary in content and application.

Where for example, the tax authorities in the parent's country require interest to be charged on an inter-company loan, and, therefore, tax such "interest income" to the parent, the question is whether the subsidiary's country will recognise the interest charge and permit a resulting payment from the subsidiary to be treated for purposes of its laws as an "interest cost". Similarly, if the tax authorities in the parent's country, increase the price at which goods are transferred to the subsidiary, would the subsidiary's country recognise the price increase and, hence, reduce the subsidiary's taxable profit on its resale of the goods?

A failure by the subsidiary's country to permit necessary complementary adjustment could result in two countries together finding a total taxable profit on a transaction greater than the "economic profit", since the allocated item is considered an element of profit on both sides. This raises the spectre of "economic double taxation" which may be no less costly than "juridical double taxation". Furthermore, it is interesting

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to observe that if the parent's country uses an exemption system for foreign income, then the parent in effect bears the additional cost of the subsidiary country's tax on the duplicated profit. The same is equally true where the parent's country uses a foreign tax credit system but does not recognise the tax paid by the subsidiary as creditable. Where the parent's country uses a foreign tax credit which takes into account the corporate tax paid by the subsidiary, the additional cost may or may not be borne by the parent. To the extent that it is, the parent country will in effect suffer the same revenue loss that it sought to avoid in initiating the allocation.

The problem faced by taxpayers when rules of allocation are applied, are genuine and substantial. As a consequence, while taxpayers on the one hand can be asked to recognise the national needs of countries to have rules of allocation based on the economic stakes earlier described, the tax authorities on the other hand must accept that rules of allocation and the procedures for applying them should take account of the problems faced by taxpayers. The fact that a particular country, for whatever reasons, may not desire to initiate many allocations on its part does not relieve that country of the responsibility for responding in a proper manner to the allocation initiated by other countries.

B. Rules of Allocation Under Nigerian Law

The Revenue on legal grounds may re-adjust transactions between related or unrelated parties which do not meet certain requirements.[2]

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2. s.25 CITA; s. 14 ITMA.

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Broadly speaking, the applicable rules fall into two categories (a) provisions dealing specifically with the readjustment of transactions between related entities,[3] (b) re-adjustment of transactions achieved by applying the general rules governing the determination of income.[4] The former provisions basically state that transactions which differ from those which would have been made between independent parties dealing at "arm's length" and which consequently reduce the taxpayer's income shall be disregarded by the Revenue. Example of the latter are provisions discussed in Chapter IV which stipulate that only expenses "wholly, exclusively and necessarily" incurred for the production of income can be deducted in computing taxable income, and that other expenses cannot be deducted.

The intercompany transfer of goods and services and the prices paid thereon is a major problem of international tax law. With developing countries it is a very crucial problem indeed. For instance, where there is a strict foreign exchange regime governing the repatriation of profits, interests, dividends and other factor payments, foreign subsidiaries can yet take out substantial amounts of profit by irregular intercompany pricing of goods and services. Phenomenal increases in cost could arise by means of what is politely called a <u>transfer price mechanism</u> viz, a "discretionary pricing of inter-company transfers of goods and services at a higher or lower amount than for value received"[5]

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3. s.25(2)(ii) CITA; s.14 (3)(ii) ITMA

4. s.17, 18 ITMA; s. 27, s.28 CITA

5. Olaseni Akintola - Bello: <u>Transfer of Industrial Technology to Developing Countries through Direct Private Investment</u>. M.A. Thesis (1971), Sussex University at page 109. For a recent example see Daily Times (Nigeria) November 19th 1972 page 24. Report of probe into an Ikeja (Lagos) company for several malpractices e.g. transferring money abroad by raising the prices of all goods coming to Nigeria through the company from abroad.

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Evidently, by the proper application of the allocation rules under Nigerian law, prices paid or prices received differing from those which would have resulted from transactions between unrelated parties dealing at "arms length" may not be taken into account for the determination of taxable income. But the great flaw in the law is the presumption that an objective price can always be arrived at on the basis of a hypothetical transaction between unrelated parties dealing in the same or similar goods under comparable circumstances. Experience tells us, however, that this is not always possible. Where an objective price cannot be determined, a price based upon cost plus a predetermined percentage profit can be used. This is supportable on an assumption that implicit in an "arm's length" dealing is a profit element; even though, relatively sophisticated concepts such as "incremental costing" and "market penetration" are cited as examples of situations when a profit element need not be present.

As it seems, the Nigerian allocation rules are applicable to both domestic and foreign related taxpayers. This is different from what obtains in some other countries where the treatment of transactions between related corporations if both are domestic, is not the same where one is non-resident. The substance of these rules in the latter situation is to disallow the deduction of certain payments made by the domestic subsidiary to its foreign parent and automatically, therefore, to consider these payments as a distribution of profits. Such a provision exists in the United Kingdom for certain interests and royalties paid by a British company to a foreign parent.[6] In many instances, Argentine law and

6. Cf. s. 233 ICTA 1970 - Meaning of a "distribution" under the U.K. tax laws.

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administrative practice follow a similar rule; the rule is based on the principle that when a subsidiary forms an "economic unit" or has a "community of interest" with its parent company, the payments made to the parent have the character of a distribution of profits.[7] In these situations, there is no need for the tax authorities to consider a "re-adjustment" of these payments.

Considering the volume of inter-company transactions especially the inter-company pricing of goods and services between Nigerian subsidiaries and their oversea parent companies, it is quite clear that the Revenue must be vigilant in order to ensure that profits which are properly liable to Nigerian tax are not transferred abroad untaxed.

Since the purpose of the provisions dealing with re-allocation is to reflect the profit which would have resulted from transactions between unrelated parties, must a tax avoidance motive be present or proved to sustain a re-allocation under Nigerian law? The relevant section of the law provides that:

> "where the Board is of the opinion that any disposition is not given effect to, or that any transaction which reduces or would reduce the amount of any tax payable is artificial or fictitious, it may disregard such disposition or direct that such adjustment shall be made as respects liability to tax as it considers appropriate etc. etc."[8]

There has been no Nigerian case on this section but it is, perhaps,

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7. Stanley S. Surrey and David R. Tillinghast op. cit at page 1/8

8. s.25(1) CITA; s. 14(1) ITMA

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correct to state that a tax avoidance motive must exist to sustain a reallocation.[9] We take this view because not all transactions "which reduce" or are likely to "reduce the amount of any tax payable" are artificial or fictitious. It is a fact of life that there are perfectly legitimate reasons why transactions between parties may be based entirely on non-commercial considerations.

The above may be compared with the Australia[10] and New Zealand[1] provisions on tax avoidance where the all-embracing provisions of the law have been interpreted in a way to suggest that a tax avoidance motive must exist before the taxpayer's transaction can be disregarded.

Faced with the task of reconciling a number of decisions on the Australian statute the Judicial Committee of the Privy Council enunciated this principle:

> "In order to bring (any) arrangement within the section, you must be able to predicate- by looking at the overt acts by which it was implemented - that it was implemented in

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9. The distinction between tax avoidance and tax evasion must always be borne in mind.

10. Cf. Income Tax and Social Services Contribution Assessment Act 1936 - 1960, s. 260 reads: "Every contract, agreement or arrangement made or entered into, orally or in writing ...... shall so far as has or purports to have the purpose or effect of in any way, directly or indirectly - (a) altering the incidence of any income tax; (b) relieving any person from liability to pay any income tax or to make any return; (c) defeating, avading, or avoiding any duty on liability imposed on any person by this Act; or (d) preventing the operation of this Act in any respect, be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect for any other purpose.

1. Cf. Land and Income Tax Act 1954, s. 108: "Every contract, agreement or arrangement made or entered into whether before or after the commencement of this Act, shall be absolutely void in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence of income tax or relieving any person of his liability to pay income tax".

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> that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section".[2]

Although the actual wording of the New Zealand section differs from that of the Australian Statute, it is interesting to note that the Court of Appeal in the former country has held that they embody the same principle.[3]

Without deviating further into problems of tax avoidance the Nigerian position may be stated as follows: For a re-allocation to take place two things must happen. Firstly, a transaction must have been arranged in such a way as to reduce or tend to reduce tax liability. Secondly, such an arrangement must be prima facie bogus and without any rationale behind it, save that of avoiding tax. In other words, there must be an intention to avoid tax.

In future, it is submitted that the Nigerian provisions must be interpreted in an objective way, with a view primarily to discover and reject transactions which are "artificial" or "fictitious". Any other approach is likely to be unnecessarily burdensome to the Revenue and the taxpayer alike.

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2. Per Lord Denning in Newton v. Federal Commissioner of Taxation [1958] A.C. 450 at p. 466.

3. Cf. Elmiger v. I.R.C. (1967), 10 A.I.T.R. 349 especially at p. 358 per Turner, J.

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C. Re-allocation Rules in Practice

Similar to what obtains in several other countries, the operative rules governing the application of the basic statutory provisions regarding re-allocation in Nigeria are generally unknown to the taxpayers and the public. One suspects that if such rules exist at all, they are sketchy and relatively undeveloped. Our assumption is based on the fact that if allocation rules were frequently used and well rooted in actual practice, there would be little uncertainty. Proper rules could logically have been evolved from the proper functioning of a "Scrutineer Committee" if one had been in existence.

The U.S. example is instructive. In that country, extensive and detailed regulations give guidelines on the different methods to be used for determining an "arm's length" price. While advance tax rulings are not generally available, the Internal Revenue Service may enter into an industry wide agreement as to methods to be utilised. Safe havens are provided in the Regulations with respect to several kinds of transactions e.g. interest, rentals and certain services.[4] The U.S. solution is something to be studied by Nigeria.

As multinational corporations become more active in the country, a firm and well defined allocation policy must be developed. The present system of ad hoc negotiation between the taxpayer's accountant and the Revenue on controversial items of income and expense is of doubtful value.

4. Stanley S. Surrey and David R. Tillinghast op. cit. page 1/10.

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The first step towards a proper re-allocation procedure is an efficient scrutiny of accounts - for without meticulous scrutiny of submitted accounts, there would hardly be any occasion for re-allocation. Considering that businessmen do not enter into business for altruistic or philanthropic reasons, it is quite surprising how little re-allocation problems have arisen in actual practice, not only in Nigeria but in several other countries as well.[5]

Perhaps, one of the reasons why there have been few formal application of the statutory re-allocation provisions is that for certain international transactions a prior authorization has to be granted by the Federal Ministry of Finance or prior consultations have to be held with the Central Bank of Nigeria for exchange control purposes. These authorities can require that certain conditions be fulfilled before giving their consent to proposed transactions. In these circumstances, it would be unlikely that a transaction having gone through this procedure would be questioned under the tax re-allocation provisions.

In spite of the above, however, one realises from the studies of the International Fiscal Association that the degree of awareness or concern which the legislative bodies and tax authorities have shown with respect to these problems varies markedly from one country to another; - and in Nigeria, it is certainly not enough. This lack of awareness is manifested

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5. Ibid., 1/10 -- 1/11.

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in a variety of ways; e.g. in the absence of detailed statutory rules, the little development of regulations and case law, and the general non-existence of a practice and experience which give predictable content to tax administration in this area.[6] One also senses, in varying degrees, the feeling in many countries that since an "arm's length" price or a "fair market value" are matters not easy to know or determine with accuracy, the tax authorities should proceed with caution. Much is obviously left to the pragmatic judgement of the Revenue.

As far as Nigeria is concerned, we can only hope that it would soon be recognised by the authorities that situations when a re-allocation may be called for are increasing in number and that the often rudimentary framework presently existing is inadequate to cope with the challenge.

The I.F.A. is optimistic that in some countries an awareness may develop in response to the needs for initiating adjustments in order to protect their revenue; while in others, this development could come as a reaction to adjustments being initiated in other countries.

At this juncture, attention may be drawn to an interesting difference between the Ghana and Nigeria tax laws in a matter of practical importance as regards re-allocation. Unlike Nigeria, the Ghana position is that where a non-resident carries on a trade or business in the country, the entire income is deemed to have been derived from Ghana even though a part of the operations generating that income is carried on outside Ghana.[7]

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6. The position is likely to change as the machinery for tax administration becomes more sophisticated.

7. (1966) Ghana Income Tax Decree, s. 6.

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The immediate purpose of the provision, it appears, is to enable the Commissioner to readily assess non-resident companies on the income they derive through the operation or control of Ghana branches or subsidiaries. This is a big contrast to the Nigerian provision whereby only the profits directly attributable to the operations carried on in Nigeria by a non-resident are taxed.[8]

The point to note is that neither approach is trouble free. Nigeria's divisibility approach creates potentially stormy allocation problems since it is often difficult to determine the value contributed to an international process by one particular operation. Similarly, while the Ghana law substantially relieves the Revenue of difficult allocation problems, it loses sight to some extent of the realities of international commerce and may raise questions of double taxation. We know for instance, that many non-residents maintain purchasing offices in Ghana for the purpose of obtaining raw materials which are converted into finished product overseas. Since the country where the finished product is manufactured will undoubtedly insist upon taxing at least the profits attributable to the local operations in that country the foreign resident will be caught by the taxing laws of two competing jurisdictions. This may, however, not be so where there is a a tax treaty in force.

A harmonisation of company and revenue laws in Nigeria is urgently required in order to minimise the present uncertainties as regards the

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8. s. 5(1) ITMA; s.30 1(b) CITA

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allocation of items of income and expense between related entities especially where both are resident in different states. However, so long as international trading goes on allocation problems will continue to occur. Not only must this basic fact be clearly recognised but it should be an impetus towards the evolution of well defined allocation rules and procedures.

The effect of tax treaties on the adjustment process is considered in the appropriate chapters.

TAX TREATMENT OF LOSSES: TWO BASIC ISSUES EXAMINED

A. General Principles

Our previous discussion show that in arriving at the "total profits" for any year of assessment, the taxpayer may deduct from the receipts of any trade or business the amount of any loss incurred by him subject to the right of the Revenue to accept, refuse or modify any loss claim as it thinks fit.[9] Such deduction for losses is strictly limited by law to the actual amount of loss and on no condition may it exceed the amount of assessable profits included in the total profits for any year of assessment. Where there is an excess of losses over assessable profits in any particular year, such losses may be deducted from the assessable profits of subsequent years.[10] In other words, there is an indefinite carry-forward of losses.

This unrestricted carry-forward of losses is clearly an incentive to the foreign investor.

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9. s.31(2)(a) CITA, s. 21(2)(b) ITMA. See also s. 31(5) CITA.

10. s. 31(2)(b) CITA

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For the set-off of losses under the income tax law, it is evident that the loss must be a "trading loss" and not a loss caused by other extraneous factors as distinct from trade e.g.devaluation and other changes in monetary parities. Bearing in mind that the activities of companies are rarely confined to one country and that they may have assets and financial reserves in other countries and in foreign currencies, alterations in exchange parities may have a profound international repercussion on their affairs thus creating what is technically a "profit" or a "loss". For purposes of loss relief too, there may have to be enquiries into whether or not the loss sustained is a "capital loss" or a "revenue loss". Whereas the latter can be set-off in the process of profit adjustment, the former cannot. The intriguing thing is that where a business transaction transcends two or more tax jurisdictions, the characterisation of any receipt either as of a capital or revenue nature varies from country to country depending on internal law.[1]

Although these principles are quite easily stated the decided cases show that they are difficult to apply.

B. Tax Treatment of Foreign Exchange Profits and Losses

If a person is in the business of buying currency for the purpose of re-selling at a profit there is no doubt as to the taxability of the profit and the deductibility of any loss. The question which does provide the difficulty, however, is where the profit or loss is made on a foreign exchange transaction which is, or is alleged to be, a purely collateral transaction to the real business of the taxpayer.

1. Cf. Cases like Lazards Investment Co. v. Rae; Inchyra v. Jennings.

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To illustrate the position we refer here to the East African case of C.O.T. v. Diamond Corporation Tanzania Ltd.[2] In that case, the respondent company incorporated in Tanzania, bought diamonds from Williamson Diamonds Ltd at a price $7\frac{1}{2}$ per cent below the price it obtained from its parent company in London. The $7\frac{1}{2}$ per cent commission was retained as a deposit with the parent company on a seven day call basis at a low interest rate. On making up its accounts to the end of 1967, the respondent showed the loss it had suffered on its deposit as a result of the devaluation of sterling as a "trading loss". This was allowed in the High Court and the Revenue appealed contending that the loss was a "capital loss" of part of an investment, and that the income should have been transferred to Tanzania as it was earned. The East African Court of Appeal rejected the Revenue's contention and held that since the devaluation took place during the accounting year in question the loss was a "trading loss".

Similar to the above is the Hong Kong case of C.I.R. v. Hang Seng Bank Ltd[3] where the Board of Appeal had to decide whether all foreign exchange losses were allowable against Hong Kong tax; or, whether only losses on funds being used to produce profits taxable in Hong Kong were allowable. The material facts were as follows:

In November 1967 the respondent bank held balances in sterling and United States dollars. In that month sterling was devalued in terms of Hong Kong currency whilst the Hong Kong dollar was devalued against the United States dollar. It was common ground that subject to one consideration the increase or decrease resulting from the change in relative values

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2. [1970] E.A.C.A. 552

3. [1972] H.K.L.R. p. 484

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of the currencies should be taken into account as profits or losses for the purposes of assessing business profits tax under the Inland Revenue Ordinance Cap. 112.

The Commissioner, however, contended that the decreases in the value of the sterling balances held for the purpose of ordinary foreign exchange dealings which could earn profits taxable in Hong Kong were allowable as losses but that balances which were invested abroad and not available for that purpose were not. It was conceded that foreign currency purchased by a bank is at least initially part of its stock-in-trade. The argument was confined to the use made of the currency and not the purpose for which the currency was purchased. For the Commissioner, it was argued that upon investment abroad the foreign currency ceased to be stock-in-trade capable of earning profits in Hong Kong and therefore played no part in the activities of the bank which may result in a profit or loss arising in Hong Kong.

Upon these fact, Huggins, J., held that (1) the temporary use of stock-in-trade to earn profits not taxable in Hong Kong cannot change the status of the goods whether they be in currency or anything else, as stock-in-trade of the business; (2) the profit being taxed in Hong Kong takes into account the notional increase or decrease in the value in Hong Kong of the foreign currency held.

No similar case has been decided in Nigeria and so it remains to be seen how much of a persuasive authority the above two cases are likely to be. With several companies operating in Nigeria keeping part of their reserves abroad, it is only a matter of time for similar questions to arise.

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making the purchase of the marble.

Prior to the purchase, the lire appreciated in value, whereupon appellant, not unwilling to make a profit, sold the lire for more pounds sterling than it had originally paid. Subsequently, when the time came to purchase the marble, it acquired an additional supply of lire which it used to make the purchase, and its expenditure in acquiring the second supply was allowed as a deduction in computing the appellant's trading profit. The Revenue, however, claimed that the profit made on the earlier transaction of purchase and sale was a "trading profit" and therefore taxable.

Mr. Justice Rowlatt, rejected the Crown's claim. The profit on the first transaction, he said, was made on a temporary investment of free funds and was not a profit arising out of a contract for the supply of marble. It was, he summarized, simply a speculation in foreign exchange with capital lying idle.

Although the decision in this case has not been expressly overruled, its correctness is doubtful. Clearly, the original purchase of the lire was not made with a view to speculation as suggested by Rowlatt, J., but as a part of the overall business operations of the taxpayer.[5]

The extent to which a foreign exchange transaction may be regarded as an integral part of the taxpayer's business emerges in Imperial Tobacco Co. v. Kelly.[6] In that case, the appellant which was an English company,

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5. For example, in Landes Bros. v. Simpson 19 T.C. 62 where the transaction resulting in foreign exchange profit was an integral part of an agency business, the profits were held to be taxable.

6. 25 T.C. 292.

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followed the practice of purchasing large quantities of U.S. dollars to finance its substantial purchases of tobacco leaf in the United States. Every year it acquired a stock of U.S. dollars for this purpose, but on no occasion did it ever buy dollars for the purpose of resale as a speculation. On the outbreak of war, a government regulation prevented further purchases of American tobacco leaf and the company was also obliged to sell its stock of U.S. Dollars to the British Government. The sale produced a considerable profit, which the Revenue claimed was a "trading profit" subject to income tax.

It was held by the Court of Appeal that the sale was effected in the course of the company's regular trading operations and that the profit made was accordingly to be included in computing the company's profits for the year. Lord Green[2] the Master of the Rolls, characterized the transaction as a sale of surplus dollars which had been acquired for the purpose of effecting a transaction on revenue account. In his opinion, any transaction of this description, whether in dollars or in any other commodity, must be on trading account and so taxable. His Lordship also expressed some doubt (though not explicitly) about the correctness of Rowlatt, J's decision in the McKinlay case.

Again, this writer is sceptical about the validity of the decision in the Imperial Tobacco Case. If, indeed, the taxpayer was held not to be taxable on the gain resulting from an isolated speculation in currency as in McKinlay's case (i.e. speculation in foreign exchange with idle capital), why then must he be liable on a similar gain when compelled to speculate in currency as a result of the exigencies of war?

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The decision in the Imperial Tobacco case can probably be explained on the basis that the foreign exchange (i.e. dollars) were originally acquired for the purposes of carrying out transactions on revenue account. But this distinction from the McKinlay case is unsatisfactory because the Italian lire acquired by the taxpayer in that case was also on revenue account.

The above two cases may be contrasted with Davies v. Shell Co. of China[7] where the tax principles were correctly applied. In that case, a British company which sold petroleum products in China required its agents in that country to put up deposits as a guarantee that they would meet their obligations. The deposits, which were in Chinese dollars, were ordinarily held by the company in its Shanghai bank, but after the outbreak of hostilities between China and Japan, it transferred the deposits to London and deposited the sterling equivalent with its London bankers. Subsequently, the Chinese dollar fell in value with the result that the company was able to repay the deposits to its Chinese agents when their agencies terminated at very much less in sterling than it had orginally obtained for the Chinese dollars.

It was held by the U.K. Court of Appeal that the profit was a "capital profit" and not taxable. According to Jenkins, L.J.,

> "if the agent's deposit had in truth .... been a payment in advance to be applied by the company in discharging

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7. 32 T.C. 133. See also Eli Lilly Co. (Canada) Limited v. M.N.R. 55 D.T.C. page 1139. In this case a foreign exchange gain arose as a direct result of delayed payments on inventory account. The Supreme Court of Canada following the reasoning in the Shell Oil Company of China case held that the foreign exchange gain was a trading profit arising as an integral part of a trading transaction.

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the sums from time to time due from the agent in respect of petroleum products transferred to the agent and sold by him the case might well be different".[8]

But it was clear here that such was not the case: the deposits were to be held by the company for the duration of the agency and were available to the company in one circumstance only, viz, if the agent defaulted at any time during the term of his agency.

In summary, the principles emanating from the decided cases may be stated as follows: It would appear that foreign exchange gains arising from investment or capital account would not be subject to tax,[9] unless such investment or capital accounts were in disguise vehicles for accommodating revenue account matters or providing funds on revenue account. If they were such vehicles, then gains thereon, would be taxable and losses thereon would be deductible. In order to escape any tax one would have to show that a foreign exchange activity was not a necessary and integral part of a trade or an adventure in the nature of trade.

Relating the above more specifically to Nigeria, it must be pointed out that since 1967 foreign exchange gains on capital transactions are now subject to a capital gains tax at twenty per cent.[10] In other words, tax is now payable on any foreign exchange profits or gains under the Income Tax Acts or the Capital Gains Tax Decree 1967 as the case may be. One

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8. 32 T. C. 133 at page 156.

9. Such gains may, however, be liable to a Capital Gains Tax.

10. s.3(a) Capital Gains Tax Decree 1967. No. 44 of 1967.

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distinction as regards the taxpayer's liability under the two laws must, however, be made. Whereas, foreign exchange losses on revenue account are allowable in computing taxable profit for the purposes of income tax liability, no such losses are allowable under the Capital Gains Tax Decree.[1] In this circumstance, the taxpayer may be better off by establishing that a foreign exchange transaction was an integral part of his business operation.

Apart from the question of foreign exchange gains or losses on currency transactions there are other complex problems in this area of tax law.

The issues become more intractable when the changes in monetary parities affect the amortisation of debts and the prices of stocks or equipment from overseas which may have been arranged on a deferred payment basis. In Texas Co. (Australasia Limited) v. Fed. Comm. of Taxation[2] for example, one of the matters which arose for settlement was whether it was proper to allow deductions claimed by the taxpayer in respect of payments of Australian money made in remitting money to New York in order to satisfy debts owed in the United States in dollars.

In the above case, the main business of the taxpayer was the purchase and sale of petroleum products in Australia and New Zealand. Those products were purchased from a company or group of companies in America hereinafter referred to as the "supplier". All transactions between the taxpayer and the supplier were on dollar basis. With the depreciation of the Australian currency between 1931 and 1933, the taxpayer could not

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1. Ibid., s. 5
2. [1940] 63 C.L.R. 382.

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pay its current liabilities in U.S. dollars without suffering tremendous "exchange losses". This was so because the amount required in Australian money to discharge a liability which was due in the foreign currency turned out to be greater than the amount which had already been allowed as a deduction for the purposes of ascertaining the business profits of the tax-payer. Considerable adjustments had to be made for exchange differences which the taxpayer claimed as deductions in its returns for the purpose of assessment to income tax. The court upheld the taxpayer's contention.

In spite of the decision in the Texas (Australasia) Case, however, it does not appear to be settled law in Australia that an "exchange loss" would always be regarded as a "trading loss" and thus an allowable item in computing "total profits". Our view is supportable because in the latter case of Armco (Australasia) Pty Limited v. Fed. Com. of Taxation,[3] where the facts were substantially similar to the Texas (Australasia) Case, the High Court of Australia was evenly divided; Latham, C.J., and Starke, J., being of the opinion that the appeal should be allowed and Dixon and McTierman, J.J., being of a contrary view.

At this juncture, we must emphasize that what is often at stake is not simply whether or not an "exchange loss" should be regarded as a "trading loss" but how to reflect in the company's "Profit and Loss" account and its "Balance Sheet" the real economic situation as distinct from distortions caused by nominal fluctuation in figures due to domestic inflation or other currency anormalies.

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3. (1948) 22 A.L.J. 234

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If a change in monetary parity results in a heavy increase or decrease in financial liabilities, there are three ways of treating the problem for accounting purposes: (1) to regard them as losses sustained in the year in which the change in parity occurred as was done in the Tanzania Diamond Case, (2) postpone the treatment of the loss until payment of the higher cost has been made, or (3) alter the accounting value of the imported equipment in the balance sheet thereby regularising the position by increasing the value of the asset and acknowledging the higher cost of meeting the greater financial liability.[4]

"Exchange losses" accounted for and accepted immediately which is the first of the above solutions is that adopted in most tax legislations and would most likely be followed by Nigeria if the problem ever reaches the courts. The second solution is nothing more than a postponement of the problem and it is only the third solution that really provides a comprehensive treatment of the problem by adjusting the accounting valuations to the economic realities.

In order to treat the subject in a systematic fashion, the first need is to draw up a summary of the principles governing balance sheets in accordance with the general provisions of the tax law, and then to study possible ways of correcting anomalies arising in the balance sheets. What is envisaged is a method whereby balance sheets can be prepared to reflect not only changes in monetary parities but price alterations as well. In

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4. See Professor M. Sebastian "Tax Consequences of changes in Foreign Exchange Rates": - General Report of the 26th Congress of the IFA held in Madrid in 1972. Cahiers de droit Vol. LVII b page 1/33 at 1/59. Note that in the Armco (Australasia) Pty Ltd. Case, one of the very difficult issues here was the fact that the purported "exchange loss" was not claimed as a deduction in the year of the currency anomaly but much later on.

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this way, a reconciliation may be achieved between accounting values and real values and certain undesirable fiscal consequences can also be avoided e.g. taxing a profits increase that are not "profits", or not recognising losses that have actually occurred.

The hitherto most often used method of preparing company accounts (i.e. historic cost) is now obsolete. What is commonly advocated by experts is the determination of profits by comparing the balance sheets at the beginning and at the end of the tax year.[5] But the extent to which the latter system would be adopted remains to be seen.

The U.K. accounting profession in a recent paper[6] "to establish a standard method for calculating the effect of changes in the purchasing power of money on conventional historical cost account" proposed that historic account should still be prepared but that a supplementary set of accounts adjusted for changes in the general price level by reference to the consumer price index should be attached to the Annual Report. If finally adopted, there can be no question that this is a great step forward, for it does recognise that profits cannot be measured in differing monetary units. Since a company's profits are usually computed by deducting relevant costs incurred from sales revenue, during an inflationary period the time between purchase and sale, if significant, means that historic figures represent transactions in different currencies.

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5. A lot of the theoretical arguments on this subject was presented to the Royal Commission and appear in their Final Report Cmnd. 9474 in Chapter 15. i.e. Depreciation and Wasting Assets especially at para. 329 et seq on Inflation and Fixed Assets.

6. See John Plender: "Accounting for Inflation: the Profession Drafts its Blueprint", The Times, London, January 17th 1973.

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From our discussion on the tax treatment of foreign exchange profits and gains the following general observations may be made: (1) While "foreign exchange losses" on revenue account are strictly speaking deductible in computing taxable profits, the application of this principle when such losses occur abroad is open to some doubt. Clearly, a country like Nigeria cannot allow her revenue position to be affected by the internal monetary policies of oversea countries. (2) Secondly, in order to meet the difficulties created by inflation and other currency anomalies, the country may adopt a system of comparative balance sheets to determine "economic profits". Alternatively, Nigeria may follow the Latin American countries[7] which furnish many examples of adjustment of balance sheets, with capital assets being revalued in the light of price levels and being amortised at their replacement cost. This is something which has been achieved at the cost of a little effort in the tax field; the revaluation being processed through a special reserve fund included among the liabilities -- known as an equalisation fund. (3) Finally, if however, Nigeria decides to treat all "exchange losses" as "trading losses" the principle of autonomy and exclusivity of each accounting period must be dispensed with to enable these losses to be spread over several financial years.[8]

C. Transfer of Losses Between Related Entities:

Most of the detrimental consequences of unrestricted allocation of income and expense between entities under common control as discussed

7. Cf. M. Sebastian op. cit., at page 1/55
8. Cf. M. Sebastian op. cit., at page 1/58.

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earlier on apply <u>mutatis mutandis</u> to the transfer of losses (by subvention or otherwise), between related entities. In Nigeria, where majority of the companies are foreign owned, to what extent are the tax and company law provisions adequate to mitigate the problem?

It would appear that one positive result of the Nigerian Companies Decree 1968 is to prevent the transfer of losses between Nigerian subsidiaries and oversea parent companies. This view is advanced because all companies have to be incorporated in Nigeria as "separate and distinct" entities from their parent companies[9] and are obliged to file their own profit and loss accounts and balance sheets. But it would seem that it is still possible for a parent and subsidiary company which are both incorporated in Nigeria to transfer losses <u>inter se</u>, if they elect to file a consolidated balance sheet.[10]

The inter-company transfer of losses in a complicated subject. Suppose, for example, that a company incorporated in Nigeria decides to do business abroad through several oversea branches, would the Nigerian revenue and company laws permit the unrestricted transfer of losses between the oversea branches and the Nigerian company simply because they are legally one and the same entity?

The true position is obscure, since unlike some other countries no statutory provisions exist and no case has been decided on the subject which is of assistance. But similar questions have been adjudicated on in at least one Commonwealth country which is of great help.

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9. ss. 369, 370. Companies Decree 1968.

10. <u>Ibid</u>., ss. 143 - 145

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According to the law of Sarawak,[1] the amount of a loss which can be carried forward is "the amount of such loss attributable to activities in Sarawak". The Nigerian law has no such qualification but like that country's law, the whole of the income from a trade or business is deemed to be derived from Nigeria if the "control and management" thereof is exercised in Nigeria.[2] In Borneo Airways Limited v. I.R.C. and Harper Gilfallan (Borneo) Ltd. v. I.R.C.[3] there were two appellant companies each of which carried on business with the management in Sarawak. Business was carried on not only there, but also in Sabah and Brunei. In the case of Borneo Airways a loss was sustained in each of the years 1959 - 62, both in the business as a whole and in each of the branches. In 1963-65 the company made a profit both as a whole and in every branch. In the case of Harper Gilfallan, a loss was made in 1962 both in the business as a whole and also in every branch. In 1963 there was an overall loss and also a loss in two of the branches; in 1964, there was a profit overall and in every branch.

Assessments to Sarawak corporation tax were made on the footing that only the losses of the Sarawak branch could be carried forward against the subsequent profits of that branch. The companies both contended that the control and management of the whole of their business was in Sarawak and that it was an activity in Sarawak so that the whole of the loss should be carried forward against the Sarawak profits.

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1. Inland Revenue Ordinance of Sarawak. (1960) s. 28.

2. s. 18(1) CITA read in conjunction with s.2 CITA; s. 43 of the Sarawak Ordinance.

3. [1969] T.R. 509 P.C.. See L. Lazar [1970] A.S.C.L. Chapter on Taxation, p. 365 at 378.

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The Privy Council had little difficulty in construing the crucial words of s. 28 in so far as the present appeals were concerned: viz "the amount of such loss attributable to activities in Sarawak shall be set off".

In its view, the legislature had made it abundantly clear that it did not propose to allow the deduction of the whole of the loss as contended by the taxpayers. The language was unambiguous. What may be deducted or set-off was the part of the overall loss which was "attributable to activities in Sarawak".

The appellants had endeavoured to introduce the provisions of s.43 as machinery to include the whole of the losses of their respective businesses. The appellants reasoned that since in the computation of the assessable profits of the corporation which conducts trade in, and is controlled and managed in Sarawak, the earnings of that trade are to be included "wheresoever derived", it follows that losses had also to be brought into this computation on the same basis so that losses could be carried forward from branches and overall as though derived from Sarawak.

Their Lordships did not agree with the contention of the appellants. In their view, the operation of s.43 was fully reflected in the computation of the profit or the loss. It could not be made to do double service by creating an exemption to s.28 which clearly it does not, or by denying

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4. Inland Revenue Ord. Sarawak (1960) s. 43 reads "For the purposes of assessment ...... the whole of the income derived by any person from any trade, profession or business shall be deemed to accrue in, be derived or .... received in Sarawak if the control or management of such trade, profession or business is exercised there".

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any effect to the limitation contained in that section as to the portion of an overall loss which might be carried forward.

As far as Nigeria is concerned, it is suggested that the law be amended to follow the Sarawak example in order to prevent the unrestricted transfer of losses between a Nigerian company and its several oversea branches. What must be clearly emphasised is that only losses attributable to activities in Nigeria may be set off.

The double taxation implications of the transfer of losses between related entities have been ignored here.

VI. SOME SPECIAL TRADES

The peculiar characteristics of a number of trades make it impossible to tax their profits under the general provisions of the tax statutes. Thus, like several other jurisdictions, the Nigerian law accords special treatment to the taxation of shipping and airways undertakings,[5] insurance business,[6] cable and wireless telegraphy,[7] agriculture[8] and mining.[9] This section is devoted to an examination of the first two types of trade as well as the import and export trade on which the Act is silent. The taxation of oil companies, of crucial importance to Nigeria, forms the subject of a different chapter.[9a]

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5. s. 19 CITA
6. s. 20 CITA
7. s. 21 CITA
8. s. 7 ITMA
9. The provisions of the Petroleum Profits Tax Ordinance 1959 are examined presently.

9a. See ABSTRACT and note at page 610.

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A. Shipping and Air Transport

(i) General Principles:

The criterion of "presence" of international carrier enterprises such as shipping and air transport must of necessity be based on compromise.[10] In other words, the traditional tests of "carrying on business" as expounded above cannot be applied because these commercial activities by their unique nature come under several tax jurisdictions. States have, therefore, recognised that carrier enterprises must not be exposed to the laws of the numerous countries to which their operations extend on the basis that if every country taxed a portion of their profits computed according to its own rules the sum of these portions may well exceed the total income of the enterprise.

The tax treatment of international carrier enterprises are similarly complicated even where there is a tax treaty in existence because the traditional concept of a "permanent establishment" is inapplicable. Usually, the right to tax shipping and aircraft profit is reserved to the country in which the proprietor of such enterprise is resident or to their place of "effective management".[1]

What is of importance as regards the tax treatment of carrier enterprises are as follows: (1) How can the profits of these enterprises be

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10. The taxation of profits from the operation of ships in internal canals, rivers and lakes and from the internal operation of air traffic within the country are less problematic. These profits are liable to internal taxation.

1. Notice the changes brought in by Article 9 of the OECD Model Convention (1963), to modify the hitherto held view that shipping profits were taxable only in the country of residence of the entrepreneur. The double taxation aspects of the taxation of international carrier enterprises are considered in the appropriate chapters.

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taxed if the "freedom of commerce and navigation" as envisaged by international law is to have any meaning? (2) What exactly are the specie of profits to be covered? (3) Recognising that the majority of ships and aircraft are owned by residents of developed countries, how can developing countries exercise their tax jurisdiction to ensure that they get an adequate share of the profits resulting from the carrying of passengers and goods to and from their territories?

(ii) Liability under Nigerian Law:

Where a carrier enterprise other than a Nigerian company carries on the business of transport by sea or air, and any ship or aircraft owned or or chartered by it calls at any port or airport in Nigeria, its profit or loss deemed to be derived from Nigeria are the full profit or loss arising from the carriage of passengers, mails, livestock or goods shipped or loaded into an aircraft in Nigeria.[2] This in effect is an application of the "source" concept although not so explicitly stated.

It is interesting to note that in spite of the often quoted Companies Decree 1968, the Nigerian authorities have not insisted that all ships or aircrafts calling in Nigeria must belong to companies incorporated in Nigeria. This approach is correct as international trade is likely to be hampered were nations to behave otherwise.[3]

2. s. 19 CITA

3. Where ships from non-resident companies carry on trade with Nigeria, they are nevertheless liable to local taxation.

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Although the tax Code is not quite explicit on this point, what is clearly intended to be covered are profits from the operation of ships or aircrafts in international traffic.[4] This is in accordance with international usage as evidenced in the various double taxation treaties, noteably, the OECD Draft.[5] The proviso to s.19 CITA exempts from taxation in Nigeria incidental profits arising where passengers, mails, livestock or goods have been brought into the country solely for trans-shipment or for transfer from one aircraft to another. As we understand it, this amounts to a restriction of the "source" concept.

Perhaps, also taxable are other classes of profit, that is, those which by reason of their nature or their close relationship with the profits directly obtained from shipping and aircraft transport may be placed in the same category. For example, the profits obtained by leasing a ship or aircraft on charter fully equipped, manned and supplied must be treated like the profits from the carriage of passengers and cargo. Unless this is so, a great deal of business of shipping and air transport would not come within the scope of the tax provisions.[6]

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4. We can easily infer this from s.26(1)(g) CITA. The case of Furness, Withy and Co. Ltd. v. M.N.R. (1968) 66 D.L.R. (2nd) 657 (S.C.)(Canada) is also helpful here. The taxpayer in that case tried to claim an exemption under the Canada - U.K. Double Taxation Agreement which is usually accorded to shipowners on the grounds that the profits from his stevedoring activities in Canada were analogous to the profits from the operation of a ship.

5. Cf. OECD Draft, Article 8.

6. Cf. Commentaries on OECD Draft at pages 90-92 where the whole specie of profits anciliary to international carrier enterprises were explaine[illegible] While the profits from the sale of tickets on behalf of other enterprises may be included, a bare boat charter was excluded.

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If under the law, an international carrier enterprise is to be taxed on its Nigerian source income, how precisely is this to be achieved? Theoretically, it would seem that where the company furnishes a ratio certificate from the taxing authority responsible for assessing its full profits (showing the ratio of the gross profits and of the relevant allowances for depreciation to the total receipts for fares and freight), its profits for tax purposes in Nigeria are obtained by applying the first ratio to the receipts for Nigerian fares and freight and the allowances for depreciation are computed by applying the second ratio to those receipts.[7]

Where the ratio basis cannot be satisfactorily applied at the time of assessment, the profits in Nigeria may be computed, on a fair and reasonable percentage of the receipts for Nigerian fares and freight, subject to the company's right to claim within six years after the relevant year of assessment that its liability be recomputed on the ratio basis.[8]

Where there is no tax treaty, the Nigerian Revenue has chosen to follow what was meant to be an exception to the mle, rather than the rule itself. To avoid complicated calculations it assumes that the amount of taxable profits accruing from Nigeria is ten per cent of gross freight earned by carrying passengers, goods etc. to and from Nigeria, multiplied by the standard rate of income tax. The great virtue of this method is its simplicity, but whether Nigeria is getting as much as it ought to get is difficult to say.

The precise mode of taxing a "Nigerian company"[9] deriving profits

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7. s. 19(2) CITA

8. s. 19(3) CITA

9. As defined in s. 2 CITA, i.e., a company whose management and control are exercised in Nigeria.

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from international traffic is obscure because the Code is silent on this vital point. It is, however, a matter of doubt whether a shipping company whose "control and management" are exercised in Nigeria and, therefore, technically a "Nigerian company" would be taxed on its global profits as provided by law without regard to the fact that such profits might have been subjected to taxation elsewhere.[10] In our view, the appropriate thing to do is to tax Nigerian carrier enterprises engaged in international traffic on their Nigerian source income determined as in the case of a non-Nigerian company. Admittedly, our suggestion, though realistic, seems contrary to the tax Code.

In common with many other countries, Nigeria exempts the profits of a foreign carrier enterprise from tax provided that the country of residence of the operator gives an equivalent exemption to Nigerian Companies.[1] Several legal problems are raised by these provisions. To which country does the tax exemption apply? Is it to the country of residence of a company operating a ship or aircraft or to the country under whose flag the ship or aircraft operates? Suppose an English company resident in England owns a ship registered in Liberia, that is, under a "flag of convenience", to which country does Nigeria look in order to grant an exemption?[2] It would seem that the Liberian provisions are the relevant

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10. The double taxation implications here are obvious. According to s.18(1) CITA - "The profits of a Nigerian company shall be deemed to accrue in Nigeria wherever they have arisen and whether or not they have been brought into or received in Nigeria".

1. s. 26(1)(g) CITA.

2. For a discussion of the international economic problem created see - Walton J. MacLeod: "The Flag of Convenience Problem". (1963/4) Vol. 16. South Carolina Law Review at p. 409.

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ones because under international law a ship belongs to the country where it is registered; and its activities are regulated by that law.[3] This is the generally accepted view however fictitous it may appear.

The second criticism against the Nigeria law is this: For the purposes of the Nigerian tax exemption, is the mere existence of a reciprocal provision in a foreign country for Nigerian shipping companies sufficient by itself, without further enquiry into whether or not Nigerian companies are in actual fact enjoying the benefit? This question is of fundamental importance because Nigeria's merchant navy is in its infancy and the bulk of the country's import and export are carried by foreign vessels at grossly inflated and discriminatory freight rates.

In view of the foregoing discussion our conclusion are as follows : (1) Nigeria must adhere strictly to the source principle, thus making international carrier enterprises liable on income derived from the operation of ships and aircrafts to and from Nigeria. (2) The present rule of thumb applied by the Revenue i.e. tax liability on ten per cent of gross Nigerian freight and fares is too small. This must be revised upwards to something like thirty per cent of gross Nigerian freight and fares. Where a ratio certificate is furnished, the figure should nevertheless be thirty per cent. (3) Unilateral tax exemption should be granted only to shipping companies from countries to which Nigerian ships operate and not on a mere theoretical existence of a tax exemption in a foreign country from which Nigerian shipping companies might benefit.

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3. Ibid., at page 410.

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(4) Finally, a note on tax administration. Until recently, several foreign airlines and shipping companies were not paying any tax in Nigeria.[4] Why? Simply because the Revenue did not enforce the law. For the future, we recommend that all non-Nigerian carrier enterprises operating to the country must have a permanent "representative" in Nigeria.[5] The Revenue should look out particularly for charters and tour operators who carry passengers and cargo to and from Nigeria on a non-regular basis.

The effect of Nigeria's tax treaties on the general law are considered subsequently.

B. The Insurance Business

(i) Significance of Insurance to the National Economy[6]

Today, there are 73 insurance companies operating in Nigeria. Of these, 17 are foreign owned, while four are operated as joint ventures between foreigners and Nigerians. The most important thing to note, however, is that the few foreign insurance companies control about 60 per cent of insurance business in the country. In view of this, the government is being urged to acquire a shareholding in these companies as was

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4. This information was revealed by a leading firm of accountants and not rebutted by the Revenue. However, the position is changing.

5. There was probably no liability because there was no "permanent establishment".

6. For a well written summary of the economic arguments, see - "Insurance and Developing Countries"- 1967. Journal of World Trade Law, page 229. This article also traces the beginning of the UNCTAD interest on this subject.

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done recently in the case of banks.[7]

The economic argument for compulsory government participation is that banks are not the only financial intermediaries for accumulating savings to be diverted to productive enterprises. Insurance companies are known to be major controllers of savings. By the very nature of their business, they are, in fact, in a better position than commercial banks to undertake medium and long term investments.

Since foreign-owned companies owe very little allegiance to the host country, there has always been a natural tendency for these companies to seek reinsurance and investments overseas on the pretext that the local capital markets are undeveloped. But it would be sad indeed if in a country like Nigeria where the lack of sufficient investible funds constitutes an obstacle to development, the little savings generated within the country are allowed to be invested abroad.[8]

(ii) "Carrying on Business" in Nigeria

Where an insurance company is incorporated in Nigeria and carries on business within the country, there is little doubt that it is liable to local taxation. Difficulties arise, however, where a foreign insurance company carries on business in the country through agents and other commercial representatives.

After the Companies Decree 1968, are there still non-resident insurance companies "doing business" in Nigeria? The answer is yes.

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7. Daily Times (Nigeria) January 24th, 1973. Editorial calling for action on Insurance.

8. With the establishment of the National Insurance Corporation of Nigeria in 1969, all registered insurers are required to re-insure a part of their business with the Corporation. Cf. s.8 National Insurance Corporation Decree 1969. Furthermore, according to the Insurance Companies Act 1961 all companies must invest at least two fifths of their life funds within Nigeria

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Firstly, foreign based insurance companies continue to insure risks situated in Nigeria and, therefore, from our theoretical discussion on the source of income are deriving profit from Nigeria.[9] Secondly, since local insurers cede a part of their risks to reinsurers overseas, it is perhaps correct to state that the latter are "carrying on business in Nigeria" and so deriving profits from a Nigerian source which is the situs of the risks insured.[10]

This matter, which appear not to have arisen in Nigeria, has been the subject of litigation elsewhere where the courts have held that the profits accruing to a non-resident reinsurer did not accrue from Victoria (Australia). In Tariff Reinsurances Ltd. v. C.O.T.[1] T.R. Ltd., was a company incorporated in England which carried on the business of re-insurance on insurance risks accepted by other persons. The Automobile Fire and General Insurance Co. of Australia Ltd was a company incorporated in Victoria and carried on the business of insurance, principally insurance on motor vehicles against damage and other risks. On 22nd August 1928, the two companies made an agreement in writing for the reinsurance by the English company of certain motor insurance risks accepted and to be accepted from time to time by the Victorian company. The contract was made in London, the manager of the Victorian company having travelled to England for the purpose of making an arrangement for reinsurance.

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9. It is quite possible to effect a policy in London on produce to be shipped from Lagos to London.

10. Even though the National Insurance Corporation of Nigeria acts as a re-insurer to local insurers, the Corporation in turn reinsures with overseas re-insurers just as othe companies do in respect of a proportion of their risks.

1. (1938) A.L.J. p. 567

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The English company was not registered in Victoria as a foreign company; it did not carry on business in Victoria and had no agent or representative in Victoria. The contract between the parties was of the type known as a treaty of re-insurance. Under the contract, the English company reinsured the Victoria company in respect of two-thirds of the risks to which the contract applied. The consideration for the English company undertaking this liability was constituted by monthly payments made by the Victorian company. These payments were calculated by taking two-thirds of the gross premiums in respect of the relevant risks and deducting therefrom an amount varying with the loss ratio from 35% when the loss ratio was relatively low to 27½% when the loss ratio was relatively high. Thus, the better the selection of risks by the Victorian company the smaller the payment made by it to the English company. A further deduction was made of 10½ of the profits of the Victorian Company calculated in the manner set forth in the contract. It was quite possible under the contract for the English company to make a profit out of the agreement in any year where the Victorian company made no profit at all. It was obvious from all the surrounding circumstances that the agreement was not an agreement for the sharing of profits made by the Victorian company.

The contract provided that monies payable to the English company shall be paid into its account at the Bank of New South Wales in Melbourne. Where the English company had to make any payment on account of leases to the Victorian company which could not be satisfied by deductions from the monies payable to the credit of the English company, it was necessary under the terms of the contract for these payments to be made by the

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English company to the Victorian company in Victoria. The contract provided that the Victorian company may accept such insurance risks and pay such claims as it thought proper. The English company was deemed to have re-insured the risks insured by the company upon the same conditions as existed for the time being with regard to the policies of insurance issued by the Victorian company the intention being that the re-insurer should follow the fortunes of the company in regard to the policies of insurance in which the re-insurer by virtue of the agreement took part. The English company took no part in the business contracted by the Victorian company and was not entitled to exercise any control over the business.

The English company in fact made profits in a number of years out of the reinsurance business which came to it under the contract. The question was whether these profits were taxable under the Income Tax 1928 of Victoria. The High Court reversing the decision of the Supreme Court of Victoria, held that the fact that the contract for reinsurance was made in England was an important element in the determination of the question which arose and that the profits were derived from that contract and were not derived from the insurance operations of the Victorian company in Victoria. These operations, doubtless, provided the means with which the Victorian company paid its debts to the English company, but that fact did not bring about the result that profits were derived by the English company from Victoria. The Court held that the profits of the appellant company was not "derived in or from Victoria" and were, therefore, not taxable under the Victorian Act.

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This writer is of the opinion that the above case should not be considered by Nigeria as a guiding authority as it seems contrary to the source philosophy and out of keeping with economic reality. Clearly, re-insurance companies insuring Nigerian risks are deriving income from Nigerian sources. However, having said that, it must be acknowledged that the actual mode of computing what proportion of re-insurance profits is liable to Nigerian tax is not easy. In the circumstance, the best thing, perhaps, is to compute the taxpayer's liability on a rough and ready basis, e.g., ten per cent of gross premium on business ceded to overseas insurers.

For the purposes of determining tax presence in Nigeria, the situs of the risk ought to be the applicable criterion. The place of the contract and place of payment being secondary issues applicable only in determining the source of premium payments where the object insured has no fixed situs, e.g. ships, and aeroplanes.

(iii) Computation of Tax Liability

(a) (Life Insurance Companies)

The profit for tax purposes of a foreign life assurance company, whether mutual or proprietary, which carries on business through a "permanent establishment"[2] in Nigeria is the investment income less the

2. s.21(2) CITA. "A permanent establishment in relation to an insurance company means a branch, management, or other fixed place of business in Nigeria, but does not include an agency, unless the agent has and habitually exercises a general authority to negotiate and conclude contracts on behalf of such company".

This definition is similar to that employed in double taxation agreements.

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management expenses, including commissions. Where the profits accrue partly outside Nigeria, the taxable profit is taken to be that same proportion of the total investment income as the Nigerian premiums bear to the total world premiums less the Nigerian agency expenses and a fair proportion of the head office expenses. But the Revenue may vary the basis of calculation where the head office of a company is outside Nigeria.[3]

At this juncture, we pose yet another question. Since all insurance companies have to be incorporated in Nigeria as a "separate and distinct entities"[4] from their parent companies can they logically claim that part of their headquarters expenses are incurred by them "wholly, exclusively and necessarily" for the purposes of their trade?[5] In logic, the answer should be yes because locally incorporated foreign subsidiaries still remain foreign and in truth continue to maintain economic and financial ties with their parent companies. In law, however, the parent and subsidiary are two completely separate persons, and the expense incurred by one cannot be attributed to the other.

Recalling the hitherto prevailing tendency among foreign insurance companies and branches to transfer profits overseas in the guise of headquarters expenses, the present reluctance of the Revenue to allow any such expenditure is understandable.

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3. s.21(1)(b) CITA
4. ss. 369, 370; 1968 Companies Decree
5. As required by s. 27 CITA. The meaning of the expression "wholly, exclusively and necessarily" is discussed in full in the next chapter.

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The taxation of indigenous life assurance companies is essentially similar to that described above. But unlike the foreign companies, local companies are presumed to derive their whole investment and premium income from Nigeria where they are also deemed to have incurred all their expenses.[6]

(b) Non-Life Insurance Companies

The profits of a foreign insurance company (non-life) trading in Nigeria through a permanent establishment is ascertained by taking the gross premiums and interest, and other income receivable in Nigeria (less any premiums returned to the insured and premiums paid on reinsurances), and deducting from the balance so arrived at a reserve for unexpired risks at the percentage adopted by the company in relation to its operations as a whole for such risks at the end of the period for which the profits are being ascertained, and adding thereto a reserve similarly calculated for unexpired risks outstanding at the commencement of such period, and then from the net amount so arrived at deducting the actual loss in Nigeria (less the amount recovered in respect thereof under re-insurance), the agency expenses in Nigeria and a fair proportion of the expenses of the head office of the company.[7]

Stated more briefly, foreign non-life insurance companies are taxed on their Nigerian source income less Nigerian source expenses.

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6. s.21(1)(c)
7. s.21(1)(a) CITA

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Indigenous non-life companies are also taxed on the above formula except that like the local life companies all their premiums and investment income are deemed to have been derived from Nigeria where they are supposed also to have incurred all their expenses.[8]

To conclude our discussion, the potential difficulty (i.e. double taxation) of taxing Nigerian insurance companies (life and non-life) on their global income as provided by statute must be emphasized. This presumes that income derived by these companies from insuring risks outside Nigeria are not subject to tax elsewhere. The truth, of course, is that they invariably are. In this circumstance, therefore, it is to be hoped that credit would be given in respect of taxes paid abroad on all foreign income whether or not derived from a treaty or Commonwealth country.[9] In this regard too, expenses incurred outside the country in respect of such income may be allowed provided they are genuine and have been incurred "wholly and exclusively" for the purposes of the trade.[10]

The effect of tax treaties on the foregoing discussion are considered in the appropriate chapters.

C. <u>The Import and Export Trade</u>

The activities of taxpayers engaged in either import or export business of necessity come within two or more tax jurisdictions. The

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8. s.21(1)(c) CITA. In other words, an indigenous insurance company is taxed on its global income but is not allowed to deduct its global expenses.

9. Clearly, indigenous insurance companies must be encouraged to trade on a world-wide basis.

10. The difficulty of ascertaining the quantum of expenses incurred abroad must be acknowledged. However, this does not detract from the quality of our argument.

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kinds of problem which arise have been alluded to already,[1] but may now be set out more succinctly.

According to the Nigerian law, where is the "source" of income derived from an import or export business? Since there is no provision in the tax code which is of direct relevance to the question, a solution can be ventured only by way of analogy.

As discussed previously in this chapter, the "source" of profit from an import or export trade would depend largely on the real essence of the business and the locality in which that business is carried on. Thus, where a business depends for its profits on the sale of goods which are acquired for resale, the essence of the business is the "selling of the goods" and the profits are made wholly where the sales are effected. Where on the other hand, the business depends for its profits on the manufacture or treatment of the goods and their resale, the essence of the business is "manufacturing and selling goods" and the profits are apportionable as between the place where the manufacturing is carried on and the place where the sales are effected.

In practice, an overseas exporter must "carry on" business in Nigeria through agents and other types of commercial representatives. His ultimate liability to local taxation would, therefore, depend on the legal relationship between him and his representatives i.e. whether the latter is technically a "permanent establishment" of the former.[2] Where this is

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1. *Supra* at pages 68 to 70.

2. The method of determining the quantum of taxable profits of an agency p.e. is discussed in Chapter VII on double taxation. Especially important as regards the same is the problem of ascertaining the true position where parties (i.e. agent and principal) are not dealing at arm's length.

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so, any profits attributable to the agency permanent establishment would be taxable. Alternatively, where the representative in Nigeria is technically a "general commission agent" the overseas exporter is only liable to local taxation indirectly since commissions, fees etc payable to the general commission agent are taken into account in the computation of his taxable profits.

VII. CONCLUSION

The important aspects of our discussion in this chapter may now be summarised.

While observing that the term "business" may be wider than "trade", for our purposes it was accepted that income from a trade or business is essentially income from the same specie of activity - so that the use of one term implied the use of the other.

Following the trend in many Commonwealth countries, it was our view that the Nigerian Courts would be influenced by the so-called "six badges" of trade as recognised by the U.K. Royal Commission on taxation, (i.e. when deciding the question of "trade" or "no trade"). Also, notwithstanding the views of a number of authorities suggesting that the words to "exercise a trade or business" imply that the trade or business must be habitually or systematically exercised and that they do not apply to isolated transactions, the Courts are likely to take a contrary stand.

From our discussion in Chapter Two any trading or business income the "source" of which is in Nigeria is liable to local taxation. Even though this proposition is easily stated, in practice, however, to determine

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precisely when or under what circumstances an individual or company is carrying on a trade or business in Nigeria is not always easy. Several tests were considered (e.g. place of contract test, situs of control, situs of activity) and our conclusion was that a multiplicity of tests was best for determining "tax presence" in the country.

A lot of attention was focussed on the accounting and related problems in the computation of profits. The law provides that accounts are to be prepared in accordance with a number of statutory rules as supplemented by "good accounting practice". But it was shown in our discussion that "good accounting practice" in many instances is an illusion because accountants are as divergent and subjective in their views and methods as psychiatrists or economists. Furthermore, apart from good accounting practice articulated by the courts, it would appear that this is not the only test because an accounting principle, though sound, may yet be rejected.

Since accounts are expected to reflect the "true and fair view" of a business the use of oversea based accountants by local subsidiaries was criticised. As was emphasized throughout our discussion, the task of accurate profit computation which is quite difficult to accomplish is rendered even more so in developing countries like Nigeria as a result of various social factors (e.g. illiteracy, lack of proper business organisations etc.). Clearly, it is impossible to "compute" taxable income in any meaningful sense of that word without proper records. In our opinion, all traders must in future be compelled to keep proper books of account - a task which could be made easier by the introduction of simplified returns and standard deductions.

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The possible role of a "Scrutineer Committee" in the process of profit adjustment was considered. With the appointment of accomplished experts to this Committee, we argued that it likely to be a useful instrument in scrutinising company accounts in view of the close relationship between several Nigerian subsidiaries and their oversea parent companies. Since related entities often transfer goods and services inter-se at less than market value, it is clear that the allocation of items of income and expenses among themselves must always be closely examined. In our opinion, such rules of allocation as exist in Nigeria at present are rudimentary and ill-defined. As situations when a re-allocation is necessary increase, it is to be hoped that the authorities will recognise that the present rudimentary framework is inadequate to cope with the challenge.

Similar to the above is the transfer of losses between related entities. Since local subsidiaries are required to prepare separate accounts distinct from that of their parent companies the transfer of losses between them is unlikely. But there is the possibility of a transfer of losses between a company incorporated in Nigeria and its several oversea branches. This situation is unacceptable. What must be clearly emphasized, we submit, is that only profits attributable to activities in Nigeria may be set off against Nigerian source profits.

The unusual case of a "gain" or "loss" derived from a foreign exchange transaction or other currency anomaly was gone into in detail. In our view, foreign exchange "gains" or losses" arising from transactions on capital account would neither be subject to tax nor deductible from profits as the case may be. Such gains would, however, be taxable where they accrue as a result of an activity which was a necessary and integral part of a "trade" or an "adventure in the nature of trade". In this situation

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too, a loss would be deductible.

As was clearly demonstrated, the peculiar characteristics of a number of special trades make it difficult to tax their profits under the general provisions of the tax statutes. Thus, like several other jurisdictions, the Nigerian law accords special treatment to the taxation of shipping and airways undertakings, insurance, cable and wireless telegraphy and mining.

As regards shipping, it was our view that all foreign shipping companies must be liable on their Nigerian source income calculated at thirty per cent of their gross freight. Also, it was suggested that all insurance companies insuring risks situated in Nigeria must be liable to local taxation. But, as was acknowledged there would be difficulty in computing the precise amount of profits liable to local taxation in the case of re-insurance business.

Finally, it is perhaps proper to say again that the objective of this chapter has not been to analyse every conceivable aspect of the taxation of trading and business income. Rather, we have endeavoured to examine a number of problem areas in detail and in a manner complementary to the efforts of other writers on Nigerian taxation.

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CHAPTER FOUR

TAXATION OF EMPLOYMENT AND PROFESSIONAL INCOME

I. BASIC ISSUES OUTLINED

A. Tax Jurisdiction, Mobility of Labour, Balance of Payments Consideration and other issues

In this chapter, attention is focussed on a number of problems relating to the taxation of employment and professional income especially in a developing country. Apart from capital, these countries need skill in order to fulfil their economic goals.[1] Tax systems, therefore, must and often do take cognisance of this fact so as not to constitute a barrier to the movement of qualified personnel.[2]

Problems of taxation may arise because the free movement of persons across national frontiers implies an interaction with two or more tax jurisdictions. Since the place of signing a contract of employment and the place of work may be different, while the taxpayer may yet be a national of a third state, where one of these countries levies tax on an "arising basis" and the others on the basis of

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1. For example, note General Gowon's recent call for the free movement of capital, labour and goods among West African States. Sunday Times (Nigeria) Nov. 19th 1972.
2. Roger Vielvoye: The Times (London) March 12th 1973: "Oil Groups fear Widening of Income Tax Net May hit Recruitment on North Sea Rigs" - This writer states that up to 1,500 skilled workers on oil rigs operating in British waters are likely to be affected by the government decision to make all personnel in this field liable to U.K. tax. The new move could make it more difficult to persuade skilled expatriate and foreign workers to leave the tax-free zones of the Middle East and Far East to operate in the North Sea. Note that some countries do not insist on offshore drilling personnel paying onshore income tax rates, e.g. the Persian Gulf.

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residence, domicile or nationality, serious problems of double taxation could occur. Similarly, in the exercise of a "profession", there may be need for the professional to travel to several countries other than his own thus running the risk of finding himself subject to conflicting tax claims.

Among other things, we are concerned in this chapter with how the above potential conflicts are dealt with under the Nigerian law and the desirability for a change or otherwise. The legal provisions are examined against the background of the country's tax philosophy as expounded in chapter two, speficically as regards (1) liability on source income as applicable to employees and professionals; (2) the significance of Residence bearing in mind the twelve-state federal structure of the country, and the need to guarantee the free movement of persons, especially for reasons inter-state commerce; (3) the problems of computing taxable emoluments and profits or gains as influenced by some cultural and social phenomena peculiar to Nigeria; (4) the relative tax positions of "employees" and "office-holders" on one hand, and of "professionals" etc., on the other, as regards, e.g. deductibility of expenses, method of assessment etc., (5) some special categories of persons whose unique status or circumstance can raise tax problems are considered in a separate section. These include directors of companies (resident or non-resident), artistes, diplomats and military personnel.

Our enquiry which inevitably raises issues of conflicts of law, is directed where necessary to the international aspects of the country's tax law. Double taxation questions are highlighted in outline

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only wherever appropriate, as these are considered in great detail elsewhere. Provisions of purely internal application are examined closely, but due to the pioneering work of a few Nigerians[3] some points are omitted or else given a cursory treatment.

This chapter is also very important from another angle because it views the exporting and importing of skilled labour against the background of a country's balance of payments position, as well as the political expediency of alleviating structural unemployment by diverting surplus high level manpower resources to areas of scarcity.[4] To illustrate the position vividly, attention may be drawn to the recent exhilarating announcement by the U.K Committee on Invisible Export that "British professional men and women are making a significant and growing contribution to the nation's invisible earnings".[5] The Report, a survey of nine professions,[6] show that overseas earnings are now about 2.8 per cent of the gross balance of payments invisible receipts and 10 per cent of the balance of payments net receipts for the year in question.

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3. See S.O. Fashokun: Personal Taxation in Nigeria - Ph.D thesis (London) 1971 - especially Chapter V. "Taxation of Employment Income". Also G.O. Orewa: "Taxation in Western Nigeria" O.U.P. (1962).
4. Structural unemployment may occur where there is an oversupply of a particular type of skill. e.g. Nowadays, it is becoming increasingly difficult in many countries for people with an Arts Degree to obtain suitable employment.
5. The Times (London) 30th November 1972. Summary of the Report on "Overseas Earnings of British Professions".
6. Those mentioned in the Report were accountants, chartered surveyors and architects, consulting engineers, independent schools, management schools, medicine, patent agents, advertising and solicitors.

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While the exporting of skill is obviously beneficial to the economy of the exporting country, the importing of skilled manpower may not be totally beneficial to the economy of the recipient country. Firstly, excessive reliance on foreign expertise may actually delay the process of learning in a poor and backward developing state. Secondly, noting the one way migration of skilled personnel from developed to developing countries, states like Nigeria must do a delicate balancing act in order to achieve the effective taxation of the income of foreign personnel, while at the same time ensuring that such tax measures do not constitute a deterrent or barrier to the attraction of such qualified personnel to the country.

As a corollary to the above, how flexible is the Nigerian tax law as a means of encouraging or discouraging the emigration of indigenous skilled personnel either to (a) countries less developed than Nigeria where they are sorely needed; or, (b) to highly advanced places where the personal remuneration may be greater.[7] The policy and other related issues which necessarily arise are duly considered bearing in mind that a substantial proportion of the country's indigenous high level man power were educated or trained at public expense.[8]

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7. See Daily Times (Nigeria) March 23rd 1973. Study by Professor F.O. Okediji and O.O. Okediji: "Nigerian Brain Drain to America - A Sociological Perspective". Same authors: Daily Times (Nigeria) March 24th 1973: "Social and Psychological Causes of Brain Drain". On the other hand, we may note the tendency among African Countries to look up to Nigeria for high level manpower. e.g. General Amin's appeal to Nigeria to loan teachers and skilled personnel to Uganda. - Daily Times (Nigeria) November 25th 1972.

8. Faced with this dilemma the Soviet Union until lately imposed a head tax on Jewish emigrants with higher education because of the loss of their services to the states which had financed their education. Henry Shapiro: The Times U.K. March 22nd 1973 - "Soviet Tax on Jewish Emigrants no Longer Being Collected". Considering the serious opposition to this kind of tax it is extremely doubtful whether such a scheme can be introduced in Nigeria.

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As a prelude to our discussion, Section B below clarifies the basic terms and concepts as employed herein in this chapter.

B. Who is a "Professional" and who is an "Employee"?

The terms "profession" or "employment" are nowhere defined under the Nigerian Code. They are certainly not synonymous except, perhaps, to the extent that they relate to natural persons. In that regard, therefore, a more appropriate title to this chapter could have been "The Taxation of Persons". Yet, we have rejected this because on a proper understanding of the Nigerian tax provisions, the law is not so much concerned with the taxation of "individuals" or "persons" as such, but with the taxation of various species of income. Hence, the slight concern shown for the personal circumstances of the taxpayer e.g. his place of residence, domicile or nationality.

For our immediate purposes, what is important is to distinguish clearly between "professional income" and "employment income" because of the different treatment accorded to each under the law. The logic of our treating these two categories of income together in one chapter is basic. They both accrue to individuals and we, therefore, find it convenient to look at the two categories of income within the same context.

(i) Income from a "Profession" or a "Vocation"

The Nigerian Code employs the terms "profession" and "vocation" which though not defined, are presumably *sui generia* because of the context in which they appear.[9] A most helpful judicial exposition

9. ITMA. 1961 S. 4(1)(a).

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of the meaning of "profession" is to be found in the judgement of Scrutton, L.J., in I.R.C. v. Maxse where he stated inter alia[10]:

> "that a 'profession' in the present use of language involves the idea of an occupation requiring either purely intellectual skill,[11] or of any manual skill controlled, as in painting and sculpture or surgery, by the intellectual skill of the operator[12] as distinguished from an occupation which is substantially the production or sale or arrangements for the production or sale of commodities".

While the line of demarcation may vary from time to time, the decided cases do little more than provide illustrations of what the courts have or have not regarded as professions.

With the older professions like Medicine, Law and Theology, there would be little difficulty in recognising them as such.[1] However, in places like Africa problems could arise because of the existence of "professions" which are not known in the Western world e.g. the Oracle priest, the Town Crier or Native Doctor. Formidable difficulties could arise too by the simple fact that a finite list of all professions cannot be compiled. With the advances in science and technology, classification has become almost impossible. For example, how is an astronaut or air pilot to be classified?

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10. [1919] 1 K.B.647 at page 656; 12 T.C. 41 at page 61. This dictum was quoted with approval in the Canadian case of A. Seni v. M.N.R. 33 Tax A.B.C. 88 at page 97.

11. Emphasis supplied.

12. Emphasis supplied.

1. Whiteman and Wheatcroft, op.cit. page 218 para.5-41. See the cases cited therein. The following have been regarded as carrying on a profession - a journalist, an actress, an architect, an optician, and the headmaster of a school. Whereas, a stock-broker, an insurance broker, and a photographer have been held not to be carrying on a profession.

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Furthermore, there has also been a suggestion that a distinction must be made between a "true professional", as opposed to a"higher technician, artisan or tradesman" - a photographer, being more properly classified under the latter head rather than the former.[2]

In our opinion, even this subtle distinction can be blurred at the best of times.

The question of personal qualification raises another different problem. If to become a professional a person must undergo some training or education or apprenticeship, what degree or standard of intellectual attainment or manual dexterity controlled by the faculties is sufficient to make a person qualify as a professional?[2a]

In practice, it would appear that the Appeal Commissioners do attach some importance to the fact that a particular individual is a member of a profession which is well organised, having a clearly defined body of norms and a determinable standard of proficiency enforceable in the practice. But this is not always conclusive.[3]

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2. This is the view of many experts on Industrial Relations especially those who specialise in the classification and evaluation of skill.

2a. See <u>Architects' Registration Council v Breeze</u> (C.A) Times Law Reports, April 1973. Held, that a false statement made by a person offering services in the course of a trade or business that he has a professional or other qualification goes to the likely qualities of the services that he will perform, therefore an offence under S.14(1) of the Trade Descriptions Act 1968. <u>Facts</u>. Student of architecture held himself out to be an architect.

3. Note the case of <u>A. Seni v. M.N.R.</u> 33 Tax A.B.C. 88. Here the Court held that the taxpayer though trained in France and not yet registered in Canada as a civil engineer for emigration reasons was nevertheless a professional. Broader issues may be involved here i.e. the mutual international recognition of the diplomas and certificates obtained in other countries. <u>The EEC</u> is currently examining the problem in order to facilitate the intra-EEC movement of skilled labour.

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As far as the tax law is concerned, what we must emphasize is that a professional is usually somebody who is self-employed or "trading in his skill", and very often the computation of his taxable profits is along the lines of a business or trading income. But not all self-employed persons are professionals, and not all professionals are self employed. There are, of course, "professional employees" e.g. an accountant or lawyer working for a private concern or government.[4]

The word "vocation" employed in the Nigerian law which is undefined,[5] has been held in Patridge v. Mallandaine[6] to be analogous to a "calling". And according to Denman, J., "it is a word of wide significance meaning the way in which a man passes his life".[7] In the instant case, it was held that a bookmaker who accepts bets is carrying on an organised vocation. Similarly, in Graham v. Arnott[8] it was held that an individual who habitually supplied racing forecasts to newspapers for reward was chargeable to tax under Case II of Schedule D. On the other hand, it may be noted that in Graham v. Green,[9] an individual was held not to be so chargeable in respect of gains derived from betting. Again in Down v. Compston[10] the winnings of a golf professional on bets on his own matches were held not to be the earnings of a vocation.

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4. e.g. Razzel v. Snowball [1954] 3 All E.R. 429. A specialist doctor held to be an employee of the Minister of Health.
5. S. 4(1)(a) ITMA 1961.
6. [1886] 18 QBD 276; 2 T.C. 179.
7. Ibid K.B. at page 278; T.C. at page 180.
8. [1941] 24 T.C. 157.
9. [1925] 2 K.B. 37., 9 T.C. 309.
10. [1937] 21 T.C. 60. See Whiteman and Wheatcroft op.cit., para 5-43. A dramatist, a land agent, and jockey have all been regarded as carrying on a vocation; whereas, a film producer was not so treated.

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It is suggested here that the Nigerian courts and the Revenue must for a long time to come construe the word "vocation" in its widest possible sense. This is necessary because of a number of social and economic factors peculiar to Nigeria. Statistics show that only about 3% of the adult population are in salaried and regular employments, while only a slightly higher percentage can be said to be carrying on a profession or trade.[1] A substantial number engage in agriculture, but the truth is that the vast majority of Nigerians indulge in what can only be called vocational activities. For this reason, it is considered that an unduly legalistic or restrictive interpretation of the word "vocation" would be self defeating.

One general point on both "professions" and "vocation" may be noticed at this stage, namely, that although "trade" includes "an adventure or concern in the nature of trade", there is no similar statutory or judicial extension of a "profession" or "vocation".[2] Accordingly, it has been stated that an isolated transaction in the nature of a professional activity at least as far as the U.K. is concerned cannot be taxed qua professional income under Case 11 of Schedule D, as the practice of a profession implies some degree of continuity.[3]

Strictly speaking, this may be so. But in Nigeria, where most of the activities generating taxable income can be classified as "non-trading", "non-professional", and "non-agricultural" but simply as

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1. For a general discussion of the employment scene in Nigeria, see O. Teriba and A.O. Philips: Income Distribution and National Integration" (1971) Vol.14 No.1 Nigeria Journal of Econ. and Soc. Studies, p.77 et seq.

2. See chapter three, Supra where it would be seen that the word "trade" or "business" is given the widest possible interpretation. Note in particular the judgement of Sowemimo, J., in Arbico v Fed. Board of Inland Revenue /1966/ 2 All N.L.R. 303.

3. Whiteman and Wheatcroft para. 5-45, page 221.

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"vocational" it is doubtful whether the U.K approach here should be followed. Clearly, if a "vocation" is interpreted as a "calling" or simply regarded as the way in which a person "passes his life", it is obvious that the taxpayer can be a man of "multiple vocations". In Nigeria, he is certainly so to a very large extent because a lot of economic activities take place on a seasonal basis. And since no degree of skill or formal training is required for a vocation, the majority of Nigerians pass their lives doing several things and playing several roles without any notable degree of continuity or regularity.

In practice, what is important is not whether an individual is carrying on a profession or vocation, but whether some particular activity of a person who is admittedly carrying on a profession or vocation is, or is not, within the ambit of that profession or vocation. In Davies v. Braithwaite,[4] considered in more detail subsequently, the taxpayer's chargeable income was held to include not only receipts from her acting profession exercised in the U.K, but sums received under a contract for appearances in the United States. Similar to this is Household v. Grimshaw,[5] the facts of which were as follows: An author entered into an agreement with a film company which provided that for a minimum period of twelve weeks in each of three successive years he should render exclusive services to the company by way of writing and composing stories and other film matter. The agreement also provided that the company should have the option of acquiring at specified prices the film rights of any novels written by the appellant and published

4. [1931] 2 K.B. 628.

5. [1953] 34 T.C. 366. Also Humphreys v. Peare [1913] 6 T.C.201 where a land agent's Commission on sales were held to be professional receipts.

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prior to the expiration of the three years. The court held that the agreement was an engagement in the course of the appellant's profession as an author, and that receipts derived from it were, therefore, properly assessable to tax under Case II of Schedule D.

These two cases cited should be contrasted with Mitchell and Eden v. Ross [6] (examined in more detail later), - where a doctor in private practice was said to hold a separate office in respect of his part-time salaried appointment under the National Health Service. In this case, the doctor's income from his part-time appointment was held to be chargeable under Schedule E.

The real trouble here is that it is not clear where the line should be drawn, a conclusion which is reinforced by two other conflicting cases relating to doctors.

In the first, Leaky v. Hawkins [7] a doctor who under superannuation regulations of the National Health Scheme elected to take from the Ministry during each year of his service under the scheme a sum equivalent to 8% of his remuneration, in lieu of being pensioned off at the end of his service, was held not to receive that sum as part of his profession. In contrast, in the second case, Temperley v. Smith [8] a doctor who received the surrender value of some endowment policies when a voluntary hospital came under the health service scheme was held to have received the sums as professional receipts.

An illustration in a somewhat different context of a receipt that was held to be outside the ambit of the taxpayer's profession is provided by the previously cited case of Down v. Compston [9]. There, a

6. [1960] Ch.498.

7. [1952] 34 T.C. 28. These sums were held assessable as annual payments under Case III of Schedule D.

8. [1956] 37 T.C. 18.

9. [1937] 21 T.C. 60.

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professional golfer who laid large bets on the results of his games (which he usually won) was held not to be exercising his profession when making the bets. Also, in the judgement of Buckley, J., in Norman v. Evans[10] it was stated that a racehorse breeder who races his horses and wins prices at race meetings is not required to bring those prices into account as profits of his trade of breeding horses.

Finally, in deciding what income is derived from the exercise of a "profession" or "vocation", the Nigerian Revenue must maintain a flexible approach bearing in mind the following facts. (1) That, the degree of proficiency required of a professional must be related to the general level of education in the country. (2) That, there are thousands of de facto "professionals" in the country who never had any formal training and do not possess any paper qualifications.[1] (3) That, to facilitate intra-African mobility of skilled manpower automatic recognition should, where possible, be accorded to diplomas and certificates obtained in other African countries.[2] The basic assumption here is that there is a "minimum standard" of expertise required of professionals in all countries which should be universally acceptable.

However, where all the above prove unhelpful, the Revenue may simply regard the taxpayer's independent activities as the pursuit of a

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10. [1964] 42 T.C. 188 at p.198.

1. For example, the native doctor who acquires his skill, by oral instruction and on-the-job training.

2. Note that the countries of the EEC are currently faced with the problem of working out an acceptable formula for harmonising educational, especially professional, qualifications obtained in member countries. See Patricia Tisdall: "Accountants worried by EEC Rules on Qualifying". The Times U.K. October 17th 1972 at p.17.

3. The case of A. Seni v. M.N.R. Supra suggests this.

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"vocation" - the income from which may for tax purposes may be treated like the income derived from the exercise of a "profession".

(ii) Income from an "Employment"

The term "employment" is not statutorily defined within the Tax Code. All that we are told is that "employment" includes "any service rendered by any person in return for any gains or profits".[4] The various state income tax legislations do no more than lay down a list of those who are considered to be employees and in some cases the employers.[5]

Basically, it would seem that the concept of an employment the income of which the law contemplates involves a master-servant relationship[6] - that is, one man providing his services to another. Where there is a contract of service as distinct from a contract for services between the parties - the employer requiring the other party to perform a certain service - the existence of an "employment" is not difficult to infer. But it may be necessary to infer this relationship from the facts whether or not there is a contract of service.[7]

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4. S.4(2)(d) ITMA 1961 incorporating amendment introduced by s.1(2) of the (1966) Income Tax (Amendment) Decree. No.65 of 1966.

5. For example, Western and Mid-Western States where the Income Tax Law (1957) Cap.48 S.61(1) provides for the P.A.Y.E. system and sub-section (5) provides that it applies to emoluments of any employment or office and any pension. In the Income Tax Emoluments Rules, legal notice 350 of 1961 the word "employee" is not defined. The Lagos State personal Income Tax (Employments) Regulations 1965 para.2. defines "employee" as any person including a director receiving emolument etc. The Eastern Nigeria States: Finance Law 1962 S.8 defines "employer" by enumerating those whom the law regards as such. The Northern States: The Personal Tax Law (1962) S.45 (10) defines "employee" as including any employee or office holder etc.

6. Whiteman and Wheatcroft supra page 494 para 14-04 et seq. Also S.O. Fashokun op.cit., 418, 423.

7. For example, Lee v. Lee's Air Farming Ltd. /1961/ A.C.12 (P.C). Where it was held that a controlling shareholder and governing director of a company who also flew aircraft for company was capable of functioning in a dual capacity - giving orders in one capacity and carrying out these orders in another capacity. The legal relationship here was nevertheless that of Master and Servant.

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The correct approach seems to be to distinguish between a "mere employee" and an "independent contractor" on tort lines. Thus Lord Denning comparing and contrasting a "contract of service" and a "contract for service", observed that whilst "it is often easy to recognise a contract of service when you see it, it is difficult to say wherein lies the difference" between the two types of personal contracts. Clearly, while a "ship's master, a chaffeur, and a reporter on the staff of a newspaper are all employed under a contract of service, a ship's pilot, a taxi-man, a newspaper contributor are employed under a contract for service.[8]

The one feature which appears to run through his Lordship's examples is that under a contract of service a man is employed as part of a business, and his work is done as an integral part of that business; whereas, under a contract for services, his work although done for the business is not integrated into it but only accessory to it.

It is, however, important to note that the inference or de facto existence of a Master-Servant relationship as a factor in determining whether or not there is an employment per se, or whether a specie of income received by the taxpayer relates to it, may not be an issue to which the court averts its mind especially if not raised by the parties.

To illustrate the type of situation contemplated, we refer to the East African case of Durga Dass Bawa v. C.O.T.[9] which is considered interesting in several respects. The facts of that case were as follows;

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8. cf, Stevenson, Jordan and Harrison v. Mac Donald and Evans (1952) 1 T.L.R. 101 at page 110. Also Construction Industry Training Board v Labour Force Ltd. [1970] All E.R. 220.

9. [1963] E.A.L.R. 695.

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The appellant was an agent of the British American Tobacco Company Ltd., in Tororo from 1928-1949 during which period the last mentioned company was succeeded by the East African Tobacco Company Ltd. The taxpayer was offered and he accepted the post of distributor in the Tororo area for the successor company in 1948 under an arrangement subject to termination by three months notice in writing from either side. On January 6th 1949, a private limited company under the name of D.D. Bawa Ltd. was incorporated and thereafter operated the appellant's agency with the consent of the company. On March 16th 1957, the East African Tobacco Company Ltd. informed the appellant that for business reasons it was obliged to terminate his employment as distributor with effect from the 17th, of June 1957. The letter of termination stated in part that the company had decided:

> "as a mark of our appreciation for the long and loyal service you personally have rendered to this company,[10] to grant you a personal gift on an ex-gratia basis and without admitting any legal liability for doing so, the payment of the sum of Shs.100,000/- which will be paid to you in quarterly instalments as follows . . . ."[11]

The taxpayer accepted the payments which were assessed as income liable to tax under the East African Income Tax (Management) Acts 1952 and 1958.[1]

10. Emphasis supplied.
11. Ibid., at page 696-697.
1. The appellant was assessed to tax in respect of the first two instalments under S.8(1)(i)(b) of the 1952 Act and the last two instalments under the 1958 Act. The differences in the wording of the two laws were not relied on as being material, therefore, only S.8(1)(i)(b) of the 1952 Act is set out: viz "Tax shall subject to the provisions of this Act, be charged in respect of each year of income at the rate imposed for that year by the appropriate Territorial Income Tax Ordinance upon the income of any person accruing in, derived from or received in (i) East Africa in the case of a person who is resident in the territories . . . . in respect of
   (a) . . . .

   (b) gains or profits from any employment or services rendered . . . . etc."

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The only issue in this case was whether, in fact, the purported gifts were taxable.

The East African Court of Appeal reversing the decision of the High Court of Uganda held as follows in favour of the taxpayer. (1) that, a payment is not taxable merely because it had "something to do" with one's employment, if "the occasion for making it arises out of his past services".[2] (2) That, while the taxability of a gift is not conclusively determined by the way an employer describes it, there could be no doubt about the intent conveyed by the wording of the letter in the present case. (3) That there was no significance in the fact that the letter was written before the actual termination of the appellant's employment; and finally (4) that too little weight had been attached to three factors. Namely, that the gift was made after termination of the employment, that it was not recurrent, and was not made pursuant to any legal obligation or any custom or legitimate expectation on the part of the appellant arising from the nature of his employment. The Court of Appeal concluded that the payment was a "personal gift" made after the termination of employment and was not taxable as "gains or profits" from employment or services rendered.

Although it is believed that the above decision is correct for the reasons contained therein, yet, it is our view that several other relevant legal points were not raised by counsels on either side and not commented upon by the Court.

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Firstly, it seems that insufficient consideration was given to the fact that the business of the agent company was separate and distinct from that of its principal, the East African Tobacco Co. Ltd., and that as between them the relationship was one of contractual liability and not on a Master-Servant basis as between an employer and an employee. In law, an agent though bound to exercise his authority in accordance with all lawful instructions given to him by his principal, is not usually subject in its exercise to his direct control or supervision.[3]

In our opinion, this basic distinction between an agent and a servant was relevant to the determination of the nature of employment the Court was called upon to decide. Clearly, the agent company was not a servant, and its assessable income as a distributing agent was only subject to assessment under the provisions of the law governing the assessment of profits or gains of a business or trade.

According to S.O. Fashokun,[4] with whom this writer agrees, the issue to be decided by the Court was whether the sum of Shs.100,000/- paid by the principal company to the agent company, but specified to be made in appreciation of the service of its director was the property of the agent company or that of the director in his personal capacity.

In all probability, it should be regarded as belonging to the company since on sound principles of company law, the appellant as a director could not make a secret profit out of his position in the

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3. Halsbury's Laws of England 3rd ed, Vol. 2 at p.146.

4. op.cit., at page 421.

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company.[5] Where as in this case the payment was in actual fact, received first by the agent company, and then paid over to its controlling director in accordance with the letter of 16th March 1957,[6] it seems that the question to be determined was whether or not it formed part of the "gains or profits" from his employment. However, it is difficult to see how the company could give the sum away to the appellant without any consideration having regard to the well known law relating to limited liability companies and their inability to make presents out of the funds of the company to directors. And in any case, the voluntary payment was no less taxable simply because the agency contract had come to an end if it was referrable, as it apparently did, to the services previously rendered.[7]

If on the other hand the sum was retained by the agent company as it should have been in this case, then, the issue to be determined was whether it was an income or capital receipt. And in this regard, it could be argued that it was a payment made for the cancellation of a contract of agency in the ordinary course of the business of the agent company and was, therefore, an income receipt assessable to tax in accordance with the principle in Kelsall Parsons & Co. Ltd. v. C.I.R.[8]

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5. L.C.B. Gower: Principles of Modern Company Law 3rd ed. Directors Duties pp.515 et seq.
6. [1963] E.A.L.R. 695 at p.697.
7. Skipway v. Skipmore [1932] 16 T.C. 748.
8. [1938] 21 T.C. 608 (Court of Session). The taxpayers in this case were manufacturers' agents, that is, they had contracts with a number of manufacturers whose products they sold on a commission basis. Payment on premeture termination of agency contract held taxable. Contra with Barr and Gombe & Co. Ltd. v. I.R.C. [1945] 26 T.C. 406 where similar termination receipts were held to be capital receipts because the whole structure of the business was affected.

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The crucial point we wish to stress here is that the East African Court of Appeal did not give any consideration to the fundamental point that, as regards employments, the type of income contemplated by the charging clause is one resulting from a Master-Servant relationship. As far as the tax law is concerned the decision of the Court of Appeal which turned on the contents of the notice of termination is at best misleading.

(iii) Income from an "office"

Although said to be a word of "indefinite context"[9] Greene, M.R., put it accurately, when he noted that the word "office" is not " infrequently used as a synonym for employment."[10] This exactly is the position under the Nigerian law which defines an employment to include "any appointment or office whether public or otherwise, for which remumeration is payable . . ."[1] What should be stressed, however, is that an "office" is different from a "mere employment", in that in the words of Rowlett, J., with whom this writer agrees, it denotes:

> "a subsisting, permanent, substantive position which has an existence independent of the person who fills it, and which is filled in succession by successive holders."[2]

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9. per Lord Wright in McMillan v. Guest [1942] A.C. 561 at p.566; 24 T.C. 190 at p.202. It may be noted that an office is usually a position of a more or less public character.

10. Ibid., T.C. at p.197.

1. S.2 ITMA 1961. Definition Section.

2. Great Western Railway Co. v. Bater [1920] 3 K.B. 260 at 274, cited with approval by Lard Atkin and Wright in McMillan v. Guest [1942] A.C. 561 at pp.564 and 566; 24 T.C. 190 at 204 respectively (in each case). See also S.O. Fashokun, op.cit., p.431.

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Typical examples of officeholders are trustees,[3] bishops, company directors, and in Nigeria would, perhaps, include local chiefs, Obas,[4] town criers, and the high priest or priestess of the village Oracle.

When construing the meaning of an "office" three distinct situations implicit in Rowlatt, J's dictum must be recognised. Firstly, instances where professionals and skilled men are appointed to an "office" e.g. consultants, judges etc. - which essentially involves a master-servant relationship, as between an employer and a mere employee. Secondly, where as a contrast to an ordinary employment, a clear master-servant relationship is non-existent as in the case of a company director; although technically an employee,[5] but in reality a manager or an employer. Thirdly, from his Lordship's dictum one can draw a line distinguishing the above two situations from the case of an "independent contractor" who may be engaged to do specific duty for a fee.

By way of criticism, it is believed that the present arrangement of the provisions of the Nigerian Tax Code whereby income from an office is taxable only by way of inference is unsatisfactory. The charging provisions should be re-arranged so as to categorically include income from an "office" as a separate head.[6]

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3. For example, in Dale v. C.I.R. [1954] 34 T.C. 468 (H.L.) especially Lord Normand at page 490

4. Head Chief in a native community who were men of considerable authority in the past, and in the colonial days were the bastion of Lord Lugard's Indirect Rule system.

5. Held in C.I.R. v. The Directors of A.Y. Ltd. 2 E.A.T.C.414. That a director whether controlling or otherwise, of a company is an "employee" of the company.

6. At present income from an "office" is not charged under a separate head. Such specie of income is taxable only because it is defined as being a type of employment income. - S.2 ITMA. 1961.

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(iv) Legal distinction between "Employees", "professionals" and " Officeholders"

As a result of the lack of Nigerian authorities much reliance is placed here on Commonwealth authorities as it is thought that these would be of very strong persuasive authority were the type of problems discussed herein to come before the Nigerian courts.

The leading case in the U.K on the distinction between "professions" and "vocations" chargeable to tax under Case II of Schedule D, and "employments" charged to tax under Schedule E, is Davies v. Braithwaite[7] cited above. It may be recalled that in that case an actress contended that every one of her separate theatrical engagements was a contract of employment so that the emoluments therefrom should be charged to tax under Schedule E. Rowlatt, J., rejected this contention and in so doing stated:

> 'that when the legislature took 'employment' out of Schedule D, and put it into Schedule E, alongside 'offices', the legislature had in mind employments which were something like offices and I thought of the expression 'posts' . . . .'[8]

Furthermore, his Lordship continued, observing that:

> "where one finds a method of earning a livelihood which does not consist of the obtaining of a post and staying in it, but consists of a series of engagements and moving from one side to the other, . . . then each of those engagements cannot be considered an employment but is a mere engagement in the course of exercising a profession, and every profession and every trade does involve the making of successive engagements and successive contracts, and in one sense of the word, employments".[9]

7. [1931] 2 K.B. 628; 18 T.C.198. See also Fall v. Hitchen [1973] T.L.R. where a Ballet dancer was taxed as employee.
8. Ibid., at page (635 K.B.) and 204 T.C.
9. At the time this case was decided the word 'employment" was still in the charging provisions of Schedule D but it is thought that the principle enunciated by Rowlatt, J., would still be followed - See H.G.S.Plunkett:"The Finance Act 1956 - The Effect of Residence and Domicile on the Taxation of Employment" (1957) B.T.R. p.210. The author explains the historical background to Schedule E. Under the 1918 Act, the charge to tax under Schedule E only applied to "public offices and employments" while income from other types of employment was charged to tax under Schedule D.

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Although it is a question of fact in every case whether a taxpayer is "employed" or is carrying on a profession or vocation, two factors which will tend to show that the individual in question is properly charged to tax under Case II of Schedule D are first, that the activities of the taxpayer are of their nature professional or vocational, and secondly, that the number of different engagements fulfilled by the taxpayer over a period of time is considerable. That these points especially the second, are only factors to be taken into account in reaching a conclusion and not decisive tests to be applied to obtain a definitive answer, is illustrated by the Canadian case of A. Seni v. M.N.R. previously cited,[10] and the recent case of I.R.C v. Brander and Cruickshank.[1] In the latter case, the taxpayers, a firm of advocates, carried on a substantial general legal practice and also acted as registrars to several client companies although they did not hold themselves out as such professionally. On ceasing to be registrars to two companies they received £2,500. The Revenue contended that the registrarships of the two companies were not "offices" and that the £2,500 was a receipt of the taxpayers in their profession or business. This view was rejected by the House of Lords. In the court of session, Lord Clyde stated[2] that the duties of a registrar fall into the category where a selected person is appointed to a position where he must perform a certain type of work (Schedule E) rather than the category of a person who is instructed to carry out a particular task. (Schedule D).

10. See page 6, supra.
1. [1971]2 W.L.R. 212; [1971]1 All E.R. 36.
2. [1966]T.R. 543 at p.544.

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In the opinion of Lord Guthrie,[3] while it is easier "to find that a person is the holder of an office when he only holds one such appointment, than it is to find that he holds offices when he has a number of similar appointments", there is no reason "why a number of companies cannot each create a part-time office with particular duties attached to it and appoint the same person to these offices".

In the instant case, "what the Special Commissioners had to decide was whether in the particular cases of the two companies the respondents were holders of substantive positions to which duties were attached, and which had the quality of permanency, irrespective of the particular holder's tenure, or whether they did some work of a particular kind for the companies".

The leading case where an individual was held to be both employed and carrying on a profession at the same time is Mitchell and Eden v. Ross.[4] In that case, a taxpayer who was in private practice as a consultant, also held a part-time salaried appointment under the National Health Service. It was contended on his behalf that, as his private practice would not have been successful without his appointment, that appointment should be treated as a part of his profession so that his salary should be included in his assessment under Case II of Schedule D. This submission was rejected by the

3. Ibid., at page 546.

4. [1962] A.C. 513; 40 T.C. 56.

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Court of Appeal who held that his salary was properly assessable under Schedule E and not Schedule D.[5]

The distinction between cases where a particular receipt accruing to a taxpayer from a contract is held to arise in the normal course of the carrying on of a profession (as in Davies v Braithwaite), and cases where, although an individual is carrying on a profession or vocation, a particular receipt is attributed to a separate office or employment which is charged under Schedule E (as in Mitchell and Eden v Ross), may in some instances be a fine one. The test to be applied in such borderline cases was, however, indicated by Upjohn, J, in Mitchell and Eden v. Ross and consists of a consideration of the following questions: Does the taxpayer in respect of the particular activity in question (1) occupy an office, or (2) undertake an employment, or (3) does he merely render services in the course of the exercise or practice of his profession?

The effect of the Mitchell and Eden v. Ross[6] decision, strictly speaking, is that many professional men for example, accountants who are auditors of companies and solicitors who act as magistrates' clerks are not only carrying on a profession but also holding office the emoluments of which should be separately charged to tax under Schedule E. However, it is understood that the U.K Revenue generally permit these categories of persons to treat such fees as part of their professional receipts.[6a]

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5. [1960] Ch.498; 40 T.C. 39. No appeal was taken on this point in the House of Lords. This case is again examined in relation to the deductibility of expenses.

6. [1960] Ch. 145 at p.165; 40 T.C. 11 at page 35.

6a. Whiteman and Wheatcroft para. 14-07 page 497.

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Lastly, it may be pointed out that while in the U.K, the legal distinction between "employments and offices" on one hand, and "professions and vocations" on the other, may be of the utmost importance especially as regards the deductibility of expenses etc., this may not be so crucial in Nigeria where the rules governing both categories of income are the same.

II. LIABILITY TO NIGERIAN TAX

A. Liability on Nigerian "Source" Income?

Under the present law, tax is payable in any year of assessment upon any "income accruing in, derived from, brought into or received in Nigeria in respect of:

(i). gains or profits from any . . . profession or vocation for whatever period of time such . . . profession or vocation may have been carried on or exercised;[7]

(ii). any salary, wages, fees, allowances or other gains or profits from an employment including gratuities, compensation, bonuses, premiums, benefits or other perquisites allowed, given or granted by any person to an employee[8]. . . ."

Following the detailed analysis of the charging provisions in Chapter Two above, and despite the fact that the Code does not say so

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7. S.4(1)(a) ITMA 1961.

8. S.4(1)(b) as amended by S.1. Income Tax (Amendment Decree (1966). No.65 of 1966. Note the exceptions listed in S.4(1)(b) (i)-(v) that is, categories of payments etc., made to an employee which are not deemed to be part of his taxable emoluments e.g. reimbursements for expenses incurred in the performance of his duties, medical expenses etc.

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explicitly, we came to the conclusion that the Nigerian tax law rests on two principles: (a) Liability to tax on Nigerian "source" income, and (b) liability to tax on a "remittance basis".[9] The personal circumstance of the taxpayer being of secondary importance.[10]

The real question here on which we wish to focus attention is this: When is employment or professional income derived or deemed to be derived from a Nigerian source?

According to our previous analogy, the answer is, "when the originating cause and its place of location" are to be found within the territory of Nigeria.[1] But then, what is the criteria for determining the "originating cause" under the law? Is it the place of the contract of employment, or the place of payment for services rendered or work done, or the place of actual performance of services or duties? Is there any practical difference between the "originating cause" and "ultimate cause" of an income as a number of cases seem to suggest?[2]

Although much of the discussion here is based on the applicable principles for determining the source of employment income, it is thought that what is said would apply mutatis mutandis for the determination of the source of professional income.

The Nigerian courts have been called upon to consider the source of employment income only on two occasions in a period of more than forty years. The two cases which are contradictory, are also very

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9. See the Concluding section of Chapter Two.

10. The significance of Residence under the system is considered subsequently.

1. See C.I.R. v. Lever Brothers.

2. For example, as was pointed out in C.O.T. v. Shein [1958] Rhodesia and Nyassaland L.R. 384. Discussed in more detailed presently.

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unexciting because no clear elucidation of legal principles emerge. In the earlier one, re John Potter[3] the High Court at Onitsha held that the leave salary paid to the petitioner, an employee of a shipping company in Nigeria, (while away on leave in the U.K), was derived from Nigeria as part of the gains or profits of his employment and was thereby rightly included in his assessment for income tax.[4]

Discernible, perhaps, from this judgement is the concept of "source", but since the learned judge failed to adduce any reasons for his decision, and considering that not a single legal authoroty was cited throughout the proceedings, the reasoning behind this case is obscure.

It is therefore not surprising that the West African Court of Appeal In the Matter of Non-Natives Income Tax Ordinance 1931[5] refused to follow Potter's case, distinguishing it, even though the relevant section of the law which the Court had to construe was the same and that the material facts were substantially similar. In that case, the petitioner a clergy working in Nigeria was assessed to tax on his leave salary paid to him while he was abroad. The Court held that the petitioner's leave salary was "neither received in Nigeria nor derived from Nigeria".

In the opinion of the Court, interpreting the words "derived from Nigeria" to mean "derived from employment in Nigeria" would amount

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3. 11 N.L.R. 144.

4. Ibid., Carey.J, at p.147. The relevant S.4(1) of the Non-Natives Income Tax (Protectorate) Ordinance 1931, is very similar to the present S.4 of ITMA 1961.

5. 5 W.A.C.A. 142.

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to "reading into the Ordinance words that are not there, and which would materially affect the meaning"[6]. One other basis for the Court's decision was that the fund from which the petitioner's salary was paid was subscribed in England and not contributed to from Nigeria.

From the two cases above, the following conclusions may be reached. (1) That the Nigerian courts have not yet adopted a clear-cut "source" approach as regards the taxation of employment or professional income since the West African Court of Appeal in the Non-Natives Case did not categorically overrule Carey, J., at first instance in Potter's case. (2) That the correct interpretation of the charging provisions is still a matter of doubt.

For a probable answer to the problem, attention may now be turned to Section 8 of the Income Tax Management Act 1961 which elaborates on the charging provisions of S.4 of the same Act. In that section, two things seem to be emphasized viz - the place of performance of duties and the place of residence of the employer. Income from an employment is deemed to be derived from Nigeria if "the duties are wholly or partly performed there"[7].

This clearly suggests that the source of employment income is the situs of the employment itself. In other words, once an employment is exercised in Nigeria, the gains or profits from such employment must be deemed to be derived from Nigeria whether or not they are actually received in the country[8].

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6. Ibid., at page 143.

7. S.8 (1) (a) ITMA 1961

8. S.8(3).

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However, this general proposition is modified where, even though the situs of employment is Nigeria, the duties had been performed for an employer who is in a country other than Nigeria, provided further that the employee is in Nigeria for less than 183 days and his remuneration is subject to tax at the place of residence of the employer.[9] The last mentioned provisos which amount to a restriction on the "source" principle are in no way unique.[10] They are intended to facilitate the international mobility of labour between countries especially where the duration of stay abroad is of a cursory nature. Implicit in them too is an attempt to avoid double taxation while at the same time preventing fiscal evasion, hence, the stipulation that to obtain an exemption from Nigerian tax such income must be liable to tax in the home country of the employer.

One criticism may be ventured here. The provision exempting an employee from tax says nothing about the size of his remuneration. To avoid tax, is it not possible for multinational companies to move their highly paid staff around the world at frequent intervals, since to enjoy the exemption, the employees only has to stay abroad for less

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9. Note Sections S.8(1)(a)(i) - (iii).

10. Similar provisions can be found in the laws of several other countries. However, the Ghana provisions which provide that "The gains or profits derived from any employment exercised in Ghana shall be deemed to be derived from Ghana whether the gains or profits from such employment are received in Ghana or not" - (Income Tax Decree 1966 - S.6(3)) is better and more straightforward than the Nigerian provisions because there is no time duration before liability arises and the place of residence of the employer is completely immaterial.

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than 183 days;[11] that is, assuming that the income involved is technically taxable, (though not necessarily taxed) in the home country of the employer?

Our submission is that the size of the remuneration must be a relevant factor. Following the Israeli example,[12] once the earnings of an employee is above a certain amount it should be taxable in Nigeria; subject, of course, to whatever relief may be available under double taxation arrangements.

There need to be no unusual difficulty created by our suggestion if the present situation with professional or vocational income is anything to go by. With these kinds of taxpayers, there is no stipulation of a time duration before there can be tax liability. Theoretically, tax is payable for each year of assessment in respect of gains or profits from any :

> "profession or vocation, for whatever period of time[13] such . . . profession or vocation may have been carried on or exercised".[14]

In other words, a non-resident accountant or lawyer undertaking a special assignment in Nigeria is liable to the country's tax on fees received, however, brief the duration of the assignment. If this is so for a professional, why not for an employee?

It is fascinating to note that the Nigerian law as it stands today seems to have adequately taken care of the kind of problem which

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11. This is the usual time duration in the laws of most countries.

12. S.5(2) of the Israeli Income Tax Ordinance as amended.

13. Emphasis supplied

14. S.4(1)9a ITMA 1961

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arose in Re Potter and in the Non-Native's Case 1931. Subsection 4 of section 8, ITMA 1961, categorically provides that the:

> "gains or profits from any employment the duties of which are wholly or mainly performed in Nigeria shall be deemed to be derived from Nigeria during any period of leave of the employee from the employment and during any period of his temporary absence on duty from Nigeria".[15]

Where an employer is resident in Nigeria, any income paid to an employee is deemed to be derived from Nigeria.[1] Here the criteria for liability seems to be the source of payment and its place of location. This broad principle is again modified to the effect that where an employer is resident in Nigeria, but the duties of the employment are wholly performed and remuneration paid outside Nigeria, there is no liability to Nigerian tax on any income received by the employee.

In our opinion, this is only reasonable and consistent with the "source philosophy", since the nexus between the income and territory of Nigeria (i.e. the employer's residence or presence)[2] is too tenuous or insufficient *per se* to render such income liable to the country's tax.

As regards income from an employment with a government in Nigeria, the position is slightly different from that stated hitherto. Such income is deemed to be derived from Nigeria wherever paid, if it is

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15. Emphasis supplied.

1. S.8(1)9b) ITMA 1961.

2. The law provides that . . ."the gains or profits from an employment shall be deemed to be derived from Nigeria if . . . (a) . . . (b) the employer is in Nigeria . . . etc. It is not clear whether the underlined words are intended to signify "residence" or mere "presence". The precise legal distinction is crucial. Cf O'Connel International Law Vol.2, page 715 *et seq*.

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exempt from tax in the country where the duties are performed, either as a result of a specific tax agreement or diplomatic usage. The practice now firmly entrenched in international law is that the servants of one state are not taxed by another state.[3]

In addition to all what has been said above, the law provides that income from any employment the duties of which are mainly performed outside Nigeria shall be deemed to be derived from Nigeria to the extent that those duties are performed in the country.[4] This provision is significant in that unlike the law of some other countries, it gives room for apportionment between two or more sources especially where the duties of an employment of necessity takes the taxpayer across several tax jurisdictions.[5]

From the foregoing exposition of the provisions of S.8 ITMA, it can be inferred that the overriding criterion for determining the "location" of employment income is the place of performance of the duties of the employment; the place of the contract or the place of payment being relatively unimportant matters. In other words, the overt act generating the income is the "performance of the duties" rather than the mere formal act of signing a contract of employment which is something preceding the real "action", or the act of payment which comes subsequently.

The merit of this approach for developing countries is obvious. Because countries like Nigeria are at the receiving end of the one way

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3. Stated positively by the Royal Commission (1955) Cmd. 9474, para. 307.
4. S.8(5) ITMA 1961.
5. The Ghana Law is less specific on this point.

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migration of skilled personnel, unless they are permitted to tax on a "source basis", there could be an intolerable burden on their balance of payments position. One further advantage is that of all the possible applicable criteria, the "place of performance" is the one which is least capable of manipulation.[6]

Although quite logically the most realistic test for determining the source of an employment income, somehow, the "place of performance" did not receive the support of the courts until comparatively recently. To illustrate this point, we refer briefly to the U.K position prior to 1956.[7] Romer, J's, dictum in Bennet v. Marshall[8] which was upheld in Harvey v. Breyfogle[9] and Bray v. Colenbrander[10] sums up the position admirably. As it seemed to his Lordship,

> "the House of Lords . . . in Pickles v. Foulsham[1] have definitely decided that, in the case of an employment the locality of the source of income is not the place where the activities of the employee are exercised but the place either where the contract for payment is deemed to have a locality or where the payments for the employment are made, which may mean the same thing".[2]

The case of Bray v. Colenbrander related to a Dutch journalist who was appointed to act in London as the representative of a Dutch paper.

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6. Cmd. 9474 para.299. The Royal Commission stated *inter alia* that "all other elements are capable of fairly simple manipulation for tax purposes: the place of work is not."

7. For a brief historical analysis of the law prior to the changes brought about by S.10 of the Finance Act 1956, see H.G.S. Plunkett: "The Effect of Residence and Domicile on the Taxation of Employments", (1956) B.T.R. 210 at pp.210-216.

8. [1938] 1 K.B. 591; [1938] 1 All E.R. 93; 22 T.C.73.

9.& 10. Both reported in [1953] A.C. 503; [1953] 2 W.L.R. 927; [1953] 1 All E.R. 1090; 34 T.C. 138.

1. [1925] A.C. 458; 9 T.C. 285.

2. 22 T.C. 73 at 94; 34 T.C. 134 at 157.

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Almost all the duties of the employment were carried out in London. Upon the taxpayer's request, a part of his salary was sent to him in London, otherwise, the whole thing was payable in the Netherlands. Harvey v. Breyfogle on the other hand, related to an American citizen who was appointed the manager of the London branch of an American bank and whose remuneration was paid into a banking account in New York. Like the Dutch journalist, this gentleman also was resident in England and carried out most of his duties in London. It was held in the first mentioned case that the employment was not a "public office" within paragraph I of the old Schedule E,[3] and in both cases that as payment was made abroad, the locality of the employment was abroad and the only liability to U.K tax was on remittances, This was notwithstanding that almost all the duties were carried out in the United Kingdom.

The U.K. position was changed[4] following the recommendation of the Royal Commission which concluded as follows:

> "In our view, the place in which the work is done is much the most important single test of the locality of an employment, though it is the one to which the courts have hitherto given least weight, if indeed they have not treated it as having no weight at all."[5]

It may also be noted in passing that the South African law like that of the U.K. emphasizes the place of performance as the "source"

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3. See H.G.S. Plunkett, op.cit., pp.210-216. Whiteman and Wheatcroft op.cit., p.492 para.14-01 giving a brief history of Schedule E.
4. By S.10 of the Finance Act 1956.
5. Cmd. 9474 para.299. The changes proposed by the Commission were set out in para.305 of the same Report.

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of employment income,[6] while according to A. Lapidoth,[7] S.5(2) of the Israeli Income Tax Ordinance 1965 has been interpreted by the Supreme Court of that country as expressing the intention of the Legislator to introduce one single test for determining the source of employment income, namely, the place where the work was performed.

Be that as it may, it must be pointed out at this juncture that the "situs of employment" test which is favoured by many developing countries is fraught with difficulties in its actual application. This is evident from the jurisprudence of other Common law countries. For example, in the Australian case of In re A.B and the Land and Income Tax Act 1910,[8] which came before the Supreme Court of Tasmania on appeal, the question submitted for decision was whether the salary and bonus received by the appellant in the following circumstances was "income arising, received in, or derived from the state". The facts of the case were as follows:

The appellant was employed under a written contract by a company which carried on business in Tasmania, New South Wales and South Australia but whose head office was in Victoria. He was general manager of the company, and as such was to supervise, manage and conduct all the company's operations in Tasmania or elsewhere if called upon. The

6. A.S. Silke, op.cit., at p.141. See C.I.R. v Epstein [1954] (3) S.A. 689 at 698. C.I.R. v, Lever Bros. (1940) A.D.411 at 449.

7. (1969) Israeli Law Review Vol.V. No.3 page 398 at p.402 et seq. The Ghana Law also adopts the "place of performance" test Cf. S.6(3) Income Tax Decree 1966. N.L.C.D. 78 - "The gains or profits derived from any employment exercised in Ghana shall be deemed to be derived from Ghana whether the gains or profits from such employment was received in Ghana or not".

8. [1929] 3 A.L.J. 155.

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contract provided that his salary should be £3,500 per annum payable monthly, (the place of payment was not stated in the contract) and that he should reside as near the company's works in Tasmania as should be reasonably necessary for the discharge of his duties.

During the year ended 30th June 1927, the appellant visited England and America on behalf of the company for the purposes of investigating the erection of an electrical refinery for copper and of consultations in connection with the company's superphosphate business. He was absent from Tasmania on the company's business for an aggregate of 157 days. In that year, the company paid the monthly salary into the appellant's bank at Melbourne, as requested by him, and also paid him a bonus of £175 in respect of his services for the year ended 30th June 1926, which sum was also paid into his Melbourne bank account. The resolution to pay the bonus was passed by the company at Melbourne.

Counsel for the appellant contended that a portion of the salary and bonus attributable to the period during which he was absent from Tasmania was not assessable against him on the ground that it was not income which "arose" or "accrued", or was "received in", or "derived from" the state of Tasmania; and that it "arose" and "accrued" either in places where the services of the appellant during the period in respect of which it was paid were rendered or at the place where according to the law the salary was payable. He submitted that that place was Melbourne.

Clark, J, who delivered the principal judgement was of the opinion that the salary was not "received" in Tasmania as it was paid ib Melbourn and was not "derived from" Tasmania, as it was payable by a Victorian company from whose territory it was derived.

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His Honour then had to consider whether it "arose" or "accrued" in Tasmania. Disagreeing with the appellant that it arose or accrued where the services of the employment were rendered, his Honour held that while the performance of services was no doubt a condition precedent to the right to receive the salary, the consideration, that is, the company's promise to pay the salary, was not based on the appellant's performance of the services but on his promise to perform them. The contract, therefore, and not the services was the source of the salary which must be considered as having arisen at the place appointed by the contract for payment.[9] And what was that place?

Since no particular place of payment was named, his Lordship tried to get round this by stating that there must be a specific place of payment presumed to be appointed by some general law; or, alternatively, read into the contract by way of interpretation of its express provisions.[10] By this reasoning, he came to the conclusion that the appellant should be deemed to have been paid at Queenstown, Tasmania, where he was required to reside, and where he was to be principally employed. In addition, his Honour argued that it could not have been contemplated that the taxpayer should be entitled to require the company to pay his salary at any place which he might designate. And that the mere fact of payment in Melbourne did not alter the proposition that the place of payment under the contract was at Queenstown.

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9. It is submitted that there is some logic in this argument. Whereas the contract may be the "ultimate source" of employment income, it is not what a practical man would regard as the "originating cause" of employment income. Ref. C.I.R. v Lever Bros.

10. Cf. Cheshire and Fifoot: Law of Contract 8th ed. page 141: Implied Terms.

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In conclusion, Clark, J., held that as the salary was under the contract payable in Tasmania, the whole thing "arose and accrued" in Tasmania and was, therefore, correctly included in the taxpayer's assessment. Nicholls C.J., and Crisp, J. concurred with the view expressed by his Honour.

With regard to the bonus, the view taken by the Court was that it appeared to be a voluntary payment apart from contract, made by a Victorian Company, and received in Victoria and that it was, therefore, not income which was "received" or "arose" or "accrued" or was "derived from" Tasmania.[1]

The above case which undoubtedly is very interesting from several points of view invites a lot of comment. (1) It is fascinating to note how the judge had ascribed different meanings to the words "derived" on one hand, and "arising" and "accruing" on the other. With due respect, whilst we concede that his Honour's reasoning is basically sound in law, yet we are unable to agree with his findings, for the very detailed reasons advanced in the second chapter of this study. It is submitted that "income arising, accruing . . . or derived from the state", simply means income the "source" of which is located in the state.[2] (2) In our view, the suggestion that the place of payment is the source of employment income is one which is difficult to suppor

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1. Note that under S.8(1) ITMA 1961 Nigeria, this would be deemed to be derived from Nigeria.

2. Generally, see the detailed arguments in the case of Esso Standard v. C.O.T. /1971/E.A.C.A.127. This case was reviewed in Chapter Two and would be considered again subsequently as regards the "source" of Interest income.

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This was in fact evident in Clark, J's judgement, because as it happened in this particular case, no place of payment was specified in the contract of employment. Therefore, when in the prevailing circumstances the employee was paid in Melbourne, the judge nevertheless refused to accept this as the "source", but preferred to read an implied term into the contract of employment, inferring therefrom that the appellant was in actual fact supposed to have been paid in Queenstown, Tasmania. Clearly, this is unsupportable considering the general rule that taxing legislation must never be ambiguous, vague or incomplete, and that in case of any doubt or ambiguity, this must be resolved in favour of the taxpayer.[3] (3) It would seem that this decision was influenced by public policy at the time it was made. It is, therefore, very doubtful whether the Australian Courts today would arrive at a similar decision as it did in 1929. (4) Finally, we wish to add here that were a situation parallel to that under review to arise in Nigeria, there would be no need for the Courts to apply any unconvincing analogy because the provisions of S.8(4) ITMA 1961 is quite specific on this point. "Income from any employment the duties of which are wholly or mainly performed in Nigeria" is "deemed to be derived from" the country "during any period of leave or any other temporary absence".

The case of In re A.B. etc., may be contrasted with Smith v The Assessment Committee.[4] In the latter case, the appellant, a taxpayer,

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3. Whiteman and Wheatcroft op.cit., at page 31 et seq, paras 1-53 et seq.

4. (1956-1960) Jamaica Law Reports page 38.

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domiciled in Canada was employed by a company registered in Jamaica. By his contract of employment a portion of his salary was lodged monthly into his bank account in Canada. The appellant's full salary was debited in the accounts of the Jamaican company and for income tax purposes in Jamaica was allowed as a deduction. The appellant was assessed for income tax on the whole of his salary but claimed that by virtue of S.4(2) of the relevant law, he was not liable for assessment on that portion of his salary which was paid in Canada, as it was "income derived from sources out of the Island", and that in any case he was not domiciled in Jamaica. It was held that the whole of the appellant's salary paid by the Jamaican company was income "accruing to him from employment carried on in Jamaica"; that the portion paid into his bank account in Canada was not income derived from a source outside the Island, and that the assessment to tax was lawfully made.

The above case in which it is considered that the "source" principle was correctly applied, demonstrates how easy it could be to avoid tax were any other test apart from the "place of performance of services" to be applied as the criterion for determining the source of employment income. Although the point seems to have been adequately covered by a specific statutory provision[5] the case of

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5. S.8(4) ITMA 1961.

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Smith v. The Assessment Committee should be of strong persuasive authority for Nigerian courts when confronted with a problem similar to that which the Jamaican court had to examine.

Another important point emerges from our discussion thus far: What is the legal position when a person is engaged to perform work in one place and purely as a matter of convenience he does part of the actual work elsewhere, while producing the final result in the place contracted? Difficult questions arise. Take for example, a foreign artist or decorator, who is commissioned to decorate a building[5a] in one country but who actually carries out a substantial part of his work in his own country, where precisely is the "situs of employment" and hence the source of his income?

Such a matter has not yet reached the Nigerian Courts but, theoretically, it would seem that the two countries touched by the taxpayer's activities have a right to levy taxes. The position, of course, could be resolved according to the provisions of a double taxation agreement if there is one between the countries concerned. However, to support our basic contention, we refer to the case of C.O.T v. Shein[6] decided by the Appeal Court of Rhodesia and Nyasaland as it then was. In that case, the respondent, employed to manage a store in Bechuanaland resided in Bulawayo and at his own expense employed a full-time storekeeper who resided in Bechuanaland running the day to day business of the store. The main issue here was

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5a. That is, to provide suitable paintings, carvings and other ornaments.

6. [1958] Rhodesia and Nyasaland L.R. 384.

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whether the source of income accruing to the respondent was Bechuanaland or Southern Rhodesia. The Court of Appeal, confirming the judgement of the High Court, held that in ascertaining the source of the Respondent's income from the store the work he did himself must be equated with the work done by the storekeeper on the spot, and that the Respondent's profit must be regarded as being derived from their joint work in Bechuanaland. What must be noted in particular is that the principle of apportionment was accepted to be legally correct once it can be established that income is derived from more than one source.[7] But in this case it was rejected because the work done by the appellant in Bulawayo insignificant in amount,[8] was trivial and incidental and did not affect the main issue which was the running of the store. Put in another way, the Court found that it would be quite artificial and unrealistic to all·t part of the taxpayer's earnings to his activities in Southern Rhodesia.

Finally, even though the tax systems of most common law jurisdictions provide that the source of a payment for services rendered is the place where those services are rendered, in strict logic this may not be correct. If the "ultimate" test of source is the "originating cause"[9] then in the case of employment income it is certainly not the performance of the work but the "agreement" or "contract" in pursuance of which the work is performed.

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7. Tregold, C.J., ibid., at page 388.

8. These were mainly secretarial duties.

9. C.I.R. v Lever Bros. supra at p.450. C.O.T. v Shein at page 387.

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However, this approach in our opinion is unduly legalistic and is, therefore, not an approach to be adopted by any practical man having to determine the real source of employment income.[10]

Having basically adopted the situs of employment as the "source" of employment income, the actual problem which the Nigerian Revenue has to face is how to determine the precise scope of the taxpayer's "gains or profits from any . . . profession or vocation", or the emoulments from any employment or office. As we shall discover presently, this is something which is not always easy.

B. Social Phenomena and the Determination of Taxable Gains or Profits

Even though a taxpayer is admittedly carrying on a profession or vocation, a particular receipt may yet be excluded in the computation of his gains or profits for tax purposes. Such receipts fall under four main heads. The first relates to receipts arising from activities outside the scope of the taxpayer's trade, profession or vocation. The second head concerns the fact that income tax is only charged on revenue as opposed to capital receipts. The third relates to receipts which are taxable by deduction and are not taxable again in the hands of a trader or professional person. The final head under which a receipt may be excluded from a professional account follows from the fact that there are a number of statutory provisions which exclude receipts otherwise chargeable.[1]

10. See de Villers, J.A., in Rhodesia Metals Ltd v C.O.T. [1938] A.D. 282 at 300.

1. For a list of income exempted from tax in Nigeria see Third Schedule ITMA or S. 26 CITA. These include interest on Post Office Savings accounts, petroleum dividends etc.

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In the context of our present discussion, we consider the first category of receipts the most important.

When a person indulges in activities outside his profession, the general rule is that a receipt arising therefrom is irrelevant in computing the profits of his profession.[2] But the difficulty always is to determine the extent to which income from activities which have some connection with the taxpayer's profession or vocation, may yet be outside its scope for tax purposes. In other words, how is the Revenue to distinguish between three kinds of receipts. (a) Income accruing to a professional in return for services rendered, (b) income accruing to him from isolated non-professional activities, and (c) income accruing to a professional by virtue of the fact that he is a professional per se. This last point which has never been seriously canvassed may be difficult to grasp by foreigners who know very little about Africa.[3]

Visitors to Nigeria have always been overwhelmed by its rich cultural heritage, the diversity of languages and the boisterous and

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2. Capital Gains Tax Liability may follow or more likely it would be caught by the sweeping up provisions of ITMA. S.4(1)(f). Since the computation of the profits of a "professionals" is along the lines of a trade or business, some cases which illustrate our point involve "non-trading receipts" e.g. - Reynolds v. Crompton [1952] 33 T.C. 288. Here the purchasers of a business received payment in full of a book debt which they had taken from the vendors as bad. Held that the resultant profit was not a "trading receipt" since purchasers did not trade in book debts. See also Imperial Tobacco Ltd v. Kelly [1943] 25 T.C. 292; McKinlay v. H.T. Jenkins and Son Ltd [1926] 10 T.C. 372. Both were cases involving foreign exchange profits which were held to be non-trading receipts.

3. S.O. Fashokun does not make the point.

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exuberant nature of the people. Quite discernible, too, is the great respect for elders and the idolization of learned or wise men. But the emphasis is changing. Today, the men who command the respect and admiration of the people are the "New Nigerians" - That is, the educated Nigerians, people whether young or old, who are doctors, lawyers, engineers, architects, accountants etc. Indeed, such is their unique status that much of the tributes paid hitherto to Chiefs, Obas, Emirs and other indigenous rulers now go to these "New Nigerians".

Relating the above specifically to the tax law, we know as a fact that it is not unusual for a doctor practising privately in a rural district to receive substantial cash gifts or other valuable presents from the local community, especially at harvest time or during one of those innumerable celebrations. In the same manner, a barrister may find himself showered with presents from clients, past, present or potential. Such is the abundance of goodwill all round.

Since most of these unsolicited presents are neither professional fees nor income derived by the taxpayer from any casual non-professional service rendered, one wonders whether they are taxable as being part of the profits or gains of a profession or vocation.

From our subsequent analysis of the scope of employment income, it can perhaps be argued that they are.[4]

The generally accepted proposition is that a payment, be it in cash or in kind, is a profit arising from the recipient's employment or office if it is of such a character that any other individual similarly

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4. <u>Infra</u> at page 220 <u>et seq</u>.

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employed might reasonably have expected that he too would receive such a payment in similar circumstances. Usually, it is immaterial whether the expectation is founded on contract or custom, and the relationship of payer and recipient need be no more than the contact which is the occasion of the payment.[5]

According to the above reasoning, it would seem that any payment in cash or kind accruing to a professional by virtue of the fact that he is a professional per se is analogous to income which accrues to an officeholder simply because he holds that office. Furthermore, since the latter specie of income is taxable, it is our submission that the former should be taxable too.

The crux of the matter is this, to what extent can the provisions of the tax code, supposedly very strict, be interpreted to reflect the social norms of the local community? Is there sufficient positive proof of the alleged custom of unsolicited gifts to professionals, and if so, is it a reasonable custom of which the law must take cognisance?

In their efforts not to unduly disturb traditional social institutions based on customary law, Nigerian courts frequently make an effort to adjust conflicts between customary and statutory laws. This is not unlike the principle followed in British and American practice that a law will not be declared void or invalid by reason of a conflict with another overriding statute or by operation of a constitutional principle, or rule of statutory construction, if the conflict can be resolved so as to save the statute by judicious interpretation.

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5. H.H. Monroe: 'Fees, Wages, Perquisites and Profits Whatsoever" - (1959) B.T.R. 25.

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To illustrate the point we refer to the case of Pawa v. Akangbe.[6]

In that case, decided by the High Court of Western State of Nigeria, the customary law of Hausa cattle trading was under attack. This rule gives the head of Hausa cattle traders a right, (i.e. "ladas") on the sale of each cow. The defendant contended that the custom violated his constitutional right to choose his own cattle associations. In arriving at a decision, the Court took into account the nature of the local tribal society and held that the said custom was beneficial rather than detrimental to the cattle traders and, thus, was "reasonably" justifiable in the democratic society of Oyo tribe.

How far the ratio decidendi of this constitutional law case is applicable to tax matters is open to doubt. What is not open to any doubt, however, is the basic principle it stresses. That statute law, which happens in this case to be the Federal Constitution, must be interpreted in a way to reflect social norms.

Even though within a purely theoretical framework one is inclined to suggest that where there is no consideration any payments to a professional should be regarded as part of the "gains or profits" from his profession, and therefore taxable, enforcing this may prove to be a practical impossibility. At present, it is fair to admit that the Nigerian Revenue lacks the administrative capacity to find out the facts in all cases especially if one remembers that the "giving" and "receiving" of these gifts are not documented and that some may be difficult to quantify in monetary terms.[7] For our

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6. [1961] W.N.L.R. 268. See also Thomas M. Franck: Comparative Constitutional Law Process - Cases and Materials, 1968.

7. It must be pointed out that there are detailed provisions for the valuation of benefits in Schedules I and II of the 1966 Income Tax (Amendment) Decree, now secs. 4A and 4B of ITMA 1961.

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purposes it is sufficient to recognise that there is a problem which may either disappear as society becomes more industrialised and urbanised, and as people become more individualistic and less communal. Or, alternatively, as the Revenue acquires more expertise and operational know-how.

Briefly, attention may now be turned to the tax treatment of isolated non-professional receipts.

In the U.K a payment for service rendered on an isolated occasion and which is outside the taxpayer's ordinary trade or profession, may be an "annual profit" for the purposes of Case VI of Schedule D. This principle was judicially stated by Upjohn, J., as follows:[8]

> "There is no doubt that a contract for services may and clearly does, form a matter for assessment under Case VI of Schedule D, and not the less so that the services are trivial or that they are to be rendered once and for all so that the remuneration may be regarded as a casual profit arising out of a single and isolated transaction."

The principle embodies in this dictum is particularly relevant where the taxpayer has engaged in a single transaction for services of a professional nature. As has been pointed out earlier on, whereas an isolated business transaction can be taxed under Case I as an adventure in the nature of trade, there is no similar statutory extension of the word "profession" so that a single transaction of a professional nature cannot normally come within Case II of Schedule D, for such a transaction can hardly be held to constitute a profession. To be taxable, therefore, profits of this nature must come under Case VI of Schedule D.

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8. Bradbury v. Arnold [1957] 37 T.C. 655 at p.669.

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Thus, in Hobbs v. Hussey,[9] the appellant, who was not an author by profession agreed to write his life story for a newspaper. The amount so received was assessed to tax under Case VI.

The appellant contended that the transaction was an isolated sale of property, namely, the copyright in the series of articles and that the payments made were capital receipts. It was held that the true nature of the transaction was the performance of services by the appellant, the sale of the copyright in the articles being subsidiary thereto, with the consequence that the payments received were annual profits or gains assessable under Case VI of Schedule D. In Housden v. Marshall,[10] the court reached the same conclusion, although in this case the appellant merely agreed to make reminiscences of his career available to a newspaper and the articles in question were in fact written by someone else.

The above cases must, however, be distinguished from those where the receipt is for a genuine transfer of property and so a capital receipt. In Haig's Tinstees v. I.R.C.[1] the appellants received certain sums which were held not to be chargeable in respect of the use of Earl Haig's Diaries for the purposes of publishing a biography because that publication largely exhausted the value of the Diaries. The court of session reached its decision on the basis that the sums in question were capital receipts in return for the realisation of

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9. [1942] 24 T.C. 153.

10. [1958] 38 T.C. 233.

1. [1939] 22 T.C. 725.

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an asset. Again, in Beare v. Carter[2], an author of a work published many years previously gave a licence for a new edition in return for £150, and it was held that this was a capital sum.

As a contrast to the U.K. position, the Nigerian law is quite straightforward. It is categorically provided that "tax shall . . . be payable for each year of assessment upon income accruing in, derived from, brought into, or received in Nigeria in respect of . . . any profits or gains not falling within the listed categories."[3] Accordingly, there is no need to decide whether or not a particular receipt is an "annual profit" as is the position under Case VI of Schedule D. Where the taxpayer contends that a particular receipt is not income from professional activities, what the Nigerian Revenue has to decide are as follows: (1) Is the receipt of an income or revenue nature? (2) Is it something accruing to the recipient without consideration? In other words, is it a true gift?

If the conclusion is that the taxpayer's receipt is of an income nature, and that it has been given in return for some consideration however casual or inadequate, then as a miscellaneous receipt it would be liable to Nigerian tax. The great significance of S.4(1)(f) can only be fully appreciated when one recalls the fact that the majority of Nigerians engage in activities which are of a vocational nature, several of which are on a seasonal basis.

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2. (1940) 2 K.B. 187. Also Nethersole v. Withers /1948/ 28 T.C. 501 where a lump sum paid for ten years film rights in a play and not calculated on royalties has been held to be a capital receipt.

3. S.4(1)(f) ITMA. 1961.

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As admirable as the sweeping up provisions are, nevertheless inherent in them is a fundamental problem. In other words, the need to inquire into the legal nature of a casual activity engaged in by a taxpayer, and decide whether it is a "contract of service" or a "contract for services". If it is a "contract of service" then the net income is determined within the rules governing the computation of the profits of an employment or office and tax is deducted at source under the Pay As You Earn provisions. But if on the other hand, the taxpayer's activity was a "contract for services" his net profit is arrived at on the same principles as net professional income.

C. Social Phenomena and the Determination of Taxable Emoluments

Nowhere is the disparity between the provisions of the Tax Code and Revenue practice more glaring than in the determination of taxable emoluments.[4]

In Nigeria, tax is payable "on any salary, wages, fees, allowances or other gains or profits from an employment including gratuities, compensations, bonuses, premiums, benefits or other prerequisites allowed given or granted by any person to an employee".[5] No case has yet arisen as regards the correct interpretation of these provisions, but if the U.K law is any guide, the authorities show that to be a profit arising from an employment the payment must not only be in the nature of a reward but must be made in reference to services rendered

4. i.e. "Profit from office employment, salary" - The Concise Oxford Dictionary of Current English. 5th ed. 1964 at p.397.

5. S.4(1)(b) as amended by S.1(2)(a)(i) Income Tax (Amendment) Decree 1966.

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or to be rendered.[6] Expressed differently, this means that the employment must be both the condition causa sine qua non as well as the condition causa causans. But the above proposition is not the same as saying that every payment to an employee which is in some way connected with his employment is subject to tax.

The cases where a payment to an "employee" has been held not to be part of the emoluments of that employment can be classified into three categories. Firstly, where the payment made was gratuitous. Secondly, cases where an employee has received a payment under a contractual right which was held to be outside the scope of his employment. Finally, cases where an employee has received a payment after his employment has ceased.[7]

In the U.K, as regards gifts and other voluntary payments, the general principle in relation to their chargeability to income tax under Schedule E, was summarised by Lord Cave, L.C., in Seymour v. Reed as follows:[8]

> "It must now I think be taken as settled that the (words "salaries, fees, wages, perquisites and profits whatsoever") include all payments made to the holder of an employment as such, that is to say, by way of remuneration for his services, even though such payments would be voluntary, but do not include a mere gift or present (such as a testimonial) which is made to him on personal grounds and not by way of payment for services".

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6. See Collins, M.R., in Herbert v. McQuade [1902] 4 T.C. 489 at 500. "The test is whether from the standpoint of the person who receives it, it accrues to him by virtue of his office." Also Stirling L.J., at p.501. "A profit accrues by reason of an office when it comes to the holder of the office as such in that capacity and without the fulfilment of any further or other condition on his part."

7. Whiteman and Wheatcroft, op.cit., para. 14-08.

8. [1927] A.C. 554 at p. 559; 11 T.C. 625 at pp.645-6.

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As we shall illustrate presently, the English rule is extremely harsh and unfortunately too has been interpreted in such an inflexible manner by the courts. A recent survey by TIME Magazine shows that for the "executive interested in money and fringes, Britain is less than ideal" and that "within the EEC, only the Irish executive earns less than the heavily taxed British".[1]

How true these findings are in view of the Lonrho disclosures is a matter of conjecture.[2] What is important here, however, is that to a great extent the international mobility of skilled labour is influenced by salaries and hidden compensations which vary drastically from one country to another.

Relating the matters outlined specifically to Nigeria, we ask the following pertinent questions which no other writer on the country's tax law has raised. How strictly should the expression "any salary, wages, fees, allowances or other gains or profits from an employment" be construed in revenue practice and by the courts? ; Considering, (1) the indigenous custom of the people and the traditional tendency of Nigerians to revere people in authority - and that as a contrast to the developed

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1. Time Magazine: April 2nd 1973 at page 9: "Executives Living on the Fringe".

2. The Lonrho affair was an attempt by eight directors to dismiss the Managing Director on the grounds that he conducted the affairs of the company in an unorthodox manner. Among the facts disclosed were huge payments to an individual as compensation for loss of office, excessive benefits in kind enjoyed by the M.D. tax-free - including a house valued at £350,000. The "Times" U.K. - Bernard Levin, "Putting our £350,000 houses in order" May 15th, 1973. Also, editorial of the same paper, "Mr. Rowland Must Go."

   According to Robert Jones the four main issues spotlighted by the Lonrho affair were directors "perks", dealings with companies in which the directors have interests, the relationship of the chief executive to the Board, and the ultimate responsibility of the Board: The Times, U.K. May 21st, 1973.

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countries, where the usual practice is for the employer to grant additional remuneration in form of perquisites to his employees, in developing countries the usual thing is for employees to give "presents" in cash or kind to their employers in a manner reminiscent of the feudal era; (2) the need to attract talented men from abroad on one hand and to prevent a brain drain from Nigeria on the other; (3) the extent to which the tax law can be allowed to undermine the existing social and economic order in view of the ever pressing fiscal needs of the country.

For the sake of clarity and depth the subject-matter is considered in two parts. In sub-sections (i-v) immediately following, the scope of taxable emoluments in cash or cash equivalent is probed drawing our analogies as usual where necessary from experiences in other countries. The more complex issues of benefits in kind, deductibility of expenses and tax computation are treated subsequently in separate sections.

(i). Gratuitous Payments by Employees

In theory, where a gratuitous payment is made by the employer to his employee, the circumstances will have to be truly exceptional if the payment is not to be treated as merely an additional remuneration of the employee. Moreover, in such circumstances it will make no difference that the payment made by the employer is not money but money's worth, i.e. stamps, vouchers etc. For example in Laidler v. Perry,[3] where a group of companies gave each employee who

3. [1966] A.C. 16. 42 T.C. 351. Also a bonus paid to a single employee as a reward for special services outside his normal work is taxable under Sch.E. e.g. Barson v. Airey [1925] 10 T.C. 609.

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has worked for them for more than a year a voucher for £10 as a Christmas present, the House of Lords held that the vouchers which were available for use in the shop of the employee's choice were properly charged to tax under Schedule E as an "emolument" of each employee's respective employment.[4]

On the other hand, as indicated by the dictum of Lord Cave, L.C., cited previously,[5] a payment to an employee on purely personal grounds, and not by way of remuneration for services rendered is not taxable.

From other illustrations given herein, we find once more that propositions of law are not as easily applied in practice as they are stated; due, of course, to the infinite variety of human transactions or relationships.

First, we refer to the Ceylonese case of C.I.R. v J.de Fonseka[6] which in our opinion was wrongly decided by the Supreme Court of that country. The question of law which arose in the "case stated" under S.78 of the Income Tax Ordinance for determination by the Court was whether the value of a free air passage[7] granted by the body called Air Ceylon to the assessee-respondent who was an employee of that body was part of his "profit from any employment" within the meaning of S.6 of the said Ordinance.

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4. See the observations of Lord Hodson , ibid., at p.35 A.C., and p.336 T.C.
5. Supra at page 221.
6. (1968) New Ceylon L.R. 328.
7. The value of a free air ticket can also be regarded as a "benefit in kind" which shows that the distinction between a cash payment or cash equivalent etc., is not a rigid one.

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According to the staff travel scheme set out in the "case stated," a free air passage granted under the scheme was described as a "favour" granted in his discretion by the officer of Air Ceylon competent to do so to an employee who has rendered service for not less than one year, or to a member of his family. Abeyesundee, J., delivering the judgement on behalf of the Court, and purporting to follow English law, held that the free air passage was not a reward or consideration for services.

With due respect, it is submitted that this was a misapplication of the law. If the "free air passage" was not a reward for services then what was it? Certainly, it was not a testimonial for the personal qualities of the recipients, but rather, it bore a direct relationship to the terms of their employment, the fact that there was a discretionary element in the administration of the scheme notwithstanding.

In Sutherland v. C.O.T.,[8] the Supreme Court of Ceylon seem to have applied the law correctly. In that case, the main issue was whether or not an ex-gratia payment made by a company to the wife of an employee after his death was taxable. The Court came to the conclusion that the payment in question was a gift to the appellant personally of a sum of money to which the deceased was not entitled and was not payment made to her in her capacity as executrix. Therefore, it was not a "profit" from the deceased's employment within the meaning of S.6(1)(b) and S.6(2)(a)(i) and (v) of the Income Tax Ordinance.

As regards payments or purported gifts from employers to employees on personal grounds, the difficulty which must be recognised

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8. (1951) Report of Ceylon Tax Cases. Decision affirmed by the Privy Council at page 403 of the same Report.

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is that often what is involved is an enquiry into the motive as distinct from the consideration for payment. For example, in the case of Craib v C.O.T.,[9] the directors of a company in whose estate the appellant was employed as a superintendent, by a special resolution granted him a special bonus of Rs. 10,000 in view of his "exceptional services to the company", and in consideration of the fact that he had to undergo medical treatment at home. In the return furnished by the company, this sum was mentioned as a "bonus" paid to the appellant. The Revenue regarded this sum as part of the appellant's income and assessed it to tax accordingly. But the Court upheld the taxpayer's contention that the payment was personal to him and so could not be regarded as profits from any employment within the meaning of S.6(2)(a) of the Income Tax Ordinance 1932. The main difficulty in this case was the phrase "exceptional services" mentioned in the resolution which was, in actual fact, the motive and not the consideration for the payment.

Reflecting on the practical application of the law in Nigeria what do we find? Employers make no strenuous effort to disguise additional remuneration paid out to employees. Gratuitous payments in cash or cash equivalent are paid out every day by the Federal and State governments as well as by private concerns. These include a "car basic allowance" paid on a monthly basis to employees who own

9. (1939) Reports of Ceylon Tax Cases at p.138.

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cars;[10] a "mileage allowance which is usually well above the actual expenses incurred; a "leave bonus" which may be upwards of £200 depending on the status of the employee; a "rent allowance" where accommodation is not provided which could vary in amount from £300 p.a. to £1,500 p.a.; an "inconvenience allowance" ;[1] a wife's or children's allowance which is quite different from personal reliefs allowed.[2] etc.

Somehow, it has escaped the Nigerian Revenue that these so-called "allowances" whatever sub-appellation they may bear are indeed rewards for services rendered and therefore clearly taxable under the express provisions of the Tax Code.[3] To drive home this point

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10. This is about £300 p.a. for civil servants or university lecturers but could be up to £1000 p.a. for company employees. The reason for this "car basic allowance" is very dubious considering that the employer usually provides the loan which may be interest-free for the purchase of the car. Often, a car loan is repaid with the "car basic allowance" both sums provided by the same employer, with the overall effect that the employee ends up with a free car.

    Contra: Batham v Torbay Corporation, Times Law Report April 23rd 1974, where it was held that a car allowance for "home to office" journeys was not remuneration but reimbursement of actual expenses.

1. This sort of allowance is paid to science graduate teachers in order to encourage them to teach in village secondary schools.

2. S.S.18,19 Personal Income Tax (Lagos Act) 1961 as amended hereinafter referred to as PITA. Personal reliefs are available too under the various state Income Tax Laws.

3. S.4(1)(b) ITMA. This provides that tax is payable on "any salary, wages, fees, allowances, or other gains or profits from an employment . . . ."

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in the minds of the public the Revenue must go to court on a number of test cases as has been done with apparent success by one Commonwealth country.

We refer here to Hong Kong and the case of C.I.R. v Humphrey.[4] In that case, what the court had to decide was whether a government "mileage allowance' paid to a civil servant for his home to office journeys were income from his employment, and whether any other expenses connected with these journeys were deductible. The relevant sections of the Hong Kong law are in all material respects similar to the Nigerian provisions.[5] The Supreme Court of that country reviewing a long line of Commonwealth authorities arrived at these important findings:

(1). That the respondent was not on duty when travelling between his home and his place of work.

(2). That the mileage allowance and refund of toll charges were:

(a) an additional benefit to the respondent in that they were paid as a contribution to the private expenses incurred by him in discharging his obligation to get himself to his place of work.

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4. /1970/Hong Kong L.R. 447. See also Lunney v. C.O.T. 32 A.L.J.R. 139 and Denning, L.J., in Newson v. Robertson /1953/Ch.7 at pp.15,16; 33 T.C 452 at 463,464.

5. i.e. S.8(1) as read with S.9(1) of the Inland Ord. Cap.112 of the 1964 Revised Laws of Hong Kong. The two sections as far as relevant read as follows:

"8(1) Salaries tax shall subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from the colony from the following sources.

(a) any office or employment of profit.
(b) ....

9(1) Income from any office or employment includes:

(a) any wages, salary, leave pay, commission, bonuses, gratuity, perquisites or allowance for high cost of living . . . etc."

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(b) paid as a reward for his services and were accordingly income from the respondent's office or employment of profit chargeable to Salaries Tax.

(3). That the expenses incurred by the respondent in travelling between his home and his place of work were not deductible under S.12(1)(b) of Cap.112 of the 1964 Revised Laws, because the respondent was not on duty when so travelling.[6]

The unique Nigerian concept of an "allowance" or "fringe benefit" is explained in greater detail later on.[7] Within this context, however, it is sufficient to note that these terms are understood by the generality of the people to mean something "given free" and not as a remuneration or reward for services rendered. Nigerians cannot imagine and neither can they believe that it is within the contemplation of the law that the aforementioned categories of receipts are taxable.

Whilst the layman can be forgiven for his ignorance of the tax provisions can the Revenue too claim to be uninitiated in these matters? It seems contrary to logic to suggest that the country has a tax law which was never intended to be enforced.

The only explanation that can be offered for the current lack of appreciation of the tax law is the one already advanced.[8] That the present Code, a relic of the colonial past, was not designed to

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6. The net effect of this section is that only expenses incurred "wholly, exclusively and necessarily" in the production of income and deductible. The special case of the itinerant tax-payer with more than one calling or place of employment is examined presently.

7. Infra at page 80.

8. See Chapters One and Two supra.

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suit the national characteristics of any particular country. The British introduced it in their colonies, not bothering much whether the people understood the provisions.

(ii) Gratuitous Payments by Third Parties

Where a payment in cash or cash equivalent is made to an employee by some person other than the employer a number of tax problems may arise.[9] The legal principles in this area of law were well summarised by Jenkins, L.J., in Moorehouse v. Dooland[10] and quoted with approval by Whiteman and Wheatcroft.[11]

(1) The test of liability to tax on a voluntary payment made to the holder of an office or employment is whether from the standpoint of the person who received it, it accrues to him by virtue of his office or employment, or in other words, by way of remuneration for services. (2) If the recipient's contract of employment entitles him to receive the voluntary payment . . . that is . . . a strong ground for holding that from the standpoint of the recipient it does accrue to him by virtue of his employment, or in other words, by way of remuneration for his services. (3) The fact that the payment is of a periodic or recurrent character affords a further but . . . less cogent ground for the same conclusion. (4) On the other hand, a voluntary payment may be made in circumstances which show that it is given by way of present or testimonial, on grounds personal to the recipient . . . . In such cases, the proper conclusion is likely to be that the voluntary payment is not a profit accruing to the recipient by virtue

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9. Note cases like Calvert v. Wainwright [1947] K.B.526 at p.527; 27 T.C. 475 at 477, where it was held by Atkinson, J., that the tips received by a taxi driver in the ordinary course of business were assessable to tax. In Blackiston v. Cooper (1909) A.C.104; 3 T.C. 347 the House of Lords held that a Parson's Easter offering was taxable under Schedule E.

10. [1955] 36 T.C. 1 at page 22.

11. op.cit., at page 502. para. 14-14

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of his office or employment but a gift to him as an individual paid and received by reason of his personal qualities or attainments.

In straightforward cases these principles are easy to apply. Thus, where as in Blakiston v. Cooper[2] it was suggested that Easter offerings to a vicar were personal gifts made to him as a mark of esteem and respect, Lord Ashbourne[3] had no doubt that while these sentiments might have been partly responsible for obtaining and increasing the amount of the offering, nevertheless, "they were given to the vicar as vicar and that they formed part of the profits accruing to him by reason of his office".

The courts by similar reasoning held in Wright v. Boyce[4] that the customary presents of cash at Christmas time given to a huntsman by other members of the hunt some of whom were his personal friends were chargeable to tax.

As a contrast to the above two cases, and showing what kind of difficulties may arise in the tax treatment of payments to employees by third parties we refer to the Inland Revenue Board of Review Decision Case No. 20/71 (Hong Kong)[5]. At first sight the case appears simple enough but the outcome was unsatisfactory. The material facts were as follows: Two foreign companies S. Ltd. and J. Ltd. paid commissions to the appellant in respect of business transacted through or introduced by him. Commissions were paid to the appellant in

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2. /1909/ A.C. 104; 5 T.C. 347.
3. Ibid., at p. 108 (A.C); 356 T.C.
4. /1958/ 38 T.C. 138.
5. /1972/ Hong Kong L.R. page 40.

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respect of goods supplied to the company of which he was managing director as well as on purchases by other buyers introduced by him.

The main point at issue was whether or not these sums related to the appellant's office or employment as managing director, and, therefore, chargeable to tax under S.8(1) of the Income Tax Ordinance.[6]

With respect to the commission or rebates paid to the taxpayer by the two companies it was contended on his behalf that such income did not relate to the taxpayer's office or employment as managing director of W.K.M. Co.Ltd (referred to hereinafter as W.K.) and so was not chargeable to tax under S.8 of the Ordinance.

Counsel for the Commissioner conceded that the commission relating to sales by S.Ltd. to buyers other than W.K., paid to the taxpayer, could not be attributable to the taxpayer's office or employment and should be excluded from the charge to salaries tax. However, the Board was invited to infer that the commissions on purchases by W.K. were paid to the taxpayer by S.Ltd. because of his office in W.K.

In reaching a decision, the Board felt that the effect of the concession by the Commissioner's representative was that for income

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6. This section provides; "That salaries tax shall subject to the provisions of this Ordinance be charged for each year of assessment on every person in respect of his income arising in, or derived from the colony from the following sources.

(a). any profit or employment of profit,

(b). .... etc.

NB. This section is to be read in conjunction with S.9(1) of the same Ordinance. Cap. 112 of the Revised Laws of Hong Kong 1964.

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to be chargeable under S.8(1) it must be derived from an employment by an employee even though the income is derived from some other person other than the employer. Relying on a passage from the judgement of Viscount Simon in Hochstrasser v. Mayes [7], the Board held that there was a primary onus on the Crown to prove that salaries tax was chargeable and consequently to establish that the unconceded commissions from S. Ltd. were paid to the taxpayer because of his employment with W.K. In the opinion of the Board, the fact that W.K made purchases from S. Ltd. and that the taxpayer received commissions on these purchases were not in themselves sufficient to establish that these commissions were derived from the taxpayer's employment with W.K.

It is submitted with due respect that the decision of the Board of Review is incorrect. Clearly, it seems to us that any other managing director of W.K. would probably have been in a position to receive these commissions. Therefore, according to the principles outlined in Moorhouse v. Dooland they should be taxable. [8] Secondly, the fact that they were of a periodic or recurrent nature lends additional support to our view. Certainly, these commissions had not been given on personal grounds or by way of testimonial because the recipient did furnish some consideration. Finally, considering that in Hong Kong income from office employment includes:

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7. [1960] A.C. 376 at p.389. - "It is for the Crown seeking to tax the subject to prove that the tax is exigible not for the subject to prove that his case falls within exceptions which are not expressed in the statute but arbitrarily inferred from it". - per Viscount Simon.

8. Supra at page 230.

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> [9]"any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisites or allowance whether derived from the employer or others[10] . . . .etc."

it is believed that there were sufficient grounds to hold the taxpayer's commissions liable.[1]

Relating the above general principles specifically to Nigeria, a number of observations may be made. Must the Nigerian provisions admittedly akin to the U.K law, be interpreted and applied in the same manner? Our answer is no. Taking into consideration a number of social factors peculiar to the country, it is our opinion that neither can the general principles enunciated be strictly adhered to, nor is it even desirable to do so.

By custom and tradition, the incumbents of a number of posts and offices in the country can expect and, in fact, are given voluntary payments or gifts by persons other than their employers. The school master in a rural area is a typical example. He can reasonably expect to be given cash and other presents on a fairly regular basis. The same goes for the village doctor or pharmacist working in a local government hospital. Classification is difficult here because the kinds of payment we have in mind are not bribes for often they are in appreciation for services already rendered. But then, neither can they be regarded as a testimonial to the personal qualities of the recipient because almost every holder of the type of office in question can expect to receive them.

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9. S.9(1) Income Tax Ord. Cap.112. 1964 Laws Hong Kong.

10. Emphasis supplied.

1. As a matter of interest were the above problem to arise in Nigeria, the receipts would be caught by the sweeping-up provisions of ITMA. S.4(1)(f).

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In these circumstances, the proposition is, should such unsolicited gifts, cash payments etc., be regarded as part of the emoluments of certain offices or posts? Here is a classic example of custom and tradition in direct conflict with statute law.

It is our view that the Nigerian law must not be interpreted in such a way as to make these gifts or payments by third parties taxable. Firstly, because of the widespread nature of this "giving and receiving" and secondly, because of the problems of identification and administration generally.

There is also another element involved here, viz the desirability or otherwise of a custom or tradition which undermines the statute law. Applying the rule established in Pawa v Akangbe,[2] it would seem that the custom of unsolicited gratuitous payments by third parties is "reasonably justifiable" in a democratic society, and so should be allowed to stand whether or not it is in conflict with statute law. Any attempt to do otherwise will unduly undermine the social fabric of society. Furthermore, an endeavour to follow English practice on this occasion will be quite unrealistic to say the least. The reasoning here is carried a step further in the section where the valuation of benefits and deductibility of expenses are examined.

Three other kinds of receipts which may or may not be taxable in the hands of the employee deserve mention. Firstly, contractual receipts not arising from the employment; secondly, lump sum payments and thirdly pensions and other payments after the termination of employment.

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2. Supra, at page 216

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(iii). Contractual Payments Not Arising from Employment

What is to be noted here is that apart from the "testimonial" cases, there are circumstances when an employee may receive or be entitled to receive a payment from his employer which will not be treated as part of the emoluments of his office. The words of Upjohn,J., in a case, that to be taxable a "payment must be made in reference to the services the employee renders by virtue of his office, and . . . must be something in the nature of a reward for services past, present or future",[3] should be recalled here. Thus, in Jarrold v. Boustead,[4] the Court of Appeal held that the signing-on fee to an amateur rugby football player for turning professional and agreeing to play for the club was not a taxable emolument.

The signing-on fee was, in the opinion of the Court of Appeal, a capital sum received by the player as compensation for relinquishing his amateur status.

Equally not taxable as emoluments, are payments received under a deed or covenant as in I.R.C. v. Westminster[5] where the House of Lords based its decision on the fact that the employees were legally entitled to claim payment under the deeds, whether or not they continued to be employed by the Duke, stressing that the causa causans of the payments received under the deeds of covenant was not the employment but the legal obligation constituted by the deeds themselves. The relevant facts here were as follows: The Duke of Westminster reduced the wages

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3. Hochstrasser v. Mayes [1959] Ch.22 at p.33; 38 T.C. 673 at p.705.
4. [1964] 41 T.C. 701.
5. [1936] A.C. 1; 19 T.C. 490.

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of his gardeners but at the same time entered into deeds of covenants by which he bound himself for seven years to pay them weekly sums equivalent to that reduction. The covenants were expressed to be given in respect of past services and were to remain in force whether or not the gardeners continued in his service.

Although seemingly altruistic, behind the Duke's scheme was a tax avoidance motive. As a surtax payer, it was more to his advantage if sums paid out to his gardeners were technically classed as "annual payments" rather than wages even though the amounts involved were exactly the same.[1]

In Nigeria, just as in the U.K., annual payments are chargeable to income tax in the hands of the recipient.[2]

(iv). Lump Sum Payments - Nigeria's Retrograde Step

Another specie of payments which may or may not be taxable on normal income tax principles are payments, usually lump sum, payable not in return for services rendered or to be rendered but for some reason outside the normal relationship of employer and employee.[3]

The difference between our subsections (iii) and (iv) is this; whereas under the former head the receipts have nothing to do with the terms of employment, under the latter they are directly connected with it. Otherwise, payments under the two heads have very much in common as they both often arise out of contract.

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1. The effect of this decision has now been reversed by what is now S.457 of I.C.T.A. 1970. U.K.
2. S.4(1)(e) ITMA 1961.
3. Whiteman and Wheatcroft, page 504 para.14-18.

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Since tax can only be levied on "income", many employers acting on professional advice have sought to pay out additional remuneration to their employees by exploiting the technicalities of the law. Hence, the so-called "compensation for loss of office" involving large sums of money paid out tax free, that is, in the guise of a capital payment rather than as a reward for services.[4] In practice, the plain truth is that it is often very difficult to determine the character of a payment to the holder of an office when his tenure of office is determined or the terms on which he holds it are altered and the question which the Revenue has to decide in each case is whether on the facts the lump sum paid is in the nature of remuneration or profit in respect of the office, or is in consideration of the surrender by the recipient of his rights in respect of the office. Where the sum paid is in the nature of a remuneration then it is taxable; whereas, if it is a compensation for the surrender of rights it is not taxable being a capital receipt.[5]

Usually, payments made whether in instalments or lump sum are assessable as remuneration if any service are to continue in respect of an office or employment.[6] Thus, in Cameron v. Prendergast,[7] the sum

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4. For example, in the Lonrho affair the sum of £130,000 was paid to an individual as compensation "for the loss of a consultancy". See Bernard Levin, The Times U.K. May 15th 1973. It would seem also that Redundancy Payments come under this category too. See The Redundancy Payment Act 1965 (U.K.) Vincent Hanna claims that nearly £500m. has been paid to two million redundant workers, and that Lord Denning in interpreting the Act announced that a redundancy payment is compensation for the loss of a "property right". The Sunday Times, U.K. June 3rd 1973.

5. See Jenkins, L.J., in Henley v. Murray [1950] 31 T.C. 351 at 367.

6. L. Lazar, (1966) A.S.C.L. Chapter on Taxation especially at pp.534 et seq. Remuneration Profits or Compensation. Here, the author reviews a number of important cases.

7. (1940) A.C. 549: 23 T.C. 122.

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of £45,000 paid to a director who wished to retire upon his agreeing not to resign but to continue in the company's service devoting less time to its affairs was held taxable by a unanimous decision of the House of Lords. The taxpayer in Clayton v. Lavender[8] was luckier. In that case, the appellant was employed as a resident consultant with a company for a term of five years and thereafter the employment was terminable on six months notice on either side. These terms were contained in a letter to him from the managing director, and when, in August 1957, after about a year, the appellant intimated he did not wish to continue, this director wrote another letter whose terms were accepted by the appellant and subsequently confirmed by the board of directors, terminating the agreement on the following lines:

> "We will pay you £4,000 per year for one year as from August 14, and £2,000 for the next year, that is to say, up to and until August 14th, 1959".

These payments were made to the appellant monthly as "salary" with concurrent tax and national insurance deductions by the company. The Revenue contended that the tax payer's office or employment was not terminated but continued; alternatively, that there was an express or implied agreement when the letter was written that the taxpayer should, if called upon to do so, act in an advisory capacity for the period to August 14th, 1959 when the payments ended. The Court held that the employment had terminated and that there was no express or implied agreement as submitted. That the taxpayer's contention was correct that notwithstanding the deductions made from the payments, they were paid to him in consideration of his surrender of his rights under the

8. (1965) T.R. 461. Reviewed by L. Lazar in (1966) A.S.C.L. supra.

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original letter of employment. The essence of this decision was that once the contract of employment was ended, any payments thereafter made would not be for services so that there could not be an assessment under the relevant Schedule E.

The two cases above may be contrasted with Henley v. Murray[9] where the managing director who resigned at the request of his board of directors before the time stipulated in his service agreement received a sum as compensation for loss of office. Although the sum so paid was equal to the balance of the salary which could have been paid if the appellant's employment had not been prematurely determined, the Court of Appeal held that the payment so made was not taxable emphasizing that the payment was not made under the contract but in consideration of its termination.[10]

In the U.K., where a payment received by an employee represents partly a sum in respect of taxable earnings and partly damages or compensation, it is apportionable and only the latter part escapes tax.[1]

Prior to 1966, all lump sum payments were probably chargeable to Nigerian income tax if referrable to an employment. We hold this view because of an uncertainty in the law and because of what happened

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9. [1950] 31 T.C. 351.

10. In the second class of cases although income tax may not be payable, the possibility of a charge to Capital Gains Tax on the basis that a capital sum has been received for the forfeiture or rights should be borne in mind.

1. Following Cameron v. Prendergast [1940] A.C. 549; 23 T.C. 122.

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subsequently. Whereas, "any gratuity[2] or similar payment" from an approved pension scheme made to an employee whose employment ceased after a period of less than five years (if amount is in excess of £150) was treated as income, and hence taxable, nothing specifically was said about compensation for loss of office or employment.[3] Also, the latter category of income were certainly not liable to capital gains tax on the basis that they constituted capital sums received in return for the forfeiture or surrender of rights as the Capital Gains Tax Decree was introduced only in 1967.

However, since 1966 "any compensation for loss of employment" has been categorically exempted from tax. The law as amended now reads as follows:[4]

> "Tax shall be payable for each year of assessment . . . in respect of:
>
> (a). . . . .
>
> (b). any salary, wages, fees, allowances, or other gains or profits from an employment including gratuities, compensations, bonuses, premiums, benefits or other perquisites allowed given given or granted by any person to an employee <u>other than</u>,[4a]
>
> (i) ....
>
> (ii) (iii) (iv)
>
> (iv) any compensation for loss of employment.

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2. The term "gratuity" is employed here to mean money present of amount fixed by giver in recognition of an inferior's good offices- <u>Concise Oxford English Dictionary</u> 1964. In the sense used here and with para.6 of Sch.4 ITMA 1961, a gratuity is different from "a pension or an annuity".
3. Para. 6 Sch.4 ITMA 1961.
4. S. 4(1)(b) ITMA read subject to the amendment introduced by S.1(2)(a)(ii) of the Income Tax (Amendment) Decree 1966. Decree No.65.

4a. Emphasis supplied.

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In our opinion, the 1966 amendment was a retrograde step. The trend in other countries has been towards making such monies taxable because to do otherwise usually leads to abuse. The Lonrho affair in the U.K may be recalled here. There, a sum of £130,000 was paid to an individual for an ostensible "loss of consultancy". But nobody was in any doubt that this was a tax avoidance gimmick.[5]

On first thought, the Nigerian Law appears similar to the British Redundancy Payment Act 1965 and the Contract of Employment and Redundancy Payments Acts (Northern Ireland) 1965. Under these laws, payments received by employees under schemes set up in accordance with their provisions are exempt from tax under Schedule E, and are an allowable expenditure in computing the profits or gains of the employer.[6] But unlike these enactments, the Nigerian law does not contain any guidelines setting out the conditions under which a compensation shall be paid. It does not outline what is meant by a "loss of employment" considering that an employee may lose his employment as a result of several factors. For example, this may be due to reorganisation schemes, to a breach of contractual obligations, a dismissal or simply because of winding-up proceedings.

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5. See Bernard Levin "Putting our £350,000 house in Order", The Times U.K. May 15th, 1973. Also the editorial comment in the same paper entitled, "Mr. Rowland Must Go".

6. S.412, I.C.T.A. (U.K.) 1970.

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While any contribution made by an employer in respect of a pension scheme in Nigeria is an allowable deduction,[7] the tax treatment of a "compensation for loss of employment" in the books of the employer is obscure. Could it have been intended that this kind of payment should not be liable to tax in the hands of the payor and the payee?

The absurdity of the 1966 amendment becomes more glaring because the expression "any compensation for loss of employment" is an open ended one. No upper ceiling as to what can be paid out tax free has been fixed as is the case under the U.K "Golden Handshake" provisions[8]. Also, unlike some Redundancy schemes the Nigerian employer is not called upon by law to show cause why it has become necessary for the employee to lose his employment.[9]

Since pensions, gratuities and other terminal payments are clearly taxable why not a "compensation for loss of employment"? The point we are making becomes all the more important because in practice it may be difficult to draw a line between a "gratuity" and a "compensation for loss of employment" especially when one remembers

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7. S.17(1)(f) ITMA read in conjunction with Sch.4 of the same Act.

8. These provisions are extremely complicated. What may be noted here is that any compensation for loss of office which is above £5,000 is taxable. The case of I.R.C. v. Brandser and Cruickshank op.cit. may be recalled here. I.C.T.A. ss.187,188.

9. In continental countries the employer is obliged to show cause although he is not so required to do in the U.K where he is the sole judge of the need for redundancies - Vincent Hanna, The Sunday Times U.K. June 3rd 1973.

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that, often, conditions warranting the termination or cessation of an employment are man-made phenomena and not the Act of God. A case in point here is Henry v. Foster,[10] where a company's articles of association provided that in the event of any director, who had held office for not less than five years ceasing to hold office for any cause other than misconduct, bankruptcy, lunacy or incompetence, the company was to pay that director a quantified sum as "compensation for loss of office". But it was held by the Court of Appeal (U.K) that the payment constituted a profit of the office of director, for as Lawrence, L.J., stated, "the payment to the respondent, whatever the parties may have chosen to call it, was a payment which the company had contracted to make to him as part of his remuneration for his services as director."[11]

It is doubtful whether the Nigerian authorities fully appreciate the present unfavourable position of the law. There are no statistics to show how much is paid out as "compensation for loss of employment", "loss of office", "loss of consultancy" or what not. There are probably hundreds of instances similar to the Lonrho affair where vast sums have been paid out tax free. Statistics now emerging in the U.K are staggering. According to Vincent Hanna, since 1965 over £500m have been paid out to two million redundant workers on "principles which are obscure to recipients and contributors alike."[12]

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10. (1931) 16 T.C. 605.

11. Ibid., at p.632.

12. The Sunday Times, U.K. June 3rd, 1973.

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What is to be done? The present Nigerian law must be restricted qualitatively and quantitatively. The government, therefore, must make up its mind as follows: (1) whether "any compensation for loss of employment" is akin to a redundancy payment. If so, whether the employer must be the sole judge of the need for redundancies.(2) They need to fix an upper limit to the amount which can be paid out tax free as compensation so that payments above this figure would be taxable. (3) Finally, the government must state clearly how the kind of monies in question are to be treated for tax purposes in the books of the employer.

Without amendments in line with the above submissions, the law as it stands at present is an open invitation to tax avoidance and possible fraud.

As regards lump sums generally, there is yet another category of payments which is not covered at all by the Nigerian Law. These are payments for a collateral transaction not made as a consequence of a breach of contract of employment or as compensation for its termination. The type of situation envisaged is well illustrated by the case of Cowan v. Seymour.[1] In that case, the appellant acted as the secretary of a company from its incorporation, and later as its liquidator without remuneration. After the liquidation had been completed the ordinary shareholders voted the sum remaining after all expenses had been paid to the chairman and appellant equally. Under the memorandum of association that sum was *prima facie* divisible

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1. (1920) 1 K.B. 500; 7 T.C. 372.

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among the shareholders. The U.K.Court of Appeal held that the sum so paid was not chargeable to tax under Schedule E. In the U.K. such a payment would now probably be chargeable to tax as a "golden handshake"[2]

In our view, the Nigerian law should be changed in order to make payments for collateral transactions taxable in all situations analogous to that in Cowan v. Seymour. The law at present is capable of easy manipulation to avoid tax by an employee simply refusing to accept a renumeration on an understanding that money would be channelled to him surreptitiously later on.

One final comment in connection with lump sum payments. Where a taxpayer carrying on a profession also holds an office or offices connected with that profession, a payment made as compensation for loss of such an office may be chargeable not under Schedule E but under Schedule D Case II as part of his professional receipts.[3] It will be so treated where the office is an asset of the trade or profession in question.[4]

Under the Nigerian law, it would make a lot of difference how this specie of payment is treated. The reason for this is obvious. Since "any compensation for loss of employment" is not taxable it would be unfair to aggregate any sums received as part of the receipts of a profession. The fact that the rules governing the deductibility of expenses are the same for both professional receipts

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2. S.S. 187,188 I.C.T.A (U.K) and Schedule 8 of the same enactment.
3. See Ellis v. Lucas /1967/43 T.C. 276 especially at p.288, per Ungoed-Thomas, J.
4. Whiteman and Wheatcroft op.cit., para 14-23 at page 509.

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and employment income not withstanding.[5]

(v). Pension and other Payments after Termination of Employment

Within the ambit of taxable emoluments are some payments which by their very nature the employee receives only after the termination of his employment. These include "pensions" paid in consideration of past services.[6] But pensions must be distinguished from payments which are emoluments for past services as will be the case if the payment is made a under condition of the employee's service agreement. In other words, arrears of salary or commission paid after the employment has ended are treated as remuneration in respect of the period of employment. And it would seem that payments made to an employee at, or after the termination of his employment by reason of some provision in his service agreement, even though, expressed to be in lieu of notice are equally taxable.[7]

The result will be the same where the payment falls to be made on the death of the employee to his executors.[8]

The Nigerian law specifically provides that any "pension, charge or annuity" having its source in Nigeria is liable to the

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5. The rules governing the deductibility of expenses are reviewed presently.
6. e.g. Pieris v C.O.T. Vol.1 (1936) Reports of Ceylon Tax Cases at p.62. Held inter alia that a pension is a profit from an employment, although that employment was in the past.
7. Henry v. Foster [1931] 16 T.C. 605 op.cit., See also Dale v. de Soissons . Since pensions and arrears of salary are taxable rigid classification is unimportant.
8. Note the attempt to levy tax on an executrix in Sutherland v. C.O.' Supra.

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country's tax.[9] This provision would probably be interpreted to include pensions paid voluntarily as is the case in the U.K.[10]

It is interesting to note that being an ex-colony, a substantial number of pensioners deriving income from Nigeria, are people living abroad especially in the United Kingdom. In theory, these category of persons are liable to double taxation, i.e. liability on Nigerian source income, and liability to U.K. tax on a "remittance basis" as well as by reason of their residence and domicile in that country. We examine how these potential conflicts are resolved in the chapters on double taxation.

Whereas, a "pension" is clearly taxable, a lump sum paid by an employer to his employee during the course of his employment in commutation of pension rights is not taxable in the hands of the recipient. This is because such a payment is not technically "income" so that it is neither caught by the specific nor general clauses of the charging provisions. The case of <u>Tilley v. Wales</u>[1] highlights the position admirably. In that case, a director received a single sum of £40,000 in consideration of both his acceptance of a lower salary in the future than that stipulated by his service agreement and his release of the company's obligation to pay him a pension. It was held by the House of Lords that part of the sum ascribeable to the commutation of pension rights was not taxable.

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9. S. 4(1)(e) ITMA. 1961.

10. The Nigerian law does not categorically cover voluntary pensions but the words of S.4(1)(b) ITMA as amended by S.1(2)(a)(i) of the 1966 Decree would seem to cover a voluntary pension.

1. [1943] A.C. 386; 25 T.C. 136.

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Viscount Simons, L.C., reasoned as follows:[2]

> "Neither the pension nor the sum paid to commute it constituted in my opinion, profits from the office . . . . I agree with the unanimous view of the members of the Court of Appeal that a pension is in itself a taxable subject-matter distinct from the profit of an office and if an individual agrees to exchange his right to a pension for a lump sum that sum is not taxable under Schedule E."[3]

Since the House of Lords held that part of the sum paid in consideration for the reduction of salary and forfeiture of pension rights was taxable, an apportionment to ascertain the non-taxable portion was necessary.

The importance of this decision has been overtaken by the "Golden Handshake" provisions introduced by the 1960 Finance Act.

As far as Nigeria is concerned, there is no reason why a payment in commutation of pension rights should not be taxable, especially, since pensions and gratuities are taxable. An unnecessary doctrinaire approach is unhelpful here and there is no reason for treating this specie of payment as capital receipts.

For the sake of equity and because of the progressive nature of the tax burden, a lump sum paid out in commutation of pension rights could be spread out notionally over say ten years and then taxed accordingly.

Finally, it must be established by now that the task of determining the scope of an employee's taxable emolument paid in cash or cash equivalent is not an easy one. It becomes even more complex with the question of benefits in kind and expenses. To these matters we may now turn our attention.

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2. Ibid., at page 392 (A.C) and p.147 (T.C).

3. Emphasis supplied.

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III. PROBLEMS OF COMPUTATION - VALUATION OF BENEFITS IN KIND

In a country where a substantial amount of remuneration or part of remuneration is in kind, the determination of taxable personal incomes strictly in accordance with tax principles may prove unrealistic. Under the Nigerian law, the gross taxable receipts of an individual from an office or employment, (and perhaps a profession), includes not only receipts *in cash but other benefits* in kind, convertible or inconvertible.[1]

Before analysing the statutory rules governing the valuation of benefits in kind, it is however considered necessary first, to examine another related matter already referred to above, that is, the unique Nigerian concept of an "allowance".

A. The Indigenous Concept of an "Allowance"

An "allowance" whether in cash or kind is specifically stated by the law to be a taxable receipt.[2] But in practice this is clearly not the case.

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1. On a strict construction of S.4(1)(b) as amended it appears that any benefit convertible or inconvertible is taxable. The section provides inter alia that a taxable emolument includes "any benefit or other perquisite given or granted by any person to an employee . . . etc". A benefit in kind is convertible if it is of such a nature that the recipient can turn it into money and it is inconvertible if it can only be enjoyed by the recipient. e.g. a servant's board and lodging, or an employee's free meals.

   For a general discussion of the principles of taxability of benefits in kind, see Royal Commission Report, U.K. Cmd 9474 Chapter 9.

2. S.4(1)(b) ITMA 1961 as amended by S.1(2)(a)(i) Income Tax (Amendment) Decree 1966, No. 65 of 1966,

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In Nigeria, the popular concept of an "allowance" is something given "free". The term is understood in a very general or literal sense and it is absolutely unthinkable for anybody to suggest now that it is a taxable receipt. On an enquiry into the tax treatment of "allowan es" and other perquisites in the country, a top executive of a government company put it this way:[3]

> "We are taxed on our salaries, and we live on our allowances".

However outrageous this statement may seem to a foreigner, the truth is that it is to a large extent correct. As was pointed out previously, the Federal and state governments as well as the majority of companies are constantly paying out all sorts of "allowances" to their officials which nobody has dared to suggest are taxable.

Nigerians are not alone in their misconception of the term "allowance".[4] In a recent Hong Kong case[5], for example, a policeman contended that a "hard-lying allowance" of $ 15 a day which he received during the 1967 civil disturbance was not part of his taxable emoluments. The Board of Review in rejecting the taxpayer's submissions noted, and we think rightly too, that the Revenue is not bound by the tag which the employer choses to ascribe to a payment. And that what is important is to examine what the payment really amounts to, deciding whether from the standpoint of the person who receives it, it accrues to him by virtue of his employment.

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3. The gentleman interviewed is somebody of considerable importance in the country. Another officer put his own opinion as follows: "Why pay me an allowance if it is going to be taxed"?

4. The general misconception of the term "allowance" might be due to vernacular translation.

5. [1972] H.K.L.R. p.11. Case No.13/69 decided by the Inland Revenue Board of Review. N.B. The fact that a case like this could arise in 1969 shows the fundamental nature of the misconception.

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The obvious question to ask in the given circumstances is whether the present status quo in Nigeria is the result of deliberate government policy or a Revenue concession.

In our opinion, it is neither the former nor the latter. The present gross anomaly is more likely the result of two historical accidents. We know as a fact that these schemes of generous allowances or rather thinly disguised remuneration are the product of the colonial past designed by the British for themselves at a time when it was never envisaged that the indigenous people would be in the position to enjoy them. Secondly, after independence, the people who were in a position to rectify the anomalies were precisely those who stepped into the shoes of the departing expatriates and who themselves began to enjoy these so-called "allowances".

Apart from the above, there was, and still is, a genuine lack of awareness of the provisions of the tax law or more accurately of their implications. Were it more generally known that, in actual fact, the so-called "allowances" were emoluments, the government might have been inclined to react for a number of reasons: (1) On grounds of equity, especially the need to narrow down wage differentials. At present, the scale of "tax free allowances" is in direct proportion to the employee's salary or wages, so that the greater his stipulated earnings, the larger his "tax free allowances" are likely to be. In fact, there are many instances where a taxpayer's "allowances" amount to more than double his stipulated earnings. (2) Since there is no fixed statutory upper limit as to what can be paid as an "allowance", to avoid tax is quite simple. For a moment let us assume that the intention of the law is for a citizen to be taxed on his salary while being permitted to

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live on his "allowances" as was suggested by that government official, then thousands of people would avoid tax simply by taking a cut in their salaries while accepting a corresponding increase in "allowances", (3) lastly, we believe that were the government aware of the true position, it might have exploited it as a tax incentive for the attraction of international talent, and for encouraging hundreds of qualified Nigerians overseas to return to the country. On this premise too, there would be no need to grant complete exemption from personal income tax to visiting foreign personnel.[6]

In view of the unsatisfactory state of things, it is hereby submitted that the concept of an "allowance" in the tax code is a technical one, meaning anything which is a remuneration or part remuneration. The Hong Kong cases previously cited are sufficient authority for our proposition.[7]

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6. Note the unilateral tax exemption granted under the Income Tax (Technical Assistance Personnel) (Exemption) Notice 1963. This notice amends the Third Schedule of ITMA 1961 by introducing a new section (Z), and it exempts from tax the income of personnel seconded to Nigeria as a result of a treaty or in pursuance of any other inter-governmental arrangement. The exemption extends only to emoluments under the arrangement and not to other incomes like interests, bonuses etc. - S.16(3) ITMA 1961. Furthermore, the exemption extends only to personnel seconded under governmental arrangements and not to those working for private concerns. Professor L.C.B. Gower was exempted from Nigerian tax while acting as legal adviser to the Federal Government - see Income Tax (Exemption) (Professor L.C.B. Gower) Order 1962.

7. i.e. C.I.R. v. Humphrey, supra at page 58; Board of Review decision. Case No. 13/69 [1972] H.K.L.R. p.11.

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Finally, it is also our submission that since most of the taxpayers who enjoy these so-called allowances are presently taxed under the P.A.Y.E scheme, no undue hardship will be created by bringing these allowances within the taxable emoluments of the persons concerned. What must be stressed is that the law must be enforced as it is and that the Revenue cannot remove or restrict a liability imposed by the Tax Code. The non-enforcement of the law as is the case now is inexcuseable.

If in spite of our suggestion, the government deems it necessary to make "allowances" non-taxable either on a general or selective basis, then the necessary amendment to the law must be made.

B. Valuation of Benefits in Kind to Employees

For tax purposes the general rules governing the valuation of benefits in Nigeria are set out in Schedule 1 of the Income Tax (Amendment) Decree 1966. These arbitrary rules are quite straightforward and some of them do not create any difficulty at all. They are in no way unique and can be referred to and applied as stated. The most important of these rules are those relating to the valuation of cars and accommodation provided by the employer. Whilst a detailed enunciation or extensive discussion of all the rules is thought unnecessary, we nevertheless consider it apt to make a few comments.

To start with, it is interesting to note that prior to 1966 benefits in kind were not taxable at all. The law at that time was unambiguous on this point. The Act provided inter alia that "tax shall be . . . payable for each year of assessment . . . in respect of:

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(a) . . . .

(b) any salary, wages, fees, allowances or other gains or profits from an employment which are paid or payable in money by the employer to the employee etc."[8]

Whether the omission to tax benefits in kind was deliberate or accidental in unclear. However, viewed objectively, it is quite accurate to state that the 1966 law has not been successful in changing the status quo. Statistics are lacking for any positive proof either way, but all indications are that the Revenue has been unable or unwilling to enforce the law as regards the quantification of benefits, and their aggregation to taxable incomes.

Secondly, what is striking about the valuation rules is that there is no distinction as in the U.K. between highly paid employees and directors on one hand, and ordinary employees on the other.[9] Such a distinction is considered necessary on equitable grounds in view of the enormous disparities in incomes between the working class and the top executive in government or industry. In our opinion, it would be most unfair if the economic rent of a room supplied free to a housekeeper were computed as part of his taxable income. Furthermore, the Nigerian rules are unsatisfactory in that they fail to recognise that sometimes the employer may require the employee to occupy accommodation for the more efficient performance of his duties.[10]

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8. S.4(1)(b) ITMA as it was originally between 1961 to 1966.

9. S.185 ICTA [1970] U.K; Also S.S.195, 196.

10. See Tennant v. Smith [1892] A.C. 130; 3 T.C. 158 decided under the old Sch.A. This exception follows from the fact that in such circumstances the employee is not an "occupier" in his own right, but merely a person residing in a premises on his employer's behalf.

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A recent incident which helps to put the whole question in perspective is the strike by University lecturers in Nigeria over what they termed "fringe benefits"[1]. These were vague demands to payments to which they were not entitled under their contracts of employment. While the extra payments were being fought for, it is significant to recall that few people realised that in effect the lecturers were seeking additional remuneration which were taxable. The fact that they were euphemistically described as "fringe benefits" notwithstanding.

The authorities rejected the lecturers' claims which in any case were considered frivolous by many objective observers: That is, bearing in mind that the kind of taxpayers involved in the dispute already enjoy a tax free "leave bonus", a monthly "car basic allowance", a "children's allowance", and in addition live in semi-furnished accommodation on which they paid little or no rent.

The lecturers are not alone in this, for as stated previously, senior civil servants and company officials also live in houses on which they paid sub-economic rent.

Before going on to examine the valuation rules in detail, it must be pointed out that some specified categories of benefits in kind are not regarded as additional remuneration and are, therefore, exempt from tax. These include free meals in staff canteen, free protective clothing, uniforms or overalls, reasonable removal expenses which may

1. Sunday Times (Nigeria) April 22nd 1973. An ultimatum was given to the lecturers by the Federal Government! "Return to work or quit".

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or may not include a subsistence allowance.[2] Where expenses have been incurred partly in connection with the aforesaid matters there is room for apportionment.[3]

(i) Valuation of Living Accommodation

The law provides that the difference between the rent paid and the "annual value" of living accommodation shall be treated as part of the taxable emoluments of the occupier by reason of his or his wife's holding an office or employment.[4]

The "annual value" for tax purposes is taken to be the "annual value" as fixed for the purposes of local rates by local authorities.[5] Alternatively, the "annual value" of premises may be determined by the relevant state tax authority.[6] Where premises are occupied for only a part of the year, the law permits an apportionment based on a proper proportion of the annual value: (a) in relation to a period of occupation within the year; (b) in relation to the part of premises where this is the case; or (c) in relation to both a period of occupation within a year and the part of the premises occupied.[7]

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2. S.4A(3)(a-c) ITMA as amended by Decree No. 65 of 1966.

3. Ibid., S.4A(4). Note that any reference to something provided for an employee is construed as including anything provided for his spouse, family, servant, dependant or guest. S.4A(5).

4. Ibid., S.4B(1)(a), (b).

5. Ibid., S.4B(2)(a).

6. Ibid., S.4B(2)(b) as amended by Decree No. 65 of 1966.

7. Ibid., S.4B(2)(b)(i)-(ii) as amended by Decree No. 65 of 1966. It may be noted that the provisions outlined above apply to an occupier being a woman as it applies to an occupier being a man with the substitution of "her husband" for "his wife" in the appropriate places. S.4B(3).

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Except, perhaps, for Lagos where some half-hearted attempt is made, the state Revenue authorities hardly enforce the provisions of the law. One explanation for this is that for the greater part of the Federation of Nigeria local rates are not payable; local authorities, therefore, have no cause to fix the "annual value" of dwelling houses.

In any case, in Nigeria, the suitability of the "annual value" as a yardstick for determining the quantum of the taxpayer's additional benefit is very doubtful. Often, the evidence show that there is no correlation between the annual value and the true rental value of premises – the latter usually being much greater than the former.[8] Secondly, the use of the "annual value" in these circumstances presumes the existence of a much higher degree of administrative efficiency than there really is, and that as between the local authorities and the State Revenue bodies there is much co-operation. But this is not the case.

What is required is a system which is simple, efficient and equitable. It is thought that the present position would be greatly improved were the law to be amended as follows: (a) Where an employee has a salary of less that £300 per annum, the additional benefit enjoyed by him by reason of his use of rent free accommodation should be deemed to be nil. (b) in any other case, the employee's benefit should be deemed to be 10% of his fixed annual salary if the premises

8. The problem is not peculiar to Nigeria. For example, in the Ceylon case of Mallows v. C.I.R. /1964/ 66 N.L.R. 321, the Commissioner of Inland Revenue expressed serious reservations about the "annual value" of premises being well below its rental value. See a review of the case by L. Lazar (1966) A.S.C.L. 526.

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he occupies is semi-furnished. In other words, his annual salary is to be grossed up by ten per cent. Where the accommodation is fully-furnished the grossing up should be by fiften per cent. In this circumstance, any rent paid to the employer on account of such accommodation should be deducted from the amount of the proposed percentage increases before grossing up.[9]

Apart from the pragmatic nature of the suggestions above, inherent in them too is a basic equity. This is because of the direct relationship which usually exists between the status of the employee and his salary on one hand and the size and quality of accommodation that he is likely to get on the other. Furthermore, the percentage figures for grossing up can be very readily adjusted so as to keep them in line with the constantly fluctuating rental values of property.

Administratively, the scheme is attractive too. For not only can the taxpayers concerned be identified easily, no additional strain is put on the Revenue because invariably the persons concerned are already taxable under the P.A.Y.E system.[10] What the employer has

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9. The suggestions here are very much in line with what obtains in Ghana and Hong Kong presently. See S.20(1) Income Tax Decree (1966) N.L.C.D 78 also second Schedule Table B, Ghana. And S.9(2) Income Tax Ord. Cap.112 1964 Revised Laws of Hong Kong.

   The employee may also be permitted to deduct his "outgoings and expenses" in respect of the premises if borne by him.

   Where there is any doubt as to whether any premises is fully or partly furnished, such doubt can be resolved by the Commissioner and his decision thereon should be final.

10. e.g. Lagos State. Personal Income Tax (Lagos) (Employment) Regulations L.N. 38 of 1965; Eastern Nigeria States: Income Tax (Deduction at Source) Rules E.N.L.N. 122 of 1962); Western and Midwestern States: Income Tax Emoluments Rules W.N.L.N. 350 of 1961; Northern States: Personal Tax Law (Employments) Regulations N.N.L.N. 73 of 1964 as amended by Personal Tax Law (Employments) (Amendments) Regulations N.N.L.N. 28 of 1965.

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to do is to alter the basis of computing an employee's tax liability following our proposals.

But as should be pointed out, even with the adoption of the method of valuation advocated, some difficulty could still arise. e.g. on matters of interpretation where an employee occupies a rent free accommodation only for a limited period within the year. To illustrate the point, we refer to the recent decision of the Inland Revenue Board of Review in Hong Kong viz, Case No. 25/69.[1]

The main issue on appeal was the amount of rental value to be added to the taxpayer's salary to constitute his income chargeable to tax. Although he was charged on the proportion of his salary for the periods he was resident in Hong Kong and not for the periods he was away from the Colony; the rental value had been assessed under S.9(2) for each of the whole three years of assessment.

The taxpayer appealed on the ground that the "rental value" had been calculated on an amount which included income for services rendered outside Hong Kong which income was not chargeable to salaries taxed under S.8 of the Income Tax Ordinance.[2]

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1. [1972] H.K. L.R. p.13.
2. "S.9(2) The rental value of any place of residence provided by the employer shall be deemed to be seven and one half per cent of the income as described in paragraph (a) of sub-section 9(1) derived from the employer for the period during which a place of residence is provided after deducting the outgoings and expenses etc.".

   According to S.9(1) Income from any office or employment, includes (a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite or allowance whether derived from the employee or others etc.

   The relevant proviso to S.8 which is the charging clause excludes income for services rendered outside the Colony.

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The crux of the matter was whether or not the rental value was to be determined as a percentage of the taxpayer's fixed annual income wherever derived, or whether as a percentage of the taxpayer's "chargeable income".

The majority of the Board of Review decided against the taxpayer. But it is believed that their decision was wrong. This writer agrees with the dissenting opinions of Messrs Albert Kwok and Lam Tat Sam that for the purposes of determining the quantum of the taxpayer's benefit from the use of rent-free accommodation, the word "income" in S.9(2) means "chargeable income" ; so that the rental value of the premises for each of the three years of assessment should be computed at 7½% of the 'chargeable income".[3]

In spite of the above decision, in the majority of cases our formula if adopted would prove to be quite efficient and equitable without being too difficult to administer.

(ii). Valuation of Cars

Unlike the U.K., where the valuation rules are much more sophisticated, the Nigerian law attempts to fix the measure of benefit derived by the taxpayer from the use of a free car (or indeed any other asset) as a percentage of the expense incurred by the employer in providing it. Thus, where an asset which continues to belong to the employer is wholly or partly used by an employee, the benefit derived by him is deemed to be 5% of the purchase price of the asset;[4] but where this cannot be ascertained, then the quantum of benefit is deemed to be 5% of its "market value" at the time of acquisition as may be determined by the Revenue.[5]

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3. House of Lords decision of Mapp v. Oram [1969] 3 W.L.R. cited and followed.
4. S. 4A(1)(a) ITMA 1961 as amended by Decree No.65 of 1966.
5. Ibid., S.4A(1)(b).

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On the other hand, where any sum by way of rent or hire is payable by the employer in respect of any asset made available to an employee, he shall be deemed to incur an annual expense equal to the annual amount of the rent or hire expended on the asset. The employee's benefit under the arrangement and hence his additional remuneration is taken to be the measure of expenses incurred by the employer.[6]

But the taxpayer's additional remuneration is to be reduced by so much (if any) of the said expenses as is made good by him to the employer.[7]

Admittedly, not as complicated as the U.K rules for the same subject-matter, yet, we think that the Nigerian valuation rules are too cumbersome. For example, how can the true purchase price of an asset be determined in a country where goods and money often change hands without documentation?[8] The law seems to have been drafted on the rather fallacious assumption that brand new assets will always be provided in which case it will be fairly easy to determine the purchase price. But this is not so. Companies frequently provide their employees with used or second hand cars, and surely nobody

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6. Ibid., S. 4A(1)(c).
7. Ibid., S.4A(2).
8. Except in the major urban areas, goods are often bought without the purchaser asking for a receipt; and in any case the vendor may not be able to supply any because he is illiterate. Furthermore, it may even be considered rude to ask for a receipt. The point we are making is important because the provisions apply not only to large items like cars but to other assets provided by the employer.

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will contend that the measure of benefit derived from the use of a second hand car by an employee, Mr. X., three years after purchase is the same as that derived from the use of the same car by Mr. Y when new.[9] In short, the purchase price as a reference point in the valuation of benefits in kind is unsatisfactory.

Equally questionable as a reference point is the use of the market value at the time of acquisition. We know as a fact that the ascertainment of the market value of an asset as it stood at the time of acquisition cannot be simple. It is, perhaps, impossible unless very accurate statistics have been kept for a number of years monitoring the price movements of a whole range of commodities.

Noting that the Nigerian Revenue has had a very undistinguished record in the field of income tax administration, what is required is a rough and ready formula for the valuation of benefits derived from the use of a car or, indeed, of any other asset.

The Ghanian approach is very straightforward. Where an employee is given the use for his private purposes of a motor vehicle, his chargeable income is increased by 432 <u>Cedis per annum.</u>[10] Where fuel is supplied and a chauffeur provided his chargeable income is increased by 720 <u>Cedis</u> per annum.[1] Quite simple!

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9. The crux of the matter is that the purchase price of the car remains a constant in our equation.

10. S.1 of Table A, Second Schedule - Income Tax Decree 1966; Ghana as an extension of S.20(1) N.L.C.D. 78 of 1966.

1. *Ibid.*, S.2 Table A.

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While thinking along the above lines the Nigerian provisions need not be so rudimentary. Some unsatisfactory features of the Ghana lan can be improved. Firstly, the apparent assumption under that law that all cars are the same. In reality, cars differ so very much in size, quality and price that the tax law cannot ignore this. For the sake of convenience, cars should be classified into, say three categories, i.e. standard, executive and luxury using such indicia like price, engine power and size. Then, adopting the Ghana formulae, some predetermined amounts on a progressive scale can be automatically added to the chargeable income of a taxpayer in Nigeria who is given the use of a car depending on the class of car, and whether or not fuel is supplied and a chauffeur provided.

In order to mitigate any hardship and recognising the depreciating nature of all assets, the useful life of a car could be fixed at a maximum of 10 years. The taxpayers additional remuneration for the use of the car could be reduced yearly by substracting a tenth of the standard figure for a new car. The net result is that an employee who is given the use of a car which is ten or more years old is deemed to derive a nil benefit from it.[2]

It is thought that the proposals set out above would be much easier to administer than the present Nigerian rules.

At this juncture it might be necessary to stress that any method, formula or technique of valuation to be adopted must be based on

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2. Our suggestion is analogous to the straightline method of writing down the value of an asset under the "Capital Allowances" system.

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compromise and not dogma. The futility of any legal reasoning in the valuation of money's worth as regards cars etc., is demonstrated by the case of Heaton v. Bell.[3] Briefly, the facts were as follows: The taxpayer participated in a car loan scheme and the employer subs̸tracted a sum whose amount depended on the type of car on loan. The taxpayer was assessed to income tax on his gross wages without subs̸tracting the loan amount for the car.

The taxpayer's contention regarding the nature of this transaction was that it involved him accepting a wage calculated at the amount which remained after the car loan amount was subs̸tracted (about £2.10s per week). The taxpayer argued that there was no benefit to him from the transaction, or alternatively if the loan of the car was a benefit, it could not be converted into money or money's worth. On the contrary, the Revenue contended that the car loan transaction was separate from that relating to the taxpayer's wages. Therefore, the amount substracted was a deduction from the taxpayer's wages and the loan of the car was a benefit, a perquisite which could be converted into money or money's worth by the taxpayer giving 14 days' notice to terminate the loan.

At first instance, Ungoed-Thomas, J.,[4] was sure that the taxpayer did enjoy a perquisite but the Court of Appeal reversed his decision because it found it impossible to arrive at a basis for

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3. [1968] T.R. 147 (C.A.) U.K. Reversed by H.L. [1969]2 W.L.R. 715. For a review of the case see L. Lazar (1968) A.S.C.L. 608 et seq.

4. [1967] T.R. 199. This was in the Chancery Division.

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the evaluation of what was money's worth (if any) of the car which was loaned to the employee. In the opinion of the Court, the measure of benefit was clearly not the weekly amount which the taxpayer was charged as was suggested by the trial judge. Following the principle established in Abbot v, Philbin[5] that to be taxable, money's worth had to be capable of conversion into a monetary equivalent, it was decided that the taxpayer was not taxable.

In all circumstances similar to Heaton v, Bell the provision of a rough and ready formula by the taxing legislation will be most appropriate.

Turning once more specifically to Nigeria, it can be observed that whereas a substantial number of persons enjoy the use of vehicles provided by the employer, a greater number of taxpayers in the country are granted loans or "car advances" to use the more popular expression. Below, we examine the legal position generally of loans to employees.

(iii). Loans to Employees

The question to be considered here is whether or not an interest free loan or a loan at a rate below the market value made by an employer to an individual is a taxable benefit within the law, and if so, the basis on which the charge on the employee is to be calculated.

It has been suggested and this writer agrees,[6] that such a loan must be a "benefit" in the ordinary meaning of that word. But

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5. [1961] A.C. 352; 39 T. Car 124.

6. Whiteman and Wheatcroft op.cit., p.523 para.14-41.

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that notwithstanding, it would seem that where an employer makes a loan available to an employee out of his available funds there may be no liability for the employer has not incurred an expenses in connection with the provision of the benefit.

On the contrary, as will more generally be the case, where the employer has borrowed money at interest to make the loan, S.4A of Schedule I of the Income Tax (Amendment) Decree 1966 seems applicable as the employer will have incurred an "expense" to provide a benefit.[7] In such circumstances, the measure of the charge to tax on the employee will be the interest payable by the employer.[8]

Like the U.K., it would appear that the Nigerian Revenue does not seek to apply the provisions of the law rigorously. On balance, this may have a salutary effect. Be that as it may, what is important is to recognise the true legal position. In short, that thousands of citizens may be receiving a taxable benefit whenever they are granted loans to buy personal cars, build houses or do other things.

(iv). Share Options

Directors and employees of limited liability companies frequently receive certain value rights in connection with the share capital which have been held by the English courts to constitute a perquisite of office, upon the value of which income tax is payable as remuneration arising from an office or employment. The perquisite may be the shares themselves, or such right to have the shares vested in him as the company grants to the director or employee.[9]

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7. The whole question of expenses is considered subsequently.
8. S.4A(1)(c) ITMA as amended by Decree No.65 of 1966.
9. L. Lazar (1969) A.S.C.L. at p.243 quoting from Simon's Income Tax.

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Until recently, tax liability under English law was governed in this regard by the decision in Abbot v. Philbin,[10] which makes the stock or share option scheme an effective means of conferring tax-free benefits on directors and employees. The effect of the decision was to value the benefit received on the basis of the value of the option right at the date of granting and not on the exercise of the option. Generally, the difficulty of giving the option more than a nominal value at its granting results in a small tax liability. This is apart from any question of capital gains tax liability which might arise on the transfer of the shares or the assignment of the option rights.

The whole position was altered in the U.K. by the Finance Act 1966, S.25 under which the taxable benefit received by the tax-payer is taken to be the difference between the price of the shares at the time the option was granted, and its market value at the time the gain is realised either by the exercise, assignment or release of the option. In other words, tax is not charged at the time the option is granted but when exercised.

No doubt, much of the uncertainty have been eliminated, but owing to the continuous fluctuation in the value of shares it may yet be difficult in practice to determine at what precise moment in time a share option was exercised. The New Zealand case of I.R.C. v. Parson[1] is instructive here. In that case, a director received a

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10. (1961) A.C. 352.

1. [1968] 10 A.I.T.R. 557 (N.Z.C.A.). Case reviewed by L. Lazar (1967) A.S.C.L. at p.540; and in (1968) A.S.C.L. at p.244.

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circular letter from the employer company, Woolworths (N.Z.), making a formal offer to him to take up certain shares under a scheme to benefit employees. He decided to accept the offer and so completed and returned the necessary forms. Subsequently, he applied to the company for a loan to enable him to apply for an allotment of the shares in question, and he authorised the repayment of the loan by deductions from his salary, without interest, over a period of 5 years. In addition, he furnished the company with a blank transfer to be held as security for the advance. The question whether the taxpayer obtained the taxable benefit inherent in the shares at the time of his acceptance of the company's offer (as he contended) or on the date of allotment(as the Commissioner contended) was resolved in favour of the former view. The court held that the contractual rights out of which the taxpayer's benefit arose vested in him when he accepted the company's offer.

Relating the above principles to Nigeria, we find that there is yet no provision in the Tax Code similar to the U.K. law. The 1966 Income Tax (Amendment) Decree fails to deal with the matter, and the Capital Gains Tax Decree 1967 as amended,[2] only makes the profit of a transfer of shares and stock taxable. Nothing is said about share options.

However, with the increasing volume of activity on the Lagos Stock Exchange and the tremendous growth of joint stock enterprises, S.O. Fashokun has suggested that a formula must be found in Nigeria for the valuation of share options.[3] But for a number of reasons

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2. By S.2 of the Finance (Miscellaneous Taxation Provisions) Decree 1972.

3. Thesis, op.cit., (1971) at pp.441, 444.

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this writer remains sceptical about his proposal. Firstly, companies will always find ways round any legislation against share option schemes as experience in the U.K. has shown after 1966.[4] Secondly, it must be acknowledged that there is a genuine incentive value in these schemes. Company executives are inclined to work hard because they know that over a long period of time the market value of a company's share and consequently of their options, depends on its growth and profitability. Right now, there is every indication that the harshness of the U.K. law will be mitigated.[5] Thirdly, the share option scheme as a means of granting an additional benefit to an employee is not inflationary because no immediate "spendable" benefit is conferred on him. Lastly, it is believed that the Nigerian Revenue lacks the necessary expertise to make any alteration of the law along the lines of S.25 of the U.K. Finance Act 1966 effective.

C. Valuation of Benefits in Kind to Professionals

As has been indicated previously, not only employees or office holders are in receipt of benefits in kind. In Nigeria, a lot of professionals receive similar bounties. But following the pattern in

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4. Lindsay Duncan discusses some of the very ingenious schemes in his article "Share Options for Executives", The Times U.K. August, 25th 1971. These methods include loans made to executives through a body of trustees; the partially paid schemes whereby shares are sold to executives for a small deposit; the performance related schemes and schemes which employ debentures convertible into ordinary shares after a given period of years.

5. J.F. Avery Jones: "Share Incentive Schemes" (1972) BTR 277. This author discusses the proposals contained in the 1972 Finance Act as regards accepting some share option schemes.

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many other countries, there are no rules in the country's law for the valuation of benefits in kind enjoyed by professionals or taxpayers pursuing a vocation

With the indigenous custom of bestowing gifts on the above mentioned category of persons and the substantial nature of these gifts, it is our view that the law must regard such benefits in kind as part of the "gains or profits from . . . any profession vocation".[6] While we admit that the implementation of our proposal may be difficult the true legal position must be well understood and whenever possible the present formulae for the valuation of benefits in kind as regards an employee's income should be made equally applicable so as to bring similar benefits within the scope of a professional or vocational receipt.

IV. PROBLEMS OF COMPUTATION - EXPENSES

As regards expenses, two situations must be clearly distinguished. Firstly, where the employer discharges some personal obligation of the taxpayer as an indirect way of granting him additional remuneration; e.g. paying for the education of his children, paying for his holiday, etc.[7] And secondly, where the taxpayer in computing his taxable income has to deduct some expenses. The legal principles concerning the former category of expenses have been discussed in Section III above. The discussion here centres on the latter category of expenses.

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6. S.4(1)(a) ITMA 1961.
7. See S.4A ITMA as amended by Decree No.65 of 1966.

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A. The Tax Problem

Few kinds of income are fairly represented by the gross receipt from the source concerned: most come into existence only as a balance between the gross receipt and the expense involved in obtaining it. This is why the rules that determine what expenses are to be allowed against receipts for this purpose are of fundamental importance in any tax system, both absolutely in that they affect the yield or revenue and the economic well being of the country, and relatively, in that equity requires that taxpayers with comparable kinds of income should have comparable treatment with regard to allowance for expenses.[8]

In Nigeria, the same rules govern the deductibility of expenses as regards all kinds of "personal income". That is, income whether from a profession or vocation, or from an employment or office. This is in sharp contrast with the experience elsewhere, whete the rules differ for professional income on one hand and the income from an office or employment on the other.[9]

On deductibility of expenses, the Nigerian Income Tax Management Act 1961 as amended, states inter alia that:

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8. Cmnd. 9474. para. 118, p.40.

9. Noteably, the UK where the rules for Cases I and II of Schedule D (income from trade, profession or vocation) differ from those of Schedule E (income from employments and offices).

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> "For the purposes of ascertaining the income or loss of any individual[10] for any period from any source chargeable with . . . there shall be deducted all outgoings and expenses or any part thereof, wholly exclusively and necessarily[1] incurred during that period and ultimately borne by that individual in the production of income . . .".[2]

This statement of general principle is supplemented by a statutory list of expenses which are categorically allowed[3] and a correspondingly list of expenses which are specifically disallowed.[4] Perhaps, in order to facilitate checking, only "expenses incurred within the territory of Nigeria" is ever allowable. So that any expenses incurred on any income "remitted" into the country are not deductible.[5]

Reimbursements of genuine expenses incurred by the employee in the performance of his duties are allowable. Where such payments exceed the "expenses" actually incurred, the excess payment is taxable in the hands of the recipient, assuming that apportionment is possible.[6]

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10. Emphasis supplied.
1. Emphasis supplied.
2. S.17(1)ITMA 1961 as amended by S.5(2)(a) of the(1966) Income Tax (Amendment) Decree 1966. For a critical analysis of the "expenses" rule in the U.K, see L. Lazar, "Nearly Nothing at All" (1970) B.T.R., p.5. In this article, the author puts forward a strong case for the reform of the rule for deduction of expenditure under Schedule E.
3. These are listed in S.17(1)(a-h) ITMA 1961 and include interest payment on borrowed capital, expenses for repair of premises or plant, bad debts, pension contributions etc.
4. Set out in S.18 ITMA 1961. The deductions not allowed include do domestic and private expenses, expenditure of a capital nature, taxes on income levied in Nigeria or elsewhere except under the double taxation arrangements, depreciation of any asset etc. N.B. We must also note the deductions and Add backs under the Capital Allowances Sched. in computing the income of traders, professionals and that losses suffered in the exercise or practice of a profession or vocation are allowable deductions. See esp. S.21 ITMA, and the 5th Sched. of the same Act.
5. S.17(a) ITMA 1961. The kind of hardship which may be caused are highlighted in our Chapter dealing with Interest and Royalty payments.
6. S.4(1)(b)(1) ITMA 1961.

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The great area of difficulty is the determination of what specie of expenses are "wholly, exclusively and necessarily" incurred in the production of employment or professional income.

To our dismay, the Nigerian courts have never been called upon to pronounce on the possible meaning of the above expression, which undoubtedly is of fundamental importance and is one of the most difficult to apply in the field of taxation. One suspects that the true significance of these words has not been appreciated by the Revenue. Without any decided cases or other published data, no useful assessment can be made as to whether or not (1) the rules are too wide or too narrow, (2) as to any justification or otherwise of applying the same deductibility rules to both professional and employment income.

If the rules are too narrow or strict, why have the taxpayers acquiesced so much and have failed to seek judicial remedies? On the other hand, if the present rules are too wide, why has the Revenue not sought a tougher line? Or, are we to believe that all ambiguities and doubts as regards interpretation and application can be and are being effectively sorted out by administrative remedies or with the help of the Appeal Commissioners? This writer remains deeply sceptical and slightly uneasy at the thought that something quite serious is amiss.

When eventually the Nigerian courts are called upon to determine the true meaning of the expression "outgoings and expenses . . . wholly, exclusively and necessarily incurred" , to what extent would

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it be right to rely on Commonwealth authorities for guidance? This is important because English courts have adopted a rather inflexible and unrealistic interpretation of the law.[7] Secondly, and more important still, is the necessary attention that must be paid to differences, albeit subtle, in the wording of various legislations.

Although we hold the view that as occasion arises the Nigerian courts must interpret the law in accordance with local norms and national economic objectives, yet, for the purposes of highlighting the pitfalls and complexities of this area of tax law, it is considered necessary to examine in some detail such learning as is available elsewhere on the aforesaid matters.

The rules that govern the deductibility of expenses in Commonwealth countries are remarkably similar irrespective of the slight differences in the terminologies employed.[8] Like Nigeria, it is quite interesting to observe the absence of tax cases in the majority of these countries. Whereas hundreds of cases relating to the interpretation of the "expense rules" have been decided in the U.K., Canada and South Africa, not a single reported decision appears in the Law Reports of Ghana, Sierra Leone, The Gambia, the West Indian Islands and the countries of East Africa. As for Ceylon and Hong Kong, this writer was only able to find about two or three reported cases on the subject.

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7. The U.K. rules have been strongly criticised by various experts. L. Lazar (1968) ASCL p.611 describes the principles "as notoriously difficult to apply, inequitable and restrictive", and S.M. Cretney (1971) ASCL pp.289-291. For a long line of cases where the harshness of the Schedule E rule has been discussed see Royal Commission Report Cmd. 9474, paras. 129, 130, 131 at p.44.

8. This is understandable in view of their common origin.

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In the prevailing circumstances, it would appear, although this is only a speculation, that a lot of Commonwealth countries especially the developing ones, have an insufficient understanding of their tax statutes or else an inherent inability to apply their laws. Otherwise, how can the sharp contrast be explained between developed countries where tax cases seem to crop up, and the developing countries where there are no such cases? We are assuming, of course, that human conduct everywhere is basically the same.

From the discussion below the futility and unreasonableness of some of the provisions in the laws of the new Commonwealth countries which have been modelled after the British become very obvious.

B. Expenses "Wholly and Exclusively" Incurred: Duality of Purpose?

The above expression which governs the deductibility of expenses as regards a trade, profession or vocation in the U.K., has been interpreted to the effect that where a taxpayer makes an expense, it must not be for more than one purpose. In other words, unless he applies monies exclusively to a purpose specified in the tax provisions, he loses the exemption or the deduction he might otherwise claim in respect of such application. The inflexibility of the "wholly and exclusively" provisions is well established.[9]

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9. See L. Lazar (1967) ASCL at p.534. Note also that the usual exemption for charities precludes the application of any part of the relevant income to any purpose other than "charitable": e.g. as was held in IRC v. Educational Grants Association [1967] 2 All E.R. 893 (C.A.) where the application of monies for the benefit of employee's children was held not to be for the benefit of the public as a whole and hence not charitable.

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In Murgatroyd v. Evans Jackson,[10] the obvious and for the taxpayer unhappy proposition that "partly" does not mean "wholly and exclusively", is very well demonstrated.[1] The relevant facts were as follows: The taxpayer sustained an accident which resulted in his going into hospital. He declined a bed under the National Health Scheme and took a private room in a nursing home which enabled him to carry on his profession as a trademark agent during his sojurn there. His claim for 60 per cent of the hospital bill[2] was held by Plowman, J., to be fatal to a contention that the money was "wholly and exclusively" laid out for the purposes of the profession, being a tacit admission that it was not.

The Royal Commission was aware that the expression "wholly and exclusively" does not contemplate the possibility of an apportionment of an expenditure which is attributable partly to the objects of a trade, profession or vocation, and partly to other objects. Yet, in their Report they were reluctant to recommend a change in the status quo because according to them all available evidence show "that the rule is regularly interpreted as if it did allow such apportionment wherever it was possible to dissect a block of expenditure according to its objects".[3]

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10. [1967] 1 All E.R. 881 (Ch.D. UK); [1967] B.T.R. 151.

1. The Income Tax Act (1952) UK, S.137(a) disallows the deduction of "any disbursements or expenses not being money wholly and exclusively laid out, or expended, for the purposes of the trade, profession or vocation".

2. The Crown conceded a sum of £15 for the use of the telephone.

3. Cmd. 9474 p.42, para. 123.

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In our opinion, the post-1955 experience has not justified the optimism of the Royal Commission. Clearly, the case of Murgatroyd v. Evans Jackson was one in which an apportionment should have been allowed on some sort of a rough and ready basis. The taxpayer's action in that case was by all accounts reasonable. By the use of his private room, he was able to keep his practice going and earn money, while at the same time preserving the capital asset of good will.

Even though a somewhat similar terminology is employed in both the Nigerian and U.K. tax laws, and despite the suggestions of some writers,[4] it is our submission that as regards the deductibility of expenses, the two laws differ in a number of material respects. For example, whereas apportionment was never contemplated in the U.K., it is specifically provided for under the Nigerian law.

In the words of the statute, there shall be deducted:

> "all outgoings and expenses or any part thereof,[5] wholly and exclusively . . . incurred . . . in the production of income".[6]

The fact that a duality of purpose is permitted is highly significant because this seems to be the exception rather than the rule.[7] The taxpayer's right here is not based on the discretion of the Revenue and is unquestionable. What may be questionable, however, is the precise formula for apportionment because as a practical

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4. S.O. Fashokun for example, gives the impression that the effect of the U.K. and Nigeria is the same.
5. Emphasis supplied.
6. S.17(1) ITMA as amended by S.5(2)(a) of the (1966) Income Tax (Amendment) Decree 1966. No.65 of 1966.
7. In the majority of Commonwealth countries the wording is nearer the U.K. version, e.g. see S.8 Income Tax Decree 1966. Ghana - NLCD 78.

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matter it may not be easy to dissect an item of expenditure into different parts and to attach a value to each part. Furthermore, there is the problem of inquiring into taxpayers' motives, an exercise which is manifestly difficult.

In spite of the potential problems, the basic Nigerian position must be understood, and no attempt should be made to follow the unfortunate example of the United Kingdom in this regard.

So far, so good.

Recalling what has been said previously,[8] that the same rules govern the deductibility of expenses under the Nigerian law, that is, as regards all kinds of income whether relating to a profession, vocation, employment, office or trade, no objective appraisal of these rules can be made without looking at the significance of the "necessarily" incurred test.

C. Expenses "Necessarily" Incurred

In the U.K. this condition effectively means that it must be impossible to hold the taxpayer's office or employment without incurring the expenditure claimed to be deductible. And the long line of authorities establish that in incurring the expenditure there must be nothing optional on the part of the taxpayer.[9]

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8. Supra, at p.

9. See Lord Blanesbury in Ricketts v. Colquhoun stressing the objective character of the rules when he said that "deductible expenses do not extend to those which the holder has to incur mainly . . . because of circumstances in relation to his office which are personal to himself or as a result of his own volition" (1926) A.C. p.1 at pp.7-8. The objective character of the rules were also stressed in Eagles v. Levy [1934] 19 T.C.23 where it was held that the costs of an action brought by the taxpayer to recover his pay were not deductible on the grounds that the need for the action was personal to that particular taxpayer.

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The severity of this rule has been acknowledged in a number of cases,[10] but that notwithstanding, the courts and the Revenue in the U.K. have been unrelenting in their ruthless application of the law. However, if the statement of Lord Wilberforce in Pook v. Owen[1] is anything to go by, a new judicial approach to the "necessarily obliged" part of the expenditure test may be in the offing. His Lordship while acknowledging that the test is drafted in an objective form, so as to distinguish between expenses which arise from the nature of the office and those which arise from the personal choice of the taxpayer, was of the view that this does not mean that no expenditure can ever be deductible unless those expenses are precisely those which must necessarily be incurred by each and every holder of a particular office.[2]

With that brief outline of the U.K. law, our task here is to determine the following matters. The appropriateness or otherwise of the "necessarily obliged" part of the expenditure test under the Nigerian law; in the computation of the income of an office or employment on one hand, and the income from a profession, vocation or trade on the other.

(i). Employment or Office Income

In deciding whether or not an expense has been incurred necessarily, the Nigerian Revenue must not ignore social realities.

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10. Cmd. 9474 p.44, paras. 129,130,131 and the cases cited therein.

1. [1969] 45 T.C. 571.

2. Ibid., at pp.595-7.

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It must be remembered that there are numerous posts in the country, the incumbents of which according to tradition and custom are obliged to spend a part of their remuneration on hospitality. These include Obas[3] and Emirs[4] who have to spend lavishly on entertainment, travel and protocol as well as in maintaining their aura of authority and respectability.

There is no need to be strictly legalistic here and to follow English precedents. To hold that the above kind expenditure are not allowable because the taxpayer could do without incurring them and yet discharge the duties of his office is unacceptable.

Although, as we must admit, there may be abuses as taxpayers submit grossly excessive claims, nevertheless, this does not detract from our basic submission since the objective character of the expenditure test relates to their nature and not their amount.

Apart from the liberal application of the law as advocated above, there is probably a justification for tightening up things in several other directions. A number of instances may be highlighted.

In Nigeria, the usual practice is for companies to sponsor their executives to become members of purely social and rather elitist clubs. The excuse given is that this has to be done in order to establish "business contacts". Sometimes no excuse is given at all and it is stated quite blatantly that a "fringe benefit" is being conferred on the employee.

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3. Local Indigenous Rulers. Royal person (Southern Nigeria).

4. Local Indigenous Rulers. Royal person (Northern Nigeria).

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Without bothering to inquire into motives the legal position may be restated as follows: Where an employee enjoys a perquisite or benefit by reason of his employment, it is taxable as an additional remuneration and the measure of the benefit is taken to be the amount incurred by the employer in providing the benefit.[5] In case of club membership , it would probably be the amount of the annual subscription, which in Lagos can be as much as £500.

Our contention is that not only is the amount of the subscription taxable in the hands of the recipient, it is also not an allowable deduction from the payer's standpoint, because not being an expenditure incurred "wholly and exclusively" nor "necessarily" in the production of income. Where the employee himself pays the club subscription out of his remuneration it is equally not an allowable deduction unless it is proved that this was an expense "necessarily" incurred for the discharge of the taxpayer's duties, and that it was a kind of expenditure which every holder of his office or employment was required to meet. That is assuming, of course, that the taxpayer satisfies the first arm of the rule having proved that the expenditure was "wholly and exclusively" incurred for the purpose specified.

The U.K. cases support our argument.

Thus, in Brown v. Bullock[6] where a bank manager became a member of a West End club, something which was virtually a condition of his employment, the Court of Appeal held that no deduction was

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5. S.4A ITMA 1961 as amended by Decree No.65 of 1966.

6. [1961] 41 T.C. 1. Also Humbles v. Brooks [1962] 40 T.C.500 and Lupton v. Potts (1969 45 T.C. where it was held that a solicitor's articled clerk could perform his articles without taking the Law Society Examinations. The fees for that examination were therefore not deductible.

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allowable in respect of the expenses so incurred as the duties of the office could be performed without his becoming a member of the club. The decision in this case was not followed in Elwood v. Utitz[7]. In the latter case, the taxpayer who lived in Ireland was required by his company to make frequent visits to London in the performance of his duties. In order to obtain accommodation which was less expensive than staying at hotels, he became a member of two London clubs. The Court of Appeal of Northern Ireland held that the membership subscriptions of the two clubs which resulted overall in a net saving of expense were allowable as deductions, the fact that other club facilities were enjoyed by virtue of these subscriptions being largely irrelevant.

The decision in the Utitz case can be explained quite simply if it is accepted that the club subscriptions were paid not to gain membership as an end itself but to obtain accommodation and facilities which the appellant had to get if he was to perform the duties of his office. This is quite different from the Nigerian situation where membership of prestigious clubs are ends in themselves.

Still dwelling on the question of subscriptions by taxpayers, we must not be understood to suggest that no such payment should ever be allowable. Indeed, subscriptions to learned or professional bodies can produce a salutory effect both on the taxpayer and society in general. But such is the absurdity of the "necessarily obliged" test that although it is often desirable for an employee to incur certain expenses it is extremely rare for such expenditure to be considered necessary.

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7. [1965] 42 T.C. 482.

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In Simpson v.Tate[8] for example, a county medical officer of health joined certain medical and scientific societies in order that he might be aware of all recent advances in sanitary science and keep himself up to date on all medical questions affecting public health. It was held that the subscriptions paid by the tax-payer to those societies were not deductible for tax purposes as they were not monies expended "necessarily" in the performance of the duties of an office. Rather, they were expended to enable the taxpayer to continue to be qualified which is an entirely different matter.

This decision is now subject to a statutory provision[9] in the U.K. which established that fees and subscriptions paid to professional and learned societies can, if certain conditions are satisfied, be deducted for tax purposes.

It is our view that a similar provision should be made in the Nigerian law. Nothing should be done to discourage learning or self improvement.

(ii). Income from a Profession, Vocation (or Trade)

Unlike the Ghana[10] and U.K.[1] position, for a professional to be able to claim any payment as a deductible expense in Nigeria,

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8. /1925/2 K.B. 214; 9 T.C. 314. Note the case of Chelvanayakan v. C.O.T. (S.C) /1939/Reports of Ceylon Tax Cases, p.144 where the cost of a set of Law Reports purchased by an advocate was held not to be an allowable deduction.
9. S.192 ICTA 1970. U.K. Extra Statutory Concession No.12 Cmnd.1258.
10. S.9(b); S.20(1) (1966) Income Tax Decree (Ghana.
1. We refer here to the expense rules governing Cases I and II of Schedule D.

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it must not only have been incurred "wholly and exclusively" for the profession, vocation or trade but "necessarily".

But how is the "necessarily obliged" test to be applied? Does it mean that to be allowable the expenditure must be such that it would be impossible for the professional to exercise his profession without incurring it? Stated differently, must the expenditure be such that every professional placed in the position of the taxpayer has to incur it?

Considering that the type of taxpayers under this sub-head are self-employed persons, there is not therefore an employer to be looked to whose requirements or conditions are prima facie evidence whether an expense is necessary. Is it not true then that the decision of the spender himself must be given considerable weight? Or, alternatively, can the "necessarily obliged" test be construed to be an objective one with regard to employment income, and a subjective one in the case of professional or vocational income?

With regard to a trade when is an expenditure "necessarily" incurred? Can the courts in Nigeria or the Revenue substitute its judgement for that of the trader himself? We think not.

In short, the "necessarily obliged" test is a futile one as far as the above matters are concerned. Even assuming that it can be administered effectively, how reasonable is it to restrict the freedom of entrepreneurs? In our opinion, the "necessarily obliged" part of the expenditure test should be removed so that the only test is the objective one; viz. whether the expense was "wholly and exclusively" laid out for the purposes of a trade, profession or vocation.

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However, the "necessarily obliged" test may be retained to govern the deductibility of expenses of employees and office holders provided it is applied with some degree of flexibility.

Regrettably, instead of a move to lessen the restrictiveness of the rules that govern the deductibility of expenses, the Nigerian authorities have manifested an intention to add a further test.[2] According to a press statement issued after the 1973 budget speech, the Income Tax Acts are to be amended to ensure that only expenses:

> "wholly, exclusively, necessarily and reasonably" incurred

in the production of income is allowed.

With due respect, this writer is of the view that there is some muddled thinking high up in the Revenue hierarchy. For example, is it possible for an expense to be incurred "necessarily" and yet at the same time not to be incurred "reasonably"? Does the "necessarily obliged" test not imply that the expense must be "reasonably" incurred?

Taken in isolation, what is a reasonable professional expense or a "reasonable" trading expense? Is it plausible to apply an objective test here and to hold that a reasonable expense is such that any average person would consider reasonable?

Without mincing words, our submission is that the proposed addition of the "reasonable man's test" to govern the deductibility of expenses is highly undesirable, especially when one remembers that the present tests have gone too far already.

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2. Daily Times (Nigeria) April 4th, 1973 at p.3.

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D. Expenses Must be Incurred "In the Production of Income"

To rank as a deduction from income, the expenditure must have been incurred either (1) in the course of the performance of the duties of an employment or office, or, (2) in the exercise of a profession, vocation or trade.

No authoritative pronouncement has yet been made in Nigeria on the interpretation of the expression "in the production of income", which undoubtedly is of the utmost significance. If the findings in C.O.T. v. Bukenba Mines[2a] (East Africa) are to be believed, then the words probably bear a narrower meaning than the expression "for the purposes of the trade". But this in fact does not tell us much. How much narrower, it may be asked, is the former expression in comparison with the latter?

It would seem that the two expressions in question are the legal draughtsman's way of saying that deductible expenses must bear a sufficiently close relationship to the income producing activity; be it a trade, profession, vocation or employment. The great difficulty is that no clear-cut degree of proximity between expenditure and income generating activity can be prescribed. To illustrate the legal principles involved here we refer to the South African case of Port Elizabeth Tramway Co. v. C.I.R.[3] where the meaning of the words "in the production of income" was duly considered.

In that case, the taxpayer was a transport company. On one occasion the driver of one of its cars lost control of the vehicle

2a. 2 E.A.T.C 333

3. /1936/C.P.D. 241; 8 SATC 13.

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which ran into a building as a result of which the driver suffered injuries and eventually died. The company was compelled to pay compensation and the legal costs incurred in contesting the claim of the deceased's representatives. But the real point at issue was this: How closely must a company's expense be linked to its business operation?

As the employment of drivers was necessary for carrying on the business of the company, and as the employment of drivers carried with it as a necessary consequence a potential liability to pay compensation if such drivers were injured in the course of their employment, the Court considered that the compensation paid by the company must be regarded as being so closely connected with the income earning act from which the expenditure arose as to form part of the cost of performing it. The compensation was, therefore, an allowable deduction.

As regards the legal costs, the Court held that these can be deducted if they too are so closely connected with the earning of the income as to be regarded as part of the cost of earning it. In this case, they were expended in resisting a demand for compensation and as this was not an operation entered upon for the purpose of earning income, the company's legal costs were consequently disallowed.

Another case which show that to be deductible, an expense incurred in the production of income must bear a sufficient closeness to the income generating activity, is Bolam v. Barlow.[4] In that case,

4. [1949] 31 T.C. 136.

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the taxpayer an employee of a water board, was required to live within a reasonable distance of his place of employment, and by so doing he spent more on accommodation than he would have done if he had been free to choose his place of residence. It was held that a claim to deduct this excess cost of living near his work was inadmissible.[5]

This case also illustrates the general principle that living expenses are never deductible for a taxpayer does not "eat or sleep in the course of performing his duties, but either before or after their performance".[6]

But where the taxpayer must incur an extra expense in having to live away from home in the performance of his duties, that extra expenditure is usually deductible. In Nolder v. Waters[7] for example, where the taxpayer an aerospace pilot was granted a subsistence allowance of £1 per night when away from England, it was held that expenses incurred in excess of this allowance as well as the allowance itself were allowable. In this case, they were over and above that which would have been incurred while the taxpayer was living at home.

As any strict rule is difficult to apply in practice, the U.K. Revenue now by concession allows the whole cost of living away from home so long as the taxpayer in question has a permanent residence.[8] The Nigerian Revenue apparently does the same, although a clear statement on this is not generally available.

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5. See also Collis v. Hore [1949] 31 T.C. p.173; Lomax v. Newton [1953] 34 T.C. 558.
6. Per Viscount Cave, L.C., in Ricketts v. Colquhoun [1926] A.C.1 at p.6.
7. [1930] 15 T.C. 380.
8. Whiteman and Wheatcroft op.cit., p.528, para. 14-49.

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To sum up, it would seem that the measure of expense incurred in the production of income is a practical hard matter of fact to be determined according to the particular circumstances of each case. The guiding principle, however, is the proximity or otherwise of an item of expense to the taxpayer's income generating activity.

E. Incurred During the Year of Assessment

Unlike "losses", which can be carried forward indefinitely,[9] an "expense" cannot be carried forward to a subsequent tax year or carried back to a previous tax year even though such expenditure properly relates to the income of those particular tax years.[10] Similarly, an apportionment of "expenses" over several years is not permitted.[1]

The Nigerian law which is clear on the above principles is quite acceptable. To allow apportionment of expenses over several tax years would be to complicate the task of the Revenue and the taxpayer unduly.

F. Travelling Expenses: A Special Case

The cumulative effect of the three aspects of the statutory rule on expenses just discussed is probably most clearly shown in a series of cases dealing with the travelling expenses of taxpayers.

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9. S.21(2), ITMA 1961.

10. S.17(1), ITMA 1961 as amended by S.5(2)(a) of the (1966) Income Tax (Amendment) Decree No.65 of 1966.

1. See C.O.T. v. Kotecha Estates Ltd. [1971] E.A.L.R. 63.

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In this context, a distinction must be drawn between an individual who incurs expense in travelling to his place of work and an individual who has two or more places of work and incurs expense in travelling from one such place of work to another.

(i). Expenditure Incurred in Travelling to a Place of Work

The general rule that the expense incurred by a taxpayer in travelling to and from his place of work is not deductible is well illustrated by a number of cases.[1a] Firstly, we consider the situation where the taxpayer is an employee, and here we refer to the case of Ricketts v. Colquhoun.[2] In that case, the taxpayer, a barrister practising in London, also held the appointment of Recorder of Portsmouth. He claimed *inter alia* that his travelling expenses from London to Portsmouth on the occasion when he sat as Recorder were deductible under Schedule E. The House of Lords rejected this claim because the expenses were not incurred in the exercise of the taxpayer's duties. And as Viscount Cave, L.C., rightly stated:

> "(the expenses) are incurred not because the appellant holds the office of Recorder of Portsmouth but because living and practising away from Portsmouth, he must travel to that place before he can begin to perform his duties as Recorder and, having concluded those duties desires to return home . . .".[3]

1a. The general rule emerges from S.18(a) ITMA 1961 which disallows expenses of a domestic or private nature.

2. [1926] A.C. p.1.

3. *Ibid.*, at p.4.

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The case of C.I.R. v. Humphrey[4] (Hong Kong) already discussed is also in point here. The essence of this decision we may recall, is that where the employer himself grants an allowance to the taxpayer to cover the cost of his journeys to his place of employment, then such an allowance is deemed to be an additional remuneration and hence taxable in the hands of the employee.

The general philospphy behind the taxability of travelling expenses to and from a place of employment was considered by the U.K. Royal Commission in their report. This writer agrees essentially with their conclusion which was to the effect that it was entirely up to the taxpayer to decide how far or how near he wishes to live from his place of employment.[5]

That notwithstanding, in cities like Lagos where people are obliged to make journeys of up to 20 miles to and from work, because they find it impossible to live nearer their places of employment, is there no case for allowing all or part of the amount spent as deductible from the employee's income? We think there is. What we are saying is that whereas in the past the taxpayer did have a genuinely free choice as to where or how far from his place of employment he wishes to live, today, circumstances give him very little choice.

It would perhaps have been unwise to press for any changes in the status quo considering the great administrative burden it may

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4. [1970] Hong Kong L.R. 447.
5. Cmd. 9474. Travel Between Home and Work, paras. 236,237 at p.75.

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entail, yet, in view of the widespread practice of granting generous travelling expenses to the better paid employees, a fresh thinking here is a must.

If only for reasons of equity and as a means of reducing the gap between the rich and the poor, we are suggesting that any employee in Nigeria earning below £400 p.a. should be allowed to deduct a given sum of say £20 p.a. as his cost of travelling to and from his place of employment.

It is, indeed, sad to observe that the social order in Nigeria is such that those who are highly paid already, are precisely those who are granted additional remuneration like "travelling allowances" (taxable but not taxed), to help them weather the increasingly high cost of living.[6] While on the other hand the less fortunate citizens are forced to spend a substantial part of their meagre earnings on travelling.

Our suggestion of a deduction across the board of £20 should not create any great problems especially since most employees are now taxed at source under the PAYE system. To allow the present disgraceful situation to remain unchanged under one pretext or another is to say the least, an oppression of the masses.

Much of what has been said for the employee applies to the taxpayer exercising a profession or vocation. He cannot deduct from his income any "domestic or private" expense, which in this context includes the cost of travelling between his residence and his place of work.[7]

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6. As the Royal Commission observed, "the curious paradox is that the more highly paid employee could be presumed to be the kind of person to whom benefits in kind were specially likely to be offered". Cmd. 9474, para. 216.

7. See S.18(a) ITMA. See Rajapakle v.C.O.T. infra.

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The slightly different problem which may arise when the taxpayer has more than one place of work is now considered.

(ii). Travel Expense and the Itinerant Taxpayer

To be allowable, the general rule is that:(1) an expense must be incurred in travelling from one place of work to another in connection with the same employment; or (2) from one place of activity (to use a loose word) to another in the course of the exercise of a profession or vocation.[8]

As the cases show, whether the taxpayer in a real sense does have two places of work or two places of activity is a matter of fact. In Pook v. Owen[9] for example, the taxpayer carried on practice as a general medical practitioner at his residence. He also held a part-time appointment at a hospital 15 miles away as an obstetrician and anaesthetist. On occasions he was on stand-by duty and during those periods he had to be accessible by telephone. His responsibility for a patient began as soon as he received a phone call. On receipt of a call he gave instructions to the hospital staff and usually he then set out immediately for the hospital but sometimes he advised treatment by phone and awaited further report.

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8. Cmd. 9474 p.75, paras. 238-241. The general principles involved are discussed here under the heading "The Taxpayer with more than One Calling".

9. [1969] 45 T.C. 571. This case must be contrasted with the House of Lords decision in Taylor v. Provan [1974] 2 W.L.R. p.394, where it was held that the travelling expenses between Canada and the U.K. of a Canadian resident director of a U.K. company constituted part of his emoluments within Schedule E, and were not necessarily incurred.

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The taxpayer was assessed on the travelling expenses he received from the hospital and a deduction for expenses of those for which he was reimbursed was disallowed.

On appeal, the House of Lords held that the payment to the taxpayer in respect of expenses were not emoluments and that the excess of the travelling expenses were deductible. Lord Guest distinguishing Ricketts v. Colquhoun, observed that in that case there was only one place of employment, Portsmouth, and that there was no suggestion that any duties were performed in London; whereas in the latter case there was a finding of fact that Dr. Owen's duties commenced at the moment he was first contacted by the hospital authorities. The truth was that there were two places in which the taxpayer's duties were performed - the hospital and the consulting room where the telephone was.[10]

Usually, a taxpayer who seeks to deduct travelling expenses from his taxable emoluments may be faced with two problems. Firstly, as to the deductibility of the claim at all he will have to show that he was "necessarily obliged" to incur (some) expenditure in travelling while at work. Secondly, as to the amount of the deduction claimed, that he was "necessarily obliged" to incur expenditure on travelling while at work to the full extent of the amount claimed, that is to say that he could not equally well have performed his travelling duties by cheaper transport. If he could have done so, he may be allowed the amount that he would have incurred on travelling by means of that cheaper form of transport and not the amount claimed.[1]

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10. Ibid., at p.590.

1. See Marsden v.I.R.C. [1964] 1 W.L.R. 734, Ch.D. U.K. where taxpayer used his private car for official duties instead of public transport which could have been cheaper.

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For the taxpayer exercising a profession or vocation, it is also a question of fact whether or not any expense is deductible for travelling between several places of activity. In Nigeria, the rules are exactly the same as those governing the travelling expenses of itinerant employees. To illustrate the principle here, we refer to the Ceylon case of Rajapakse v. C.O.T.[2] where the main question at issue was whether costs incurred by an advocate in travelling from the premises in which he resides and has his chambers to the Supreme Court are allowable, considering the express provisions of the law that "no deduction shall be allowed in respect of domestic or private expenses, including the cost of travelling between residence and place of employment". Drieberg, J., delivering the judgement of the Court stated that:

> "the chambers of an advocate and the courts are the place of business of an advocate, (and that) his movement from one place of business to another does not come within the scope of S.1(a) . . .".[3]

According to his Lordship, the question of whether or not a deduction would be allowed for travelling between these two places "will depend on whether they are to be regarded as outgoings or expenses incurred by the taxpayer in the production of income".

While the Nigerian law is fairly clear on the point that travelling expenses are to be allowed to a taxpayer where he proceeds from one place to another in respect of the same profession or vocation, what is not so clear is whether travelling expenses should

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2. [1934] (S.C.) Reports of Ceylon Tax cases p.27.

3. Ibid., at p.36.

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be allowed where he is carrying on two or more distinct professions or vocations. For example, nothing prevents an auctioneer in one part of the town being a freelance broadcaster in another district.

In South Africa, where the taxpayer has two or more distinct businesses, expenses incurred in travelling from one to another are not allowable.[4] We doubt very much whether Nigeria should follow this example.

Since the majority of the people in the country pursue multiple vocations some of which are on a seasonable basis, it is our submission that any expense incurred in moving from one locality to another should be allowable. To regard this as a purely private or domestic expense would be unfair.

(iii). <u>Overseas Travel: When are Expenses Allowable?</u>

Nowadays people travel around the world a great deal more. Many for the mere pleasure of seeing people and places but for some as a necessary concomitant of earning a living. Professionals we know, now have to travel abroad in order to keep abreast with the latest developments in their respective fields, while artists and architects especially, may have to hop from one continent to another in search of new ideas and for the purpose of stimulating their creative thinking.

The trouble usually is that it is not easy to distinguish a pleasure trip from a non-pleasure one. Furthermore, in situations where a travel expense is sufficiently analogous to a capital expenditure what should the legal position be?

4. A.S. Silke (1972) <u>op.cit.</u>, p.207, para. 218.

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With travel overseas, the tax position is as follows: (1) When is a travel expense "wholly and exclusively" incurred for the production of income? That is, considering that there is usually a duality of purpose when people travel abroad. (2) When is an overseas travel, and hence the expense, "necessarily" incurred in the production of income?

Whereas the first test may be easy to satisfy the latter is rarely ever satisfied because a travel overseas, though desirable, is rarely necessary.

No case has yet arisen in Nigeria as regards the above matters. Turning our attention then to other Commonwealth countries, we find that the courts have sometimes taken a fairly liberal view of expenses incurred for overseas travel. We refer first to the case of Paramac Printing Company Ltd. v. Federal Commissioner of Taxation.[5] The company in this case specialised in printing materials which contained pictures, drawings, captions etc. This involved a lot of creative work and thinking on the part of the managing director, his wife and daughter who were employees of the company.

The point at issue was whether expenses incurred by the aforementioned persons to overseas art galleries and exhibitions were allowable.

Although Owens, J., held that visits to galleries etc., were usual tourist activities, nevertheless, his Lordship was inclined to allow the cost of the overseas travel in full on the ground that such

5. [1965] A.L.R. 501. In reaching a decision, the court followed C.O.T. v. Finn [1961] 106 CLR 60, where an architect obtained a similar allowance. Note also as a contrast Bowden v. Russell and Russell [1965] T.R. 89 (Ch.D. U.K.) where the court refused to allow a solicitor carrying on his own practice the expense of attending legal conferences abroad since the trips were partly for private purposes. The conference fees were, however, allowed.

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travel provided opportunities to keep up to date with the latest developments in their field, to advance their techniques, and to gain ideas and inspiration for their work.

This case may, however, be contrasted with Thomson v. White[6] where the Court overruled the General Commissioners who had found in favour of the taxpayer that he was obliged to incur the expenditure in question, some £500 on a trip abroad for British farmers. The Court found that there was no evidence that the taxpayer was obliged to incur the expenditure in the performance of the duties of his office as a director of a company, the shares of which were held equally by the taxpayer, his wife and their three children. The trip abroad to which the expenditure related was taken in 1961 for the ostensible reason of obtaining a bull for a friesian herd owned by the company. Although it was actually possible to obtain a bull at the agricultural fair which the taxpayer visited none was in fact obtained. The trip was not authorised, and no request for reimbursement by the company was made by the taxpayer.

Next, let us consider the tax treatment of a travel expense which is analogous to a capital expenditure. Examples of such expenses are costs of travelling overseas or within Nigeria in order to purchase plant or machinery, or in an attempt to acquire new agencies etc. This would also include travelling expenses incurred preliminary to a business becoming productive, or expenses incurred in an effort to protect the assets of a business or its revenue earning properties.

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6. [1966] T.R. 51 (Ch.D U.K.).

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Strictly speaking, travelling expenses incurred for the purposes of creating or improving an income producing asset or acquiring a capital asset should be regarded as being of a capital nature and, hence, not deductible. But unlike the South African law, which expressly prohibits these kind of deductions, the Nigerian law is silent on the matter.[7]

A clarification of the basic position is called for and our opinion is that the South African example is quite acceptable.

G. Expenses "Actually" Incurred: A New Approach for Nigeria

From our foregoing discussion one major conclusion emerges, viz. that the Revenue in Nigeria has not been doing its duty. Otherwise, how is it that with the strictness of the "necessarily incurred" test as explained above, not a single case has arisen where the correct interpretation or application of the "expense" rules was in dispute?

Be that as it may, our main concern here is from the purely theoretical standpoint. We argue that the present tests which govern the deductibility of expenses are unreasonably strict and therefore unrealistic. Certainly, it cannot be the intention of a good tax system to stifle initiative and discourage entrepreneurship. Even assuming that a very tight "expense" test can yield more taxable income, this is only a short term gain because the real gain comes from greater economic activity generating greater taxable wealth.

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7. Presumably, the Nigerian law should regard such capital expenditure as non-deductible.

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With that in mind, it is thought that the words "ACTUALLY INCURRED" should be substituted for the words "NECESSARILY INCURRED"; the difference being that the former permits a wider field of deductible expenditure than the latter. In this context too, the word "incurred" should not only be understood to mean "paid", but should cover situations where a liability has been incurred for which cash payment has not been made.

We are making this suggestion because one taxpayer may conduct his business inefficiently and extravagantly thereby incurring expenses which another may not incur. The truth of the matter is that a lot depends on the personal judgement of a taxpayer whether or not an expenditure is to be incurred. So that any endeavour to formulate an objective standard of conducting a business or exercising a profession is doomed to failure.

Relating our proposals specifically to employees and professionals in Nigeria, the net result should be as follows: Taxpayers should all be allowed to deduct from their income all outgoings and expenses incurred in the production of income. In other words, while not required to show that an item of expenditure was "necessarily incurred", he must show that such expenditure was in "actual fact incurred." But in so doing, it must be seen that such expenditure was also "wholly and exclusively" incurred in the production of income as is the case at present.

Inherent in our suggestion, of course, is the danger of abuse. Some would reckon for example that if our suggestion was adppted foreign companies in Nigeria would make excessive payments to their

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parent companies overseas under the guise of "head office expenses", "management expenses" or "consultancy fees". But the situation may not be so desperate considering the power of the Revenue to disregard artificial or fictitious transactions especially where designed to effect a reduction in tax liability.[8] In any case, what proof is there that the "necessarily incurred" test has been successful in deterring excessive expense payments? None whatsoever.

Indeed, our suggestion is based on the current South African law[9] and to some extent on the Ghana provision.[10] If these countries have been able to adopt the "actually incurred" test why not Nigeria? The test albeit imperfect, is at least more realistic than the "necessarily incurred" test and perhaps simpler to administer as well.

V. ASSESSMENT, COLLECTION AND SIGNIFICANCE OF RESIDENCE

A. Basis of Assessment

The basis of assessment of any income from any employment or pension which is derived or deemed to be derived from Nigeria is the income of the year ^ assessment.[1] For this purpose income from any

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8. S. 14 ITMA 1961.
9. See S.11(a) read in conjunction with S.23(g) of the Income Tax Act 1962 of South Africa. No.58 of 1962. A. Silke op.cit., p.175, et seq. discussing the general deduction formula, especially at p.177, para. 200.
10. S.20(1) Ghana Income Tax Decree 1966. No,78 NLCD 1966.
1. S.20(5) ITMA 1961.

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employment is deemed to arise from day to day. But where such income is in the form of a bonus, commission or allowance payable on one occasion only, or at intervals exceeding one month, this is deemed to be income of the day on which it is paid; and if paid after the cessation of an employment to be income of the last day of the employment.

The real effect of the provision, of course, is to disallow any averaging.

On the other hand the basis of assessment of a professional or person pursuing a vocation is on the income of the preceding year with accounts made up to the 31st of March.[3] The provisions are the same as those that govern trading or business income.

With regard to the commencement or cessation of a profession or vocation, the general rules are modified so that liability is either postponed or brought forward earlier than would normally be the case.[4] As for receipts and payments after cessation of a profession or vocation, such sums are deemed to have been received or paid as the case may be on the last day on which the profession or vocation was carried on.[5]

B. <u>Method of Collection</u>

An employee pays tax in Nigeria by deduction at source under the P.A.Y.E. System,[6] with the employer accounting for the tax deducted to the Revenue[7]. But a professional or a person pursuing a vocation

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3. S.20(1), S.20(2) ITMA 1961.
4. S.20(3),S.20(4) ITMA 1961.
5. S.20(10) ITMA 1961.
6. S.50(1); S.50(2); S.50(3) PITA 1961. (Lagos State). Similar provisions are contained in the State Tax Laws as supplemented by various rules of computation.
7. <u>Ibid.</u>, S.51.

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pays tax following a direct assessment made on him based on the information contained in his annual return.[8]

Inevitably, a lot of problems arise because information supplied by taxpayers in their annual returns are generally inaccurate and unreliable. And considering that the vast majority of the adult population of Nigeria are pursuing a vocation the magnitude of the Revenue's task can be appreciated. For example, not only do they have to cross check returns which are largely false, but they have to seek out thousands or perhaps millions of people who never bother to submit any returns.

Below we examine the significance of the "residence" test in the general scheme of taxation in Nigeria. Other more complex problems of tax administration would warrant a separate study.

C. Elimination of Internal Double Taxation: The Residence Test

(i). Internal Tax Jurisdiction

Whatever the impression that might have been given to the contrary, a taxpayer's place of residence does have some significance in the general scheme of taxation in Nigeria. As far as personal taxation is concerned, it is the tax authority of the territory in which a taxpayer has his place of residence or his principal place of residence which under the country's tax law has the jurisdiction to tax him.[9]

8. Ibid., S.24.

9. We refer here to Chapter One supra, on the division of the taxing powers between the Federal Government at the centre and the State governments. In particular, the power of the Federal Government to enact laws ensuring uniformity in the State Tax laws. S.76 (1963) Federal Constitution. See also S.3(2) ITMA and the First Scheduled of same Act.

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Thus, the "residence" test is the most important instrument of eliminating or mitigating problems of internal double taxation likely to occur in a Federal State where there are potentially conflicting tax jurisdictions. Certainly, if the freedom of movement and the freedom of interstate commerce under the constitution is to have any meaning at all, people whose economic activities transcend state frontiers must not run the risk of internal double taxation.

With regard to foreigners, the residence test is crucial too. Where for example, employment income is held to have a "Nigerian source" because duties are performed there, the residence test is used to ensure that only one of the thirteen tax authorities in the country actually extracts the tax due.

(ii). Definition of Residence for Tax Purposes: Not akin to Domicile?

International law allows States to fix the relevant criteria for determining residence for tax purposes, but in practice the line between mere presence and actual residence may be elusive.[10] This point is well established by the East African case of Aranautoglu v. C.O.T.[1] In that case, the appellant disputed his own assessment for income tax on the ground that he was not resident in the territories of East Africa in that year.

The agreed facts were that in 1960 the appellant had a home in Dar-es-Salam and was present for periods totalling 249 days; in 1961, the appellant sold his home and was present for a total of 124 days.

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10. D.P.O.'Connell, op.cit., Vol.2 page 717.

1. [1967] E.A.L.R. 312.

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In 1962, he had no home but was present for 62 days and thus on average was present for more than four months in each of the three years.

It was argued for the appellant in relation to the definition of "resident in the territories" in the E.A. (Management) Act 1958,[2] firstly, that it was not permissible to aggregate "periods of residence" with periods of "mere presence"; and secondly, that "averaging" in subsection (I)(b)(II) meant that four months presence was required in each of the relevant years.

Dismissing the appeal, the Court held that:(1) it was permissible for the purposes of the Income Tax (Management) Act 1958, S.2(b)(II) to aggregate periods of "residence" and "presence" in the territories. (2) That in S.2(I)(II) (ibid) the period to be averaged was the total of days spent in the territories over the three relevant years.

Confronted with a similar problem, what the Nigerian courts would do is uncertain. But it would seem that the decision of the East African Court of Appeal would be of little persuasive authority. From a cursory reading of the statute, the impression one gets is that for a foreigner working in Nigeria actual residence (as defined by the Statute) as opposed to mere presence for 183 days is what counts.

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2. S.2 of the Act provides inter alia as follows: ". . . resident in the Territories" when applied in relation to any year of income. (1) to an individual means that such individual resides except for such temporary absences as the Commissioner may determine to be reasonable, in any of the Territories, and an individual shall be deemed to reside in the territories if he:

   (a). has a home in any of the Territories and was present in the Territories for any period in such year of income".

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On the whole, the Nigerian concept of "residence" is a slightly peculiar one. To be resident for tax purposes in any part of the country, the taxpayer must have a place there available for his domestic use on the 1st of April of the year of assessment.[3] Ordinarily, a place or residence is said not to include any hotel, rest house, or the like unless no more permanent place is available for his use on the appointed date. Where the taxpayer has several residences in two or more different states in the country, he is deemed to be liable to tax at his "principal place of residence" which is understood to mean a place where he usually resides most often or that of those places which is nearest to his usual place of work.

Theoretically, the Nigerian residence test is very strict because once the taxpayer has a place of residence available for his use on a particular day, there is no requirement that he must be physically present in the state on that day or indeed in the country. This is different from the East African test of residence whereby not only must the taxpayer possess a home available for his use in any of the territories of East Africa, but he must also have been physically present for some period during the year of assessment.[4]

As tightly drafted as the Nigerian provisions seem to be, it may be quite easy to avoid tax all the same. This is by ensuring that one is not technically resident on the appointed day. Thus, if a taxpayer who normally has a place of residence is deliberately absent

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3. S.3(2) ITMA 1961 as explained in the First Schedule of the same Act.

4. This point was well brought out in <u>C.O.T. v. Moorani & Sons</u> (1969) E.A.L.R. 685.

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from the country on the appointed day having given up his accommodation whether temporary or permanent, then on strict principles he should escape tax liability because he has no place available for his domestic use in any part of the country on the appointed day.

We venture this argument because the Nigerian "residence" test is quite different from the usual tests for "residence" or "domicile". There is no question of intention to sever one's relationship with Nigeria permanently and the issue of whether or not a departing taxpayer intends to return is completely irrelevant. The words of the Statute are in no way ambiguous. It is categorically provided that:

> "Tax for any year of assessment may be imposed only by the territory in which the individual is deemed to be resident for that year[5] under the provisions of the First Schedule of the Act".[6]

And as explained already, residence or no residence on the appointed day is determined by the availability or otherwise of a place for domestic use for the taxpayer on that day.[7]

(iii). Cessation of Residence: A Proposal for Change

Since residence in any part of Nigeria can be terminated and resumed at will, it is our view that something should be done to alter the law. In this regard, attention may be drawn to the ingenious Israeli formula whereby an Israeli resident who goes abroad

5. Emphasis supplied.

6. S.3(2) ITMA 1961.

7. S.1 First Schedule ITMA Definition section.

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and works there is deemed to be technically resident in Israel and hence liable to the country's tax until four years after his departure.[8]

Originally, the purpose of this rule was to provide a basis for taxing the salary of Israeli residents sent abroad for lengthy periods by Israeli companies, e.g. shipping and airline companies in particular. Of course, this extra-territorial extension of its tax jurisdiction potentially raises problems of international double taxation because of the attempt to tax income earned abroad whether or not remitted to Israel. This is particularly true where the host-country taxes employment or professional income on a "source" basis.

Furthermore, there is the problem of assessment and collection of tax from people who are in real fact "non residents", bearing in mind that without specific agreement to that effect no state would enforce the Revenue Laws of another.[9]

As far as Nigeria is concerned we reject the Israeli formula. While we accept that an individual should not have the option to terminate and resume his residence within Nigerian as he wishes, we do not believe in legal provisions such as the Israeli's which are unnecessarily burdensome and difficult to enforce.

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8. A. Lapidoth, op.cit., 392 at 405. This author explains the implication of S.5(3) of the Income Tax Ordinance of Israel.

9. A'R Albrecht (1953) 30 B.Y.I.L. 454 "The Enforcement of Taxation Under International Law"; J.G. Castel "Foreign Tax Claims and Judgements in Canadian Courts" (1964) Canadian Bar Review, Oklahoma Tax Commission v Rodgers (1946) 193 S.W. 2nd 919; U.S.A. v Harden (1963) S.C.R. 366; K-Lysyk discussing the Harden Case - (1964) Canadian Yearbook of International Law page 245.

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In order to improve the present position we recommend that residence should be presumed not only with reference to an appointed day but with regard to the availability of a place for domestic use at any time during the year. This would be subject, of course, to rules for adjustments to determine a taxpayer's "principal residence" as the case may be.

In our penultimate section below, we examine the liability to Nigerian tax of a number of taxpayers whose special status or condition of employment raise interesting tax questions. The problems are discussed against the background of all that has been said already in this chapter.

VI. SOME SPECIAL PERSONS

A. Directors: Liability to Nigerian Tax

The directors of some of the most important companies operating in Nigeria are foreigners who are non-residents.[10] Recalling what has been said in Chapter Three, whereas the Companies Decree 1968 made incorporation in Nigeria by all companies compulsory, there was no requirement that all directors on a certain number of them should be nationals or residents.[1]

10. This is not surprising because most of the big companies in Nigeria are subsidiaries of multinational companies. See O. Teriba, E.C. Dozien and M.O. Kayode: "Some Aspects of Ownership and Control Structure of Business Enterprise in a Developing Economy - The Nigerian Case": Nigerian Journal of Economic and Social Studies: Vol.14, No.1, March 1972, p.3.

1. Part X SS.368-371, Companies Decree 1968 No.51 of 1968.

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More important still, the law did not make it compulsory for the management and/or control of all companies to be exercised in Nigeria.

With the status quo likely to remain unchanged[2] for a long time, we raise the following issues. Who exactly is a director and what is the basis of liability to Nigerian tax of a non-resident director?

The precise legal status of a director has been the subject of several judicial pronouncements ranging from his description as a "mere functionary" to his being the alter ego of the company. Without bothering to go through the whole lot of epithets, it is reasonably safe to say that as far as the tax law is concerned, a director, whether controlling or otherwise, is no more than an "office holder" or an "employee" of his company.[3]

Taking the matter one step further, if a director is an employee of a company what is the source of his income? And in the case of a non-resident person who is a director of a company incorporated in Nigeria what is the legal position?

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2. The Nigerian Enterprises Promotion Decree 1972 only bars foreigners from participating in a number of businesses. Our statement should be viewed subject to the provisions of this Decree.

3. C.O.T. v Directors of A.Y. Ltd. 2 E.A.T. Cp.414 Case No.57. Here it was categorically held that "a director whether controlling or otherwise of a company is an employee of the company". See also Royal Commission Report Cmd.9474, page 70 para.216, where it was stated that the position of the director was different from that of an ordinary employee. For a general discussion of the kinds of problems envisaged, see R.D. Nicholson, "The Exemption of Incomes of Visiting United States Directors and Employees and Problems of International Tax Evasion" (1967-68) 41 A.L.J. pp.90, 119. This article was written against the background of the U.S.A. - Australia tax treaty.

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In our opinion, the source of his income is the place where he performs his duties. In other words where the board of directors regularly exercise their function of "management and control" over the affairs of the company which need not be Nigeria.[4] If, for example, the directors of a company decide to meet regularly outside the country, then it can be argued that the salary of those of them not resident in Nigeria, and not actively engaged in the day to day affairs of the company does not "accrue in" and neither is it "derived from" Nigeria. If the remuneration happens also to paid overseas (nothing illegal about this), then it would be clear too that the income would escape tax not being "received in" or brought into" Nigeria.

On the authority of Unit Construction Co. Ltd v. Bullock,[5] our analysis would still appear to be correct even where the "management and control" were exercised outside the country in complete breach of the Articles and Memorandum of Association.

One case which highlights some of the complexities involved in taxing non-resident directors is C.O.T. v P. & Co. and another.[6] The material facts for our purposes were as follows: P. Co. Ltd. was a non-resident company registered in Guernsey and almost the whole of its income resulted from agricultural operations in Tanganyika, as it then was. The directors of the company apart from the managing director, were neither resident nor ordinarily resident in Tanganyika.

4. We refer here to the principle established by the leading case of De Beers Consolidated Mines Ltd v. Howe [1906] A.C.p.455.

5. [1960] A.C. 351; (1959) 3 AU.E.R. 831.

6. I.E.A.T.C. p.131, Case No.16.

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Their duties were performed in Guernsey or in England or in Switzerland, and in Tanganyika. They were paid by funds drawn on the company's Guernsey bank account, the English directors receiving sterling in England and the Swiss directors Swiss Francs in Switzerland. All payment were made with proper Foreign Exchange approval.

As regards the Managing Director, he was found on the facts to have been resident in Tanganyika during the years 1947 and 1948. His work as director was for the most part done in Switzerland, but he paid visits to Tanganyika of some months duration and there he also did some work. His service agreement was made in Switzerland and his remuneration was received there. Neither he nor the other directors at any time remitted any of the moneys received as remuneration to Tanganyika.

One of the major points at issue in this case was whether the income of any or all of the directors was income "accruing in, derived from, or received in" the territory of Tanganyika as was contended by the Commissioner of Inland Revenue of that country. Accordingly, Mr. Newbold counsel for the Revenue asked the Court to agree with him that the words "derived from" in the circumstances of this case referred to the actual, even if distant, source of the revenue from which the payments became available, and for that reason it was necessary to consider that if there had been no sisal company operating in Tanganyika there would have been no income from which to pay the directors and shareholders. Therefore, he argued, the income must have been"derived from" Tanganyika.

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The Court of Appeal was not impressed with the above argument, the general consensus being well reflected in this passage from the judgement of Sir Herbert Cox, C.J.,

> "From the authorities to which the court's attention was directed, it appears that the source of income of a company and the source of income of the employees of that company paid out of the assets of that company may be two entirely different sources, the residence and operations of the company being of exceptional importance so far as the company is concerned, but that it is the immediate source of revenue which we look at, certainly in so far as individual employees are concerned."[7]

In short, the court held that the remuneration of the directors and the managing director were not derived from Tanganyika.

With a view to removing the present anomalies in the Nigerian law the following changes are proposed.

(1) That a certain proportion of the board of directors of all companies should be nationals or persons resident in Nigeria, and (2) That the income of all directors of companies incorporated in Nigeria should be deemed to have a "Nigerian source" wherever paid, wherever the duties of the employment are performed especially whether or not the board of directors hold their meetings in Nigeria or overseas. In this connection too, the place of the director's contract of employment should be completely irrelevant.

There is, of course, a risk of double taxation inherent in this suggestion especially where non-resident directors are in a country where tax is levied on the basis of "residence" or "source".

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7. Ibid., at page 165.

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But that notwithstanding, our basic proposition remains unchanged. Is the mere risk of double taxation such that Nigeria should forgo the right to levy taxes on the remuneration of thousands of foreign and non-resident directors of companies incorporated and operating in Nigeria? Our answer is no. Surely, to allow directors to escape tax because of legal technicalities is unacceptable.

There has been no Nigerian case so far in which the above matters have been considered. Leaving the theoretical principles aside for a moment, what is the position in practice?

According to a Revenue official, the directors of all companies incorporated in Nigeria, whether resident or otherwise, are paid in Nigeria and a proportion of their income is allowed to be repatriated overseas under the foreign exchange scheme in force. But how accurate this report is and whether or not there are directors paid overseas is a matter of speculation as nobody knows for certain.

As regards directors generally, two minor problems warrant brief comments. What is the source of income of a director of an overseas company resident in Nigeria? It would appear that his liability is on income "brought into or received" in Nigeria subject to any arrangements for relief from double taxation.[8]

The main headache of the Revenue is to determine precisely when income is "brought into" or "received in" Nigeria.[9]

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8. See S.4(1) ITMA 1961.

9. Supra Chapter Two. These expressions have been said to amount to a "Remittance Rule". The technicalities of this rule have been demonstrated by such cases as Timpsons Executors v. Yerbury [1936] 1 K.B.645; 20 T.C. 155. Thomson v. Moyse [1961] A.C. 967 39 T.C. 291; Baker v. Archer-Shee [1927] A.C. 844; 15 T.C.1.

Finally, on the question of directors' travelling expenses: The general rule we may recall is to disallow expenses incurred in travelling to and from the employee's place of work.[10] What should be noticed is that this rule particularly affects directors of several companies who cannot claim the expense of travelling between one company's boardroom and another.

What the Nigerian Revenue does in this situation is not clear. However, we submit that there is no reason whatever why the Revenue should allow expenses incurred by directors of associated companies as deductible. These kind of persons we know usually enjoy generous allowances in Nigeria which are taxable but not taxed.[1]

B. <u>Cultural Visitors, Professionals and the Like</u>

(i). <u>Cultural Visitors</u>

The use of the expression "cultural visitor" in this context should be understood to include all assorted variety of entertainers as well as boxers, athletes, gymnasts, acrobats and the like. The one thing they have in common with a "professional" is that they are usually self employed persons "trading in their skills".

Where the above categories of taxpayers confine their activities within a country's frontiers no major tax problem arises. But such is the need for cultural visits between countries that often in a year

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10. S.18 ITMA disallows "private and domestic" expenses.

1. See our previous discussion supra, "The Indigenous Concept of an Allowance".

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a cultural visitor may find himself coming within the tax jurisdiction of several countries.

For example, what is the tax liability (if any), of a visiting boxer or musician to Lagos who stays for a duration of only one week? And with potential earnings running into thousands of pounds, is it permissible for the cultural visitor to make a "quick kill" and then to leave the country without paying any tax?

The words of the law on these matters are unambiguous. A cultural visitor to Nigeria is clearly liable on Nigerian "source" income in respect of:

> "gains or profits from any . . . profession or vocation, for whatever period of time such . . . profession or vocation may have been carried on or exercised".[2]

What is important to note is that there is no time duration before liability attaches. But then what is the machinery for collecting the tax due from a musician or, indeed from any other cultural visitor? None whatsoever.

Paradoxically, this awkward situation is the result of an express provision of the law whereby as far as individuals are concerned

> "income tax may be imposed only by the territory in which the individual is deemed to be resident for that year".[3]

And the test of residence for tax purposes, we know, is the availability or otherwise of a place in the country for the domestic use of an individual on the 1st of April.

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2. S.4(1)(a) ITMA 1961.
3. S.3(2) ITMA 1961.

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In short, unless a cultural visitor happens to be in Nigeria on the appointed day and is caught by the "residence" test none of the thirteen tax authorities in the country has any power to extract tax from him.

Rather than allow entertainers and the like to escape tax, we propose the following procedural changes: (1) All cultural visitors to the country must obtain a "work permit" from the Federal Ministry of Labour; (2) No such visitor should be allowed to leave without an "exit permit" obtainable only when all appropriate taxes have been paid; (3) The "residence" test should be declared not applicable to cultural visitors, and (4) The Federal Board of Inland Revenue should be charged with the responsibility of collecting any taxes due and the amount collected should be payable into the Distributable Pool Account of the Federation.[4]

Knowing what bureaucracy can be like in a developing country, it must be emphasised that the administrative processes for effecting our proposals must not be unnecessarily burdensome. Or else, it may act as a disincentive to cultural visitors.

(ii). Visiting Professionals

Much of what has been said above apply *mutatis mutandis* to visiting professionals. For example, surveyors or engineers who visit Nigeria on an *ad hoc* basis for consultancy work, or even visiting

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4. Funds in this Account are distributed periodically between the 12 states of the Federation. Its existence is specifically provided for by the 1963 Constitution.

teachers who act as external examiners to Nigerian Universities for brief periods during the year. Fees earned by these persons, often quite substantial, are liable to the coubtry's tax.

Looking at the other side of the coin, when are services rendered outside Nigeria of such a nature as to be regarded as having been done in the exercise of a profession within Nigeria? Suppose a company operating in Nigeria engages a non-resident accountant, can fees paid to him be deemed to have a Nigeria "source" and hence taxable in the country? And if so, what is the legal basis? That is, assuming ~~of course~~ that the accountant never visits Nigeria and carries out his duties entirely overseas.

The answer is far from clear. Where the duties are performed entirely overseas, it is difficult to hold that any income "accrued in" or was "derived from" Nigeria, and if the payments were made outside the country then such income is neither "brought into" nor "received in" Nigeria. Furthermore, if the professional is neither resident nor domiciled in Nigeria there appears to be no basis whatever for liability.

The only basis for liability, perhaps, is to argue that the work done, even though physically executed overseas, was of such a nature that it related closely to a company's operation within Nigeria and h nce is a sufficient nexus to bring an overseas based accountant within the country's tax jurisdiction.[5]

5. The case of C.O.T. v. Shein is relevant here. Supra at page 210 et seq. It may be recalled here that the Nigerian law permits apportionment where there are two possible sources of income. ITMA S.8(5).

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Our submission is that in all situations analogous to that outlined, there could be an apportionment of the fees between the two possible sources, i.e. the place of residence of the accountant where he performed his duties and the place of residence of the client company which not only pays the fees but whose work is the actual thing generating the income. These suggestions are made subject to any double taxation arrangements in force.

We must admit that the problems here are enormous and that the solution we offer is quite rudimentary. But what is to be borne in mind is that Nigeria cannot afford to allow consultancy fees etc., for work done overseas in relation to Nigerian companies to remain untaxable. Otherwise, the importing of skill either directly or indirectly could cause an intolerable burden on the country's balance of payments position.

C. Foreign Diplomats in Nigeria

International comity does not permit the salary of the servants of one state to be taxed by another state.[6] Consequently, all servants of overseas governments working in Nigeria are not amenable to local taxation and if taxed at all must be taxed by their home countries.[7]

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6. Cmd. 9474 para. 307 page 95, Cf. Art.34 Vienna Convention on Diplomatic Relations 1961; Art. 49 Vienna Convention on Consular Relations, 1963.

7. We refer here to the Jamaican case of Neville Ashemheim v C.O.T. 3 W.L.R. 455 where it was held that an ambassador holds an "office" and that his salary is assessable to tax in his home country.

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This general statement of principle is, however, subject to a number of exceptions. Where a consular officer receives "any income in respect of any trade, business, profession or vocation carried on by him or in respect of any other employment exercised by him within Nigeria"[8] he is liable to the country's tax. The real effect of this is that income exempted are only those received in connection with consular activities.[9]

The second exception to the general rule is even more significant. The income of embassy employees on purely domestic duties are not exempted from tax. In this category would fall caretakers, drivers, servants, and the like. Whether or not this would include messengers and ordinary clerks is unclear. But the real problem area is the further provision that the income of a consular officer or employee who ordinarily resides in Nigeria and not being a national of the foreign state which he serves is not exempt from the country's tax.[10]

We may note here that the expression "ordinarily resides" is nowhere defined in the Code, and more important still, that the type of taxpayer contemplated need not be a Nigerian national. This means that the exception is much wider than would at first seem to be the case. It would cover for example, a Dahomeian national ordinarily resident in Lagos but working for the Senegalese embassy irrespective of his status in the hierarchy of things.

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8. S.16 ITMA read in conjunction with section (b) of the Third Schedule of ITMA.

9. This is quite reasonable otherwise diplomats would engage in trade for personal gains, and there is a possibility that they could serve as a front for businessmen wanting to evade tax.

10. The Proviso to S.(b) of the Third Schedule of ITMA 1961.

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Now we wish to recall an actual incident in order to show how these provisions have worked in practice. This was a matter that involved a Nigerian national who worked for the Indian High Commission in Lagos. The Revenue found him liable to Nigerian tax on the basis of the provisions outlined above, and somehow by a peculiarity of the Indian Code he was liable to Indian income tax. Apparently, this is because the Indian government taxes all income accruing directly or indirectly from India and these include any payments to High Commission or Embassy staff overseas.

The incident in question actually raised the spectre of double taxation since a Nigerian national ordinarily resident in Lagos suddenly found himself within the tax jurisdiction of two states. As there is no tax treaty between Nigeria and India, the problem was resolved by the use of the Commonwealth Tax Credit Relief.[1]

Looking at the same matter from another angle let us consider very briefly the tax position of Nigeria's own foreign personnel stationed abroad.

D. Foreign and Armed Forces Personnel and Decree No. 51, 1972

With independence in 1960, and then the Civil War some seven years later, Nigeria now has a fairly large diplomatic representation overseas and a vast territorial army at home. These two categories of taxpayers have been singled out for special mention here because of the inapplicability of the normal tests for tax liability and of residence.

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1. This is a scheme between Commonwealth countries to grant relief for taxes paid in other Commonwealth countries. See s.24 ITMA and Schedule Six of the same Act.

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The Income Tax (Armed Forces and Other Persons)(Special Provisions) Decree 1972 is the government's response to cope with the situation.

In short, the Decree provides for the imposition of tax on the income of Armed Forces personnel, public officers employed in the Nigerian Foreign Service and in respect of certain pensions and dividends payable overseas. The tax is to be collected by the Federal Board of Inland Revenue and not by the tax authorities of the states where the officers are resident or deemed to be resident. The proceeds of the tax after deduction of the expenses of the Board are to be credited the Distributable Pool Account for distribution to the states.

In view of the fact that officers of the foreign service and the armed forces are likely to be deployed and redeployed during a tax year, we endorse whole heartedly the provisions of Decree No. 51 of 1972 as a means of streamlining the machinery of taxing these categories of persons.[2]

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2. The success of the Decree rests, of course, on the basic assumption that servants of one state shall not be taxed by another state and that Nigeria's foreign service personnel pay no tax to overseas governments.

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VII. CONCLUSION

Several issues have been raised in this Chapter as regards the "taxation of persons" in Nigeria. Where appropriate, severe criticisms have been voiced and then suggestions made for improving not only the law but the modus operandi of the Revenue. In several other instances, however, the law has been thought acceptable as it stands at present.

In this brief section, therefore, we do no more than restate a few of our most important observations.

(1). As regards the definition of a "profession", "vocation" or an "employment", it is urged that the authorities should maintain a flexible approach, bearing in mind for example, that the standard of skill and training of a professional must be relative to the community in which he operates and never in the abstract. Also, that in the particular case of Nigeria that the majority of the adult population are neither true professionals nor employees, but simply people pursuing vocations.

(2). As has been observed elsewhere, the cornerstone of the Nigerian tax law is the principle of liability on "source income". A philosophy interpreted by us in the case of employment or professional income to mean that there is liability to Nigerian tax once the "place of performance" of the duties of a profession or employment is in Nigeria.

This approach was approved not only because it is a criterion difficult to manipulate for tax purposes, but as being very desirable in the interest of developing countries always on the receiving end of skilled labour.

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(3). Considerable attention was focussed in this chapter on the problems involved in determining the precise scope of a taxpayer's emoluments, profits or gains as the case may be. In this connection, it was noted that his earnings as well as his expenditure were influenced by the custom and tradition of the local community. It was urged that the tax authorities while endeavouring to preserve the social order must take cognisance of payments and purported gifts to professionals and employees where appropriate in the computation of "total income" for tax purposes.

(4). As a corrollary to the above, the question of benefits in kind was gone into in great detail. So also was the unique Nigerian concept of an "allowance" or "fringe benefit". It is our view that valuation must involve some compromise and wherever possible should be based on the market value of the benefit provided. Where this is not practicable a sort of "thumb rule" should be employed.

(5). It was submitted with regard to the rules governing the deductibility of expenses that these are too strict and plainly unrealistic. The "necessarily obliged" part of the expenditure test it was urged ought to be dropped in favour of the "actually incurred" test. The special case of travelling expenses was examined in some detail and it was our opinion that all employees earning £400 p.a. or less should be allowed to deduct their travelling expenses (from home to work). Tax law it is believed must yield to reason and not dogma.

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(6). The essential modification of the law and its enforcement with regard to armed forces and foreign service personnel was accepted by us. But in addition to that, it was thought that a machinery for the collection of taxes from cultural visitors and non-resident directors must be set up. This we observed is virtually non-existent at present.

Finally some value judgement. From all our discussion so far it is quite accurate to say that Nigerians are among the most "undertaxed people in the world".[3] The rates of taxes are low, the degree of progression of these rates slight, and the machinery of assessment and collection lax. We do not complain much because a country after all gets the kind of tax system it deserves and there is perhaps a valid policy reason for the Revenue not "flexing its muscles".

However, be that as it may, we wish to observe as follows:

That the Nigerian provisions are such as to encourage any intending expert or professional to the country. Not only is there a possibility of total exemption from tax but the schemes of generous allowances (taxable but not taxed) are very attractive. The risk of double taxation is also reduced or eliminated in the case of experts from some nine countries having tax treaties with Nigeria.

As for qualified Nigerians abroad who hesitates to come home because salaries appear small, a well publicised campaign showing

3. Professor Adebayo Adedeji is of the same opinion too. In a book Review by him he stated that "Nigerians were in 1953/54 and still today are one of the most undertaxed people in the world". July/1962/ Nigerian Journal of Economic and Social Studies Vol. 4 No.2 page 201 at 202.

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the numerous "fringe benefits" and "allowances" which go with these salaries should encourage them to return. On the other hand, the tax position is such as to discourage the emigration of skilled Nigerians, whose unique status and general level of remuneration, direct and indirect, have been well chronicled.

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CHAPTER FIVE

TAXATION OF INVESTMENT OR PROPERTY INCOME

I. THE PROBLEMS HIGHLIGHTED

A. Control Structure of Business, Capital Formation, Transfer of Technology, Conflicts of Interest and Jurisdiction, Re-Investment of Profits etc.

The objective of this chapter is to examine the Nigerian tax provisions in relation to "dividend" and "interest" payments collectively referred to above as "investment income", and the tax treatment of "royalties", "rents" and other payments derived from the letting of property referred to above as "property income". In the appropriate context, the characteristics of these species of income are explained and their precise ambit defined.[1] This introductory section, therefore, is no more than an attempt to sketch out the general background against which our discussion must be viewed.

On the question of approach, whereas, S.O. Fashokun[2] has considered the taxation of "property income" (defined by him to include dividends, interest and royalties); his treatment of the subject has been rather legalistic and not sufficiently geared to the realities of life in Nigeria. Our approach differs significantly from his, in that while reviewing the same subject

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1. It is not our intention here to engage in a lengthy discourse on the classification of income. What may be noted, however, is that "dividends", "interest" and "royalties" can either be classified as "property income" or as "investment income". For example, see G.S.A. Wheatcroft, "What is Taxable Income? (1957) B.T.R. 310 at 317 where he stated that the main items of Investment Income are (1) Rents; (2) Interest; (3) Dividends; (4) Annuities and Other Annual Payments; (5) Income from Estates and Trusts; (6) Royalties, Commissions, etc. On the other hand, S.O. Fashokun classifies them as "property income".

2. Personal Taxation in Nigeria - Ph.D (1971) University of London. Chapter 5. (unpublished).

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matter, problems are examined from a much broader perspective.

While the primary concern of this study is with legal problems, what must be stressed at the outset is that with the taxation of investment or property income an analysis of legal principles in the abstract is of little use, without some understanding of the underlying economic issues which they are designed to regulate. It is on this basis that we proceed, so that much of what is said herein centres around Nigeria's programme for economic development and the role of foreign investments in fulfilling that objective.

Recalling our basic premise that the private sector of the Nigerian economy is dominated by foreign interests,[3] our enquiry inevitably raises difficult questions of conflicts of law and problems of international double taxation. But above all, it brings into sharp focus the conflicts of interest and jurisdiction between the rich countries of investors where taxes are usually levied on the basis of residence, domicile or nationaltiy, and the poor host countries needing investments where tax liability is frequently on a "source" basis. Some of the relevant economic issues are now outlined.

In countries like Nigeria, lacking an industrial base, capital formation

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3. O. Teriba, E.C. Edozien and M.O. Kayode, "Some Aspects of Ownership and Control Structure of Business Enterprises in a Developing Economy: The Nigeria Case." Nigerian Jnr. of Eco. and Soc. Studies March 1972 Vol. 14 No. 1 page 3. This study based on data from the Companies Registry showed that foreigners have a tight grip on the Nigerian economy.

   In another independent study, A.O. Philips confirmed the position stating that the bulk of modern economic activity in Nigeria is carried on in organisations with substantial foreign interests. (1968) Nigerian Jnr. of Eco. and Soc. Studies Vol. 10, No. 3 page 321 at 330 article on "Nigerian Companies Tax".

   G.O. Nwankwo has also investigated how the expatriate banks dominate the Nigerian banking scene. See "Indigenisation of Nigerian Banking" - Paper delivered at the advanced seminar in African Law organised by S.O.A.S. 19th May, 1972.

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is a difficult process, and not adequate[4] for rapid development without considerable assistance from abroad. Even though it is widely accepted that in the long run what is needed is a greater mobilisation of internal resources through taxation and increased savings, in the interim, the necessary finance has to be secured from outside sources.[5]

At present, much capital for industrial development is obtained from the world capital markets or else from the intra-company transfer of resources.[6] The detailed mechanics of such transfer are unimportant here. What is, however, vital to note is that by whatever method loan capital is provided, substantial "interest" payments are involved - with its potentially adverse

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4. An eminent economist has argued that the shortage of capital in Nigeria is greatly exaggerated. Distinguishing between apparent and effective demand for capital, the author argued that often, what was lacking was the absence of viable projects or adequate security as opposed to lack of capital. See Sayre P. Schatz (1962) Nigerian Jnr. of Eco. and Soc. Studies Vol. 4, No. 1 page 66 article on: "Obstacles to Nigerian Private Investment". Many Nigerian economists disagree with the views expressed by that author, e.g. O. Sonubi at page 73 of the same journal.

5. Like most other developing countries, Nigeria was obliged to create an Industrial Development Bank; and more recently an Agricultural Credit Bank and a Bank for Commerce and Industry with the objective *inter-alia* of granting medium and long term credit for development purposes. The ordinary commercial banks especially the expatriate ones which were hitherto reluctant to grant credit facilities to businessmen are being coerced by the Federal Government to grant at least 40% of all loans and advances to indigenous borrowers. - Daily Times (Nigeria) 28th May (1973) page 3.

6. The net inflow of foreign investments in 1961 was £16 millions versus an outflow of £2.6m. giving a net flow of £13.8m. This rose gradually to a net inflow of £113.4m. in 1969 versus a net outflow of £54.00m giving a net flow of £59m. - Figures from: Economic and Financial Review - published by the Central Bank of Nigeria i.e. Vol. 6, No. 2 December 1968. Figures updated to 1969 from other C.B.N. sources. For a discussion of some of the problems faced by developing countries as regards access to Capital Markets. See Foreign Investments in Developing Countries - U.N. E/4446. Sales No. E. 68.11. D.2; page 35 para. 176, 170; page 36 para. 181, 184, 185

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effect on the borrower country's balance of payments.[7]

The need for a reasonable return on capital is accepted by the majority of developing countries because they know that investment would only come if a good return was possible. What they have often complained about in the past is that investors expect too high a return on capital investment. But the truth is that as long as there is no universally acknowledged measure of a "reasonable profit" the mutual resentment is likely to persist.[8]

In the absence of tax treaties, who has the primary right to tax interest payments? The home country of the investor, or the host country where the capital is put to work? And then what should be the basis of taxation - taxation on interest "gross" or "nett"? What are the criteria for determining the source of interest payments under the Nigerian law? When precisely does liability arise? Time of "entitlement" or time of actual receipt?

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7. An interesting example is Ghana where the public debt was so burdensome that the country was on the verge of bankruptcy. Creditors had to accept a reschedulement of payments. Highlighting the problem recently see Melvyn Westlake: "Anxiety over Developing Countries' Debt Load."- The Times (U.K.) September 17th 1973.

   It may be noted also that there are balance of payments implications too for the countries of the lender where foreign loans granted are excessive. Hence, in America and Europe borrowing by foreign entities is strictly regulated. George R. Delaume, Legal Aspects of International Lending and Economic Development Financing, page 18.

8. Dirk U. Stikker defines it "as the minimum profits required to attract investors to a project in the particular circumstances present and future, applying or judged to apply to that project". See: The Role of Private Enterprise in Investment and Promotion of Exports in Developing Countries. U.N. Publication TD/35/Rev.1; Sales No. E.68.11.D.9 page 11, paras. 55, 56 and 57. See also Panel on Foreign Investments in Developing Countries (1969) U.N. Publication E/4654-ST/ECA/117; Sales No. E.69.11.D.12; pages 20-21; para. 68 - 74.

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These, among other things, are the issues examined in this chapter.

Quite apart from the substantive provisions, the machinery for collecting the tax due is also examined. This is important especially since the bulk of those receiving interest payments from Nigeria are non-residents.

Much of what has been said already about interest apply to "royalty payments".

Under current conditions, the development of important new technology in the form of patents, processes, and scientific or industrial know-how is largely a function of the research department of major corporations in advanced countries.[9] So that just as much capital for industrial development must flow from the industrialised countries to the poorer ones, so also must know-how and managerial skill. The necessary consequence of this, of course, is a "reverse flow" of interest and royalty payments from the poor nations to the rich.

The conditions and procedures under which industrial technology is transferred to developing countries often raise a number of difficult legal and economic problems both to the suppliers and the recipients of such know-how. For example, the fact that an oversea company is able to conclude contracts

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9. Nigerian education under the British was not technically oriented. However, today there is a big move to encourage, promote, and co-ordinate industrial research programmes of all kinds in Nigeria as indicated by the introduction of the Nigerian Council for Science and Technology Decree 1970. (Decree No. 6 of 1970). Pursuant to this Decree, several Research Institutes have now been established.

   It may be noted in passing that it is perhaps better for a country to purchase patented inventions rather than engage in primary research which may amount to duplicating other peoples' work. A combination of both is probably the best solution.

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with its foreign subsidiary for the provision of intangibles and services leaves much latitude in arranging the terms of the remuneration payable by the subsidiary being fixed in a way which brings about a shifting to the parent company of profits actually earned by the former.[10] Also, there is the need for the host countries to provide adequate protection for industrial and intellectual property[1] which has to be balanced against the restraints of unjustified patent monopolies.

In discussing the taxation of royalty payments, attention is focussed in particular on the following matters: (1) The deliniation of the scope of the term "royalty". (2) The applicable tests for the purposes of liability to Nigerian tax. (3) The expense component of this kind of payment. (4) The machinery for collecting the tax due etc. etc.

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10. Nigeria is a case in point here. For the future, the Revenue is to be given more powers to disallow expenses for management, technical and other services which appear to it unreasonable. Experience show that these allowable expenses are used to reduce sizable profits to marginal profits or even losses with detriment to the Revenue: Daily Times (Nigeria) April 4th 1973, page 3 - Press statement on the 1973/4 Budget.

1 Without this protection, investors are reluctant to part with secrets. These kinds of property are now adequately protected in Nigeria with the introduction of the Patents and Designs Decree 1970. (No. 60 of 1970) and the Copyrights Decree 1970.

The recent moves by the EEC to establish a European Patents system at once highlights the need for the protection of industrial and intellectual property and the problems inherent in achieving the desired objective. Some of these problems are discussed in the letters to the editor of the U.K. Business Times, September 19th, 1973: Towards Clarification and Simplification of a Patent system for Europe.

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With dividends, a few preliminary remarks may be made. Since the subsidiary companies who dominate the Nigerian economy often send returns to overseas investors in the form of dividends and other company distributions rather than qua trading profits, the tax provisions relating to this category of income are of the highest significance. In that circumstance, is it logical not to discriminate as at present between distributed and undistributed profits in order to encourage the retention and re-investment of profits in Nigeria?[2] On the same basis, what is the rationale behind the tax exemptions granted to certain dividend payments especially the "pioneer dividends" and dividends paid by petroleum companies?

Before examining the detailed provisions on the taxation of investment or property income, it is perhaps apt to say a few words about the Nigerian Enterprises Promotion Decree 1972 — a decree not understood by many, but which in the opinion of this writer is likely to alter the whole economic order in Nigeria, especially, as regards the ownership and control of businesses and the conditions for the inflow and outflow of capital and technology into the country. Undoubtedly, these are matters which have to be taken into consideration in framing future tax provisions or in amending the existing ones.

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2. The point to note here is that retained earnings can become a major source of investment finance compensating for the deficiency of other sources. A.O. Philips examines some of the economic implications in more detail: "Nigerian Companies Tax" - (1968) Nigerian Jnr. of Eco. and Soc. Studies Vol. 10., No. 3, page 321 especially where he examines the tax treatment of distributed and re-invested profits.

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B. The Nigerian Enterprises Promotion Decree 1972, and the future of Foreign Capital and Technology

This decree establishes the Nigerian Enterprises Promotion Board which has the power to advance the promotion of Nigerian Enterprises.[3] The decree also establishes the Enterprises Promotion Committee in each state of the Federation with certain powers to assist and advise the Board on the implementation of the Decree and to ensure that its provisions are complied with by aliens resident in every state.[4]

Under s.4 of the decree, the establishment and operation of certain enterprises (listed in Schedule 1 of the Decree) are now exclusively reserved for Nigerian citizens, companies and associations;[5] and certain other enterprises (listed in Schedule 2 of the Decree)[6] cannot be operated or carried on by aliens in Nigeria unless they fulfill certain conditions specified in s.5 of the decree. That is to say, that no alien can be owner or part owner of any enterprise listed in Schedule 2 where:(i) the paid-up share capital of the enterprise does not exceed £200,000 or (ii) the turnover of the enterprise does not exceed £500,000 whichever the Enterprises Promotion Board considers to be appropriate and applicable in relation to such enterprise. And even where the above conditions (i) and (ii) are complied with, no alien can be owner or

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3. s.1 Decree No. 4 of 1972
4. Ibid., s.2
5. As shown in attached Appendix I.
6. As shown in attached Appendix II.

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part owner of any enterprise listed in Schedule 2, where the equity participation of Nigerian citizens or associations in the enterprise is less than 40 per cent.

However, the decree also provides that exemptions may be granted in certain circumstances and subject to such conditions as may be deemed necessary in respect of enterprises affected by the Decree.[7]

Relating the provisions of this decree specifically to the matters before us, the following observations may be made: (1) That the sphere of economic activity from which alien capital and technology are barred is relatively minor and inconsequential within the overall context of the Nigerian economy considering its present needs and future potential. For example, aliens are not barred from the exploitation of the country's natural resources,[8] agriculture and the provision of services like banking[9] and insurance. And neither are they prohibited from most of the heavy industrial or manufacturing businesses requiring a lot of capital and technical skill. (2) That, as a necessary concomitant of (1), private foreign capital and technology would continue to play a dominant role in the process of industrial development in Nigeria at least for the foreseeable future.

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7. s.9 Decree No. 4 1972

8. For example, Petroleum. The Oil Industry in Nigeria is dominated by foreigners.

9. It may, however, be noted that the Nigerian government has acquired 40% equity participation in the major expatriate banks operating in the country. G.O. Nwankwo gives the background to the move in his paper: "Indigenisation of Nigerian Banking" op. cit.

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From the foregoing exposition the need to have adequate provisions relating to the taxation of investment and property income must be self evident.

II. INTEREST AND ANALOGOUS PAYMENTS

A. Definition and Concept

Tax is payable in Nigeria in respect of "...... interest, discounts, charges or annuities".[10] Since these terms are nowhere defined in the Income Tax Acts, recourse must be had to the decided cases in order to discover their meaning.[1] With "interest", which is our primary concern, it is also important to determine its precise ambit; because the more comprehensive this is, the wider the category of payments covered, and the greater the resultant revenue yield.

A good working definition of "interest" may be found in the opinion of the Lord President of the Court of ession (Scotland) in the case of Schulze v. Bensted.[2] Quoting from Bell's Dictionary, His Lordship defined "interest of money", as[3]

> "the creditor's share of the profit which the borrower or debtor is presumed to make from the use of the money". Or,

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10. s.17(c) CITA 1961; s.4(1)(d) ITMA 1961. Not much attention is paid to discounts, charges or annuities. Our chief concern is with "interest".

1. Mainly Commonwealth authorities are cited because Nigerian cases are lacking.

2. [1916]S.C. 188; 7 T.C. 30.

3. Ibid., S.C. at p. 191; T.C. 33. Rowlatt, J. in Bennett v. Ogston called it "payment by time for the use of money". And in Re Foam Security 1944, a Canadian case, (1947) S.C.R. 394., it was stated that "interest is in general terms, the return or compensation for the use or retention by one person of money belonging in a colloquial sense, or owed to another". See also Halsburys Laws of England, 3rd ed., Vol. 27 page 7.

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that "otherwise stated, it is just recompense to the creditor for being deprived of the use of his money".

Similarly, in Riches v. Westminister, Lord Wright stated that:

"..... the essence of interest is that it is a payment which becomes due because the creditor has not had his money at the due date". And that "it may be regarded as representing the profit he might have made if he had had the use of the money or conversely the loss he suffered because he had not had that use".[4]

What must be stressed here is that not only may loans produce to the lender that kind of profit or income called interest, but they may produce a further profit or income derived otherwise than by way of interest on these loans.[5]

There are a number of borderline cases where the taxpayer receives something for lending his money which is not described as interest. For instance, he can lend £100 on terms that when it is repaid he gets back £105 (i.e. redemption at a premium), or, alternatively he can lend £95 on a security

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4. [1947] A.C. 390 at 400; 28 T.C. 159 at page 189.

5. Hakim Bhai v. C.O.T. Ceylon Tax Cases Vol. 1., page 8 - especially judgement of MacDonald, C.J. at pp. 16, 19.

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which will return him £100 (i.e. an issue at a discount).[6] In the U.K., the general principle seems to be that when a commercial rate of interest is charged and the premium or discount is additional, then the profit of such premium or discount is treated as paid in respect of capital at risk and is not income.[7] But if no interest is charged, or some extremely low rate, then the premium or discount is the reward for lending the money and is regarded as income.[8] In this circumstance, a lot would depend on a proper analysis of the transaction in the light of all admissible extrinsic evidence.[9]

In the case of Nigeria, such exercise is unnecessary because "discounts", "premiums", "charges" and "annuities" are expressly deemed to be taxable income;[10] presumably, on the assumption that they are sufficiently analogous to interest payments.[1]

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6. The word "discount" has no technical or universal meaning. In what is perhaps its most common meaning, it is equivalent to the payment of interest in advance e.g. when a banker advances the amount upon a bill of exchange which is not yet due, discounting the interest up to the day of payment. It is used in another sense for the abatement which is given on a debt because payment is made at an earlier date than it is customary for such debts to be paid.

7. Lomax v. Peter Dixon & Co. Ltd. [1943] K.B. 671 at 679; 25 T.C. 353 at 365. This case is important because of Lord Greene's analysis of the various methods adopted in regard to the granting of commercial loans. K.B. at 682; T.C. at 367. His Lordship's analysis has been quoted with approval by most experts. (See Simon's Taxes 3rd ed., Vol. C. at page 123 para. C.1. 201; Whiteman and Wheatcroft para. 3.34; page 80 et seq.

8. Davies v. Premium Investment Co. Ltd [1945] 27 T.C. 27

9. Lomax v. Peter Dixon, Lord Greene, M.R., K.B. at p. 677; T.C. at p. 363.

10. The charging provisions of CITA provides that tax is payable upon the profits of any company in "respect of discounts, annuities, or other charges". There is no distinction drawn here between "capital profits" and "income profits".

1. Lomax v. Peter Dixon, Lord Greene, M.R. K.B. at 681 where his Lordship stated that the "discount is the reward" which a person discounting a bill of exchange or exchequer bill receives for his money.

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As regards the scope of interest payments generally, three situations may now be considered. Firstly, where damages are given by the courts which include an addition for interest. The Nigerian practice here is not well documented, but it is the opinion of this writer that such interest should be taxable so long as the receipt in question is in substance interest and not a capital sum for damages which has been estimated on an interest basis.[2] Secondly, where arrears of interest are capitalized under the terms of the loan. The logical thing here, perhaps, is that where a sum is repaid in excess of the original capital of the loan that excess is to be regarded as taxable income.[3] Thirdly, what is the legal position where interest is unpaid because it is unclaimed?

The general principle in the U.K. is that no income can be imputed as nothing ever arose.[4] In that country, there is considerable case law on the subject of interest supporting the principle that "receivability" without receipt is nothing. For example, in St. Lucia and Estates Co. Ltd. v. St. Lucia (Colonial Treasurer)[5] unpaid interest on part of certain outstanding purchase price was held not to be assessable as it was not "income arising or accruing" in the relevant period. In Dewar v. I.R.C.[6] undrawn interest

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2. Riches v. Westminster Bank Ltd [1947] A.C. 390 especially Lord Simonds at page 398.

3. I.R.C. v. Oswald [1945] 360; 26 T.C. 448

4. G.S.A. Wheatcroft: "What is Taxable Income? (1957) B.T.R. 310 at 317. See also Ralph P. Ray, "Waiver of Remuneration, Dividends, Interests and Rents" - (1972) B.T.R. 173 at 178.

5. [1924] A.C. 508 (P.C.)

6. [1935] 2 K.B. 351; 19 T.C. 561, C.A.

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on a pecuniary legacy to which the taxpayer was legally entitled was again not included in his taxable income and this decision was followed in Woodhouse v. I.R.C.[7] Moreover, as these cases suggest, the mere voluntary non-collection of the interest was sufficient, and it was not necessary to show any default by the debtor.

An exceptional position arises in "transactions associated with loans or credit" as set out in section 496 of the Income and Corporation Taxes Act 1970. This is an anti-avoidance section applying where interest or other income is deliberately foregone in cases involving money lending or the giving of credit. The person foregoing the income is then assessed under Schedule D case VI on an "entitlement basis". But an effectively waived dividend or interest entitlement is not regarded as a distribution assessable under Schedule F pursuant to s. 233 (2) (a) and (d) of ICTA 1970.

Hitherto, the Nigerian law has been quite similar to the U.K. position outlined. That is, liability to pay tax arose only if there was an actual payment of interest. However, from the press statement subsequent to the 1973/74 budget, it has been indicated that the law is to be amended "to ensure that taxes are payable to the Revenue as at the time such interest, management fees and royalties are shown in the company's account as due to overseas beneficiaries".[8]

What this proposed amendment would amount to in practice is still to be

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7. [1936] 20 T.C. 673: The taxpayer in this case sold property to a company in consideration of covenant to pay annuity. Part only of annuity was drawn, the question was whether the whole annuity due to the taxpayer was assessable to tax.

8. Daily Times (Nigeria) April 4th 1973 page 3. This proposal has a lot of accounting implications too. That is, whether accounts are to be made up on a "cash" basis or an "earnings basis".

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seen. But it is very doubtful whether the desired objective (i.e. to bring in governmental revenue more quickly) can be achieved. For example, if liability to tax is to arise at the point of time when an interest or royalty payment becomes due, who fixes the time of maturity? Surely, this is usually a matter of contract between the creditor and the debtor, or between the licensor and the licensee as the case may be. If then the time of payment is a matter of contract, can the agreed terms not be varied by the parties in order to defeat the objectives of the law?

Since the precise wording of the proposed amendment is still unknown, any further comment on the issue is futile and purely speculative.

To sum up, it is perhaps safe to conclude that the term "interest" as employed under the Nigerian Law would include any remuneration from bonds or debentures, government securities, cash desposits in banks, as well as any other profit arising from a money lending transaction of whatever description.[9] But whether or not the scope of the term "interest" can be extended to cover the interest on deferred payment on sales is uncertain. Like most other countries, the Nigerian tax provisions were perhaps never intended to cover these specie of payments.

The real point at issue here is this: Where instalmental payments of a capital nature are payable which exceed the antecedent liability is it right to regard the balance as interest and hence taxable, while at the same time ignoring the interest element where the antecedent liability has not

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9. The term "interest" is usually defined exhaustively in tax treaties in order to remove doubts as to the precise scope of payments covered. For example, see OECD Draft Convention Article 11.

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been quantified but a settlement is made in lump sum form payable by instalments?[10]

The question whether or not interest charged on deferred payments by the seller of goods or machinery should be treated under the same rules as any other kind of interest has been considered by the U.N. Ad Hoc Group of Tax Experts.[1] The crux of the matter is that developing countries who purchase a lot of equipment from overseas often find it difficult to determine the interest element involved in the sales price of goods and machinery. Even though the interest may be substantial, they are often obliged to refrain from taxing this income because to be able to do so, there must be a provision in the law imputing an interest element on deferred credit sales where none is stated.

Bearing the above in mind, the following pertinent questions may be asked. What is the degree of revenue loss to Nigeria, potential or actual, by not taxing interest on deferred credit sales? And if a tax must be imposed, what are the administrative obstacles?

Presently, there are good grounds for suggesting that the revenue loss from the kinds of transactions in question has not been very significant.[2]

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10. Ref. Campbell v. I.R.C. 45 T.C. 427; [1970] A.C. 77 H.L.; Vestey v. I.R.C. Periodical payments in connection with the sale of shares were held to contain an interest element. N.B. The numerous cases in this area of law are discussed fully in Whiteman and Wheatcroft paras. 3 - 25 to 3 - 33.

1. Tax Treaties Between Developed and Developing Countries - U.N. Publication First Report 1969 - Part One para. 88; Second Report 1970. Part Two, page 65 i.e. Chapter VIII. Interest on Deferred Export Credit Sales.

2. No exhaustive study has been carried out on this point yet. The Ad Hoc Group of Tax Experts came to no definite conclusion too. Tax Treaties Etc. Second Report (1970) at page 65.

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This view is probably correct since most medium and long-term credits for purchases of equipment by developing countries are extended under official arrangements and in all cases, the credit agreements themselves provide that the interest payable should not be subject to tax.[3]

Even assuming that it is desirable to tax interest on deferred credit sales, the tax base will be very much eroded through administrative problems. A high degree of voluntary compliance from exporters is out of the question if it would involve significant book-keeping costs or if for some reason the tax would not offset a tax of the home country. For a developing country with rather modest administrative resources, it will certainly be a difficult task to effectively police each sale to determine if there should be some imputed interest. Consequently, the result of this administrative compromise would be to reduce the economic importance of taxing deferred credit interest.

There is the spectre of double taxation too. In order to avoid double taxation on the interest element of a deferred credit sale, it may be necessary for the country of sale and the country of residence (i.e. of the exporter) to agree on an appropriate interest rate, something which may not always be easy to achieve.[4]

It is hereby submitted, therefore, that for the time being it is not necessary to extend the scope of the term "interest" under the Nigerian law to cover the interest element under credit sales arrangements.

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3. Tax Treaties Etc. First Report (1969) para. 88, page 19.

4. One possible solution would be to use the rate on the Bankers Acceptances as an appropriate guide, since this rate is a genuine market rate for financing commercial sales. Cf. Tax Treaties Between Developed and Developing Countries. Second Report 1970 p. 66

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Attention is now focussed on "loan interest", considered to be the most important category of interest, i.e. returns on loans made to companies or individuals for trading purposes. In the following discussion the double taxation implications are largely ignored as these are fully explored in subsequent chapters.

B. Liability to Nigerian Tax: The "Source" of Interest

Tax is payable for each year of assessment upon income accruing in, derived from, brought into or received in Nigeria in respect of "... interest, discounts, charges or annuities".[5] In other words, a taxpayer is liable on any interest payment received from a Nigerian "source", or alternatively, where the interest is from a foreign "source", he is liable to pay tax on a "remittance" basis.[6]

While it is difficult to determine whether or not interest or any other income has been "remitted" into a country,[7] it is much more difficult to determine where the "source" of an interest payment is located for the purposes of taxation. It is with the latter problem that we are now concerned.

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5. s.17(c) CITA 1961; s.4 (1)(d) ITMA 1961.

6. The conclusion in Chapter Two was that the charging provisions limit the taxpayer's liability in a geographical sense to profits derived from Nigeria (i.e. having a Nigerian "source"); and restricts liability in respect of transactions carried on outside Nigeria to profits actually brought into the country.

7. This is because the word "remit" is used in a technical sense. What must be noted is that there can be a remittance of moneys into a country without the physical transfer of funds, e.g. Timpson's Executors v. Yerbury 20 T.C.155. See other cases discussed in Chapter Two.

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For the purposes of companies taxation, interest is deemed[8] to be derived from a Nigerian "source" if, (1) there is a right to payment of the interest in Nigeria or, (2) if the interest is by deed, will or otherwise charged upon or reserved out of real or personal estate situate in Nigeria, the property of the person paying the same, or as a personal debt or obligation by virtue of any contract which is entered into in Nigeria; or, (3) in the case of money lent to a "Nigerian company"[9], the loan is evidenced by mortgage, debenture, loan or other stock whether secured or unsecured issued by the company in recognition of its debt. (4) Fourthly, interest is deemed to be from a Nigerian "source" if the interest is payable on money lodged at interest in Nigeria.

On the other hand, for the purposes of personal taxation, the income from any interest on money lent by an individual, or an executor, or trustee outside Nigeria to a person in Nigeria (including a person resident or present in Nigeria at the time of the loan) is deemed to be derived from the country if there is a right to payment there, if it is charged upon the payer's real or personal estate in Nigeria as a personal debt by virtue of a contract entered into in Nigeria.[10]

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8. s.17 CITA deeming clauses after charging provisions.

9. The law is silent on the case of money lent to non-Nigerian Companies. A "Nigerian company", it may be recalled, is one whose "management and control" are exercised in Nigeria. s.2 CITA; s.2 ITMA - Interpretation sections.

10. s.11 ITMA 1961. N.B. In spite of the slight differences in phraseology between the deeming provisions in the ITMA and CITA, it is assumed that the provisions are essentially the same, so that for the purposes of this study any reference to one includes a reference to the other except where otherwise stated.

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The purpose of the above deeming provisions, it would seem, is to serve as a guide in determining when precisely an interest payment is from a Nigerian source. For example, by employing the formulae provided, once the security offered for the principal loan is situate in Nigeria, or the contract for the loan is entered into in Nigeria, it is quite easy to conclude that the "interest" has a Nigerian "source".[1] But what is not so easy to decide, however, is the source of interest on capital productively employed in Nigeria, where the security for the loan is located overseas or where the "loan contract" is made abroad.

Two reservations may be made thus far. Firstly, that the deeming provisions cannot be used to determine the "source" of income in every given situation and perhaps were not so intended anyway. Secondly, that the efficacy of these provisions is greatly reduced by difficulties of interpretation and application. For instance, what is the exact meaning of the expression "interest payable on money lodged at interest in Nigeria"? No guidance is available anywhere.[2] But in the opinion of this writer, it would appear that this deeming provision applies only to interest payments derived from sums deposited with banks, building societies, the Post Office and the like. That is, lodgements in Savings Accounts, Deposit Accounts, etc. This is as distinct from interest on loans granted to individuals or companies for commercial activities. Thus, where A lends 500 francs to B in Paris repayable there in French francs and then B with or without the knowledge or consent of A remits this sum to Nigeria for his trading purposes, can it be said therefore that A

1. i.e. following the second deeming provision in s. 17 CITA.

2. No case has arisen in Nigeria on this point.

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has "lodged money at interest" in Nigeria? We think not.[3]

The real heart of the matter is this: Under what condition are foreign investors liable to tax on interest from loans productively employed in Nigeria? This undoubtedly is a matter which is of the utmost importance for the investor and the host country alike.

Money utilised in Nigeria from a loan can be divided into two categories. (a) Firstly, money which is lent by a foreign company in a foreign country but brought into Nigeria and used by the borrower. (b) Secondly, money brought into Nigeria by a foreign company and lent out there. In practice, the distinction between these two kinds of transactions may be blurred and very often may be a matter of form rather than substance. But the tax implications of the two kinds of arrangement may differ a great deal.

Whereas, there is a clear liability to pay tax in Nigeria under (b), i.e. having regard to the charging provisions as extended by the deeming clauses; the question of liability to Nigerian tax under (a) is more controversial. This is likely to remain so, as long as there is no universally accepted formula for determining the "originating cause" of interest payment for the purposes of taxation.

The question of the "source" of interest payment has been the subject of major litigation recently in Nigeria and Kenya (East Africa). The two cases

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3. Cf. Schioler v. Westminster Bank Ltd - discussed in Chapter Two suggests the contrary. In that case, a dividend warrant in Malaysian Dollars was sent to the U.K. for realisation by Guersey Bank without consulting customer. It was held that the "dividend" was received in the U.K. and hence taxable in that country.

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involved which had very similar facts related to the correct interpretation of the charging provisions under the Nigerian and Kenyan laws; laws, which were virtually identical except that in Nigeria the issue was the interpretation of the charging provisions as modified by the first deeming clause to the effect that interest is deemed to be derived from Nigeria if "there is a right to the payment of the interest in Nigeria".

It is interesting to note that the outcome of the two cases were virtually the same thus indicating that the Nigerian deeming provision is of little or no effect. In fact, as is illustrated presently, it is capable of producing a result completely opposite to what its authors probably intended. Rather than extend the scope of Nigeria's tax jurisdiction over "interest", the deeming provision restricts it geographically.

First, we refer to the Nigerian case of Aluminium Industries Aktien Gesselshaft v. The Federal Board of Inland Revenue,[4] the relevant facts of which were not in dispute. The appellant company in that case was a Swiss company which had advanced substantial loans to its subsidiary Nigerian company known as "Alumaco". It was never in dispute that interest at the rate of 5 per cent was paid to the appellant company by Alumaco consequent upon an agreement concluded in Switzerland for a loan in Swiss francs to be repaid in that currency in Zurich.

The problem which arose in this case was whether the interest so earned by the foreign company was subject to tax under the Companies Income Tax Act 1961 as amended. The majority of the Appeal Commissioners decided that the

4. Suit No. SC/64/70 (unreported Supreme Court decision), decided on January 15th 1971 by Sir Ian Lewis, J.S.C. on behalf of the Supreme Court.

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interest so derived by the foreign company was not subject to tax, following which the Revenue appealed.

In the High Court of Lagos,[5] Sowemimo, J., gave judgement for the Revenue and allowed the appeal, holding that the interest in question was subject to tax in Nigeria. Although overruled on a further appeal to the Supreme Court, and it is thought rightly too, yet it is important to examine the reasoning behind his lordship's decision. The following passage from the judgement is quite revealing:

> "What has to be decided is whether Alumaco as the agent of the respondents[6] is liable to the payment of tax on the interest paid to the respondent. The interest is derived from the profits made by Alumaco in Nigeria. Such profits are taxable.[7] Alumaco is a subsidiary of the respondent company, the only difference being that Alumaco is a company registered in Nigeria, whereas the respondent is a foreign company. Since this foreign company had decided to invest money in a subsidiary company in Nigeria, it cannot escape payment of tax on the interest derived from the profits made on the investment in the subsidiary company[8] merely because the "deeming" provisions of s.17 speaks of a right to a payment of interest in Nigeria. I am in complete agreement with the judgement of the minority that the Swiss

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5. Suit No. LD/7A/69, judgement given on the 21st November 1969. (unreported).
6. Emphasis supplied.
7. Emphasis supplied.
8. Emphasis supplied.

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Company could sue the Alumaco in Nigeria if they should default in paying the agreed interest. It is immaterial whether the agreed interest should be paid in Swiss francs or not, the interest to be paid is out of profits made in Nigeria.[9] The money was invested in Nigeria therefore whatever profits are derived from such investment by way of interest must be subject to tax in Nigeria."

From the underlined parts of the above extracts the reasoning behind Sowemimo, J's judgment is obvious. Here was an attempt by a judge of the High Court to interpret or perhaps to bend the law in order to reflect the economic reality of the situation. To conclude as his lordship did that interest paid by Alumaco from profits made in Nigeria is from a Nigerian "source" is certainly not an unreasonable approach. It is in fact in line with the submissions of the developing countries at the meetings of the U.N. Ad Hoc. Group of Tax Experts.[10] Considering the one way flow of capital (i.e. from the developed to the developing countries), and the resultant flow of interest payments in the opposite direction, it would clearly be to the advantage of the poorer countries were it universally agreed that for tax purposes, the "source" of interest is the locality where the loan capital is utilised to generate wealth.[1]

Regrettably, however, laws of developing countries supposedly designed to regulate economic activities are all too often out of touch with reality.

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9. Emphasis supplied.

10. Tax Treaties Between Developed and Developing Countries. First Report (1969) Part One, page 19, para. 89; Part Two, page 46, para. 53; Tax Treaties Etc. Second Report (1970) Part One, page 17 paras. 98 - 105.

1. The capital exporting countries on the other hand often argue that the "source" of income is the place of residence of the lender. The contentions of both the rich and the poor appear to be valid.

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A number of observations may be made on the judgement in the Lagos High Court. Firstly, it is interesting to note that the trial judge ignored the fact that the Swiss company and Alumaco were two separate and distinct legal entities. The relationship between the parties was clearly not one of principal and agent but of lender and borrower - the fact that one was a wholly owned subsidiary of the other notwithstanding.

In this circumstance, it is doubtful whether the judge could pierce the veil of incorporation. There was nothing unusual or illegal about the transaction between the parties[2] and no evidence was adduced before the Court to show that the transaction was a sham and was entered into with a view to evade tax.[3] On the contrary, the transaction appear genuine and more or less at "arm's length". The 5 per cent rate of interest seems to be quite reasonable and does not indicate an attempt to "siphon off" profits from the subsidiary company in Nigeria to its parent company overseas - a result which is easily achieved by charging exhorbitant interest rates.[4]

Yet the dilemma facing the judge was fairly typical. That is, whether the form or substance of a transaction is to prevail. Even though the question facing the court was not a simple case of company "A" in Zurich investing money in company "B" in Nigeria, this was the net effect. In other words, Sowemimo, J. was correct at least from the practical point of view when he held that a

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2. It is common practice for parent companies to provide funds for subsidiaries. i.e. either from its own funds or from the world capital markets.

3. Where tax evasion is attempted, the Revenue may disregard such transaction especially when it is artificial or designed to reduce tax liability. s.14 ITMA; s.25 CITA.

4. The point here is that interest is an allowable deduction from gross profits. s. 17 (1)(a) ITMA; s. 27 (1)(a) CITA 1961.

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foreign company had invested money in a subsidiary in Nigeria.

In spite of the above, however, it is the opinion of this writer that what the Court had to look at in this particular case was the fact that money was paid by "B" to "A" in Zurich pursuant to an agreement and more important still that the agreement between the parties concluded in Zurich was for a loan in Swiss francs to be repaid in Zurich in Swiss currency.

Although the understanding between the parties was for the loan capital to be used for Alumaco's purposes in Nigeria, (and thus in a loose sense "invested" in Nigeria) it is important to note that having received the money in Zurich, it was possible for Alumaco to keep the money in Zurich for other purposes without remitting the same to Nigeria.

Directing our minds specifically to the tax consequences of the transaction, it is our view and we are supported by several authorities[5] that as regards "interest", the law is not concerned with how or where the borrower obtains the funds with which he pays interest. In other words, the source of the lender's income (e.g. interest) has nothing to do with the "source" of the debtor's income from which he discharges his obligation to pay interest.[6] Duffus, P., in the East African case subsequently reviewed, illustrated the point well when he stated inter-alia that :

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5. E.g. Tariff Reinsurances Ltd. v. C.O.T. [1938]59 C.L.R. 194 at 205, where Sir John Lathan, C.J., stated that "It is not relevant to consider what another person who is not an agent in any sense of the taxpayer does in order to obtain the moneys which he uses for purpose of making payments to the taxpayer." N.B. An analogy may be drawn here with the determination of the "source" of a director's remuneration viz., place where the company obtains its own profits? - See P. Co. Ltd. v. C.O.T. 1 E.A.T.C. 131.

6. North, J., in I.R.C. v. Philips Gloeilampenfabrieken [1955] N.Z.L.R. 868 at p. 891.

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"a bank which lends a trader money in the U.K. to be repaid with interest there could hardly be asked to pay Kenya income tax if the trader happens to bring that money, or a portion of that money into Kenya and trades with that money there and then pays his interest from the profit he earns in Kenya. Surely, here the position must be that the trader pays income tax on the profits he earns, but the bank in the U.K. could not be asked to pay income tax on the interest sent from Kenya when so far as the bank was concerned it has invested its money by a loan in the U.K. and had had nothing to do with the trader's venture in Kenya".[7]

One criticism of Sowemimo, J's judgement, therefore, is his failure to draw a distinction, albeit a fictional one, between the "source" of the lender's income (i.e. interest) and the "source" of the borrower's taxable profits out of which the interest was paid. To hold as he did that the interest received by the Swiss company is "derived from the profits made by Alumaco in Nigeria" is to confuse matters.

Another and perhaps more serious criticism of the judgement is this: By holding that "it is immaterial whether the agreed interest should be paid in Swiss francs or not", the trial judge completely ignored the express terms of the agreement between the parties. If this fact is immaterial, then what is material? With due respect, it is submitted that the stipulation in the loan agreement that the principal and interest are to be paid in Zurich in Swiss currency are terms fundamental to the contract. This point is discussed in further detail below.

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7. 1971 E.A.L.R. 127 at pages 143, 144.

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Finally, and as a corollary to the above, it is considered untenable to hold as the trial judge did, that the Swiss company had "a right to sue" for repayment of the interest in Nigeria in accordance with the first "deeming" provision of s.17 CITA as amended. The reasons for our submissions here would emerge presently.

As stated previously, Sowemimo, J., was overruled on appeal to the Supreme Court where some of the fallacy of his reasoning was exposed. In line with our second and third criticism above, Chief F.R.A. Williams counsel of the appellant company, recalled that while the ordinary rule in respect of a debtor is that the debt is situate where the debtor resides because there the debt can be enforced against him by process of law,[8] this rule did not apply if there was a contract (as was the position here) to pay in a specific currency.[9] Expatiating a little on the point made by counsel, the question is this; how far is it logical to regard the place of residence of the debtor as the situs of a debt and hence the location of the "source" of interest for tax purposes as has been contended in a number of cases?

The kind of anomaly which may arise is well illustrated by the Ceylonese case of National Bank of India v. C.O.T.[10] In that case, the main issue was

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8. Counsel relied on the statement of Lord Atkin, J.,(as he then was) in New York Life Insurance Company v. Public Trustees [1924] 2 Ch. 101 at 120. This writer considers the principle as stated to be correct. See R.H. Graveson: The Conflict of Laws - 6th ed. Sweet & Maxwell 1969, at pp. 52 - 53; Dicey and Morris - on The Conflict of Laws - 8th ed. 1967. Stevens & Sons at pp. 509 and 510.

9. Counsel relied on the statement of Eve, J., in Re Russian Bank for Foreign Trade [1934] Ch. 720 at 738. N.B. For the purposes of the Capital Gains Tax Decree, a debt, secured or unsecured is situated in Nigeria, if and only if the creditor is resident in Nigeria. s. 25(c) CGTD 1967.

10. Ceylon Tax Cases Volume One page 121. This case is in line with the well known South African case of C.I.R. v. Lever Bros, op. cit. where it was held that interest on money lent abroad was derived from a non-Union source even though the debtor was resident in South Africa.

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whether interest payments on loans obtained overseas can acquire a Ceylonese source once the debtor hitherto non-resident becomes resident in Ceylon. Poyser, S.P.J., in the District Court had no difficulty in rejecting the Revenue's argument holding that it is a fallacy to treat an overdraft incurred in England by a person at the time resident in England as something in the nature of an investment in Ceylon when the debtor becomes resident in that country. In this circumstance, therefore, the judge concluded that the interest payable on the overdraft could not be said to be income "arising in, or derived from Ceylon".

On a purely theoretical level, it has been suggested that a debt being a specie of intangible personal property should be taxable in the state in which the owner resides and nowhere else. And that debts due from the residents of one state to the residents of another state should not be taxed in the state in which the debtor resides, merely on account of such residence.[1]

Sound as these propositions are, they are not trouble free. For tax purposes, the proposal to locate the source of interest payment at the place of residence of the creditor rather than that of the debtor suggests that this "source" is not a fixed one. But the truth of the matter is that the "place of residence" test (i.e. either of the debtor or creditor) being something that can be changed quite easily cannot be a practical criterion for resolving the question of liability to tax on interest payments.

Putting the whole problem in perspective and to return to our main discussion, Ian Lewis, J.S.C., on behalf of the Nigerian Supreme Court stated that what they had to determine in the case before them was not whether the appellant company could recover if it chose to sue Alumaco either in Nigeria or in

1. Karl Drechsler, "Business Situs as a Basis of Property Taxation of Intangibles" - (1943) Wisconsin Law Review, page 352 at page 367.

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Switzerland. But on the contrary, their sole duty according to his Lordship was to decide whether it had a right to the payment of the interest in Nigeria in accordance with the first deeming provision of s.17 CITA especially since the case as pleaded fell within that narrow compass.

Following a number of English authorities,[2] his Lordship did not hesitate in holding (1) that it had no such right and that its sole right under the contract was for payment in Switzerland in francs; (2) that it could not sue in Nigeria for payment of interest in Swiss currency, for it was only in Swiss Courts that judgement could be obtained in Swiss currency; (3) that if the appellant company tried to sue Alumaco in Nigeria it could only be for damages for failure to pay its debt or fulfill its obligations and that a Nigerian court would then award damages in Nigerian currency.

In reaching a conclusion on the matter before him, the appeal judge directed his mind to two factors. Firstly, the "originating cause" of interest payment and secondly its place of location. In his own words:[3]

> "the source of this obligation was the agreement made in Zurich between the appellant company and the Aluminium Manufacturing

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2. Especially the statement of Lord Radcliffe in In re United Railways of Havana and Regla Warehouses Ltd [1961] A.C. 1007 at p. 1059 stating inter-alia, that "any contract to settle a debt in the currency of the country in which the settlement is to be made is a contract for the payment of money in the eyes of our law ....." And also Lord Denning at page 1067 of the same report viz that "in the absence of any express clause determining the proper law, the transaction should be governed by the law of the country of the lender". Concluding, his Lordship noted that any claims brought before the English courts must be made in "sterling and judgement given in sterling" as the English courts "do not give judgement in dollars any more than the U.S. courts give judgement in sterling".

3. At page 11 of the certified true copy of the judgement.

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Company of Nigeria Limited, and the obligation itself under that agreement was for the Aluminium Manufacturing Company of Nigeria (Alumaco) to pay the principal and the interest on the loan to the Appellant Company in Zurich in Swiss currency. Hence, neither the source of the obligation nor the obligation itself arose in Nigeria but in Switzerland.[4]

That being so, it was decided that the claim for tax could not be brought within the first deeming provisions as pleaded by the Revenue and that the Swiss company was not liable to Nigerian tax on interest payments by Alumaco.

In our opinion, the criteria applied by the Supreme Court are quite logical, even though as is pointed out shortly these are completely out of touch with economic reality.[5]

It is fascinating to note that in the case of Esso Standard Eastern Inc. v. Income Tax,[6] the East African Court of Appeal had reached exactly the same con-

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4. Emphasis supplied. Note that in reaching a decision on the "source" of obligation and its place of location his Lordship relied on the case of National Bank of Greece S.A. v. Westminster Bank Executor and Trustee Co. (Channel Islands) Ltd. H.L. [1971] 2 W.L.R.105. The crux of the matter here was whether or not the source of payments (as guarantors in default of payment of interest by the principal debtors) was situated within the United Kingdom. Lord Hailsham, L.C. at p. 109 - "I have come to the conclusion that the source of the obligation in question was outside the U.K. This obligation was undertaken by a principal debtor which was a foreign corporation. That obligation was guaranteed by another foreign coroporation which as was conceded before us had at no time any place of business within the U.K. It was secured by lands and public revenues in Greece. Payments by the principal debtor of principal and interest to residents outside Greece was to be made in sterling either at the offices of Hambros Bank or Erlanger Ltd.or (at the option of the holders) at the National Bank of Greece in Athens Greece by cheque drawn on London. Whichever method was selected ...... discharge of the principal debtors' obligation would have involved .... either a remittance from Greece to the paying agents specified in the bond, or, at the option of the holder, a cheque issued within Greece though drawn on London and presumeably payable there out of funds remitted by the debtors from abroad".

5. I.e. the one way flow of foreign investments and the possibility of tax avoidance by the manipulation of the place of contract. This writer would like the law to be changed so that the substance of a transaction prevails rather than its form.

6. [1971] E.A.L.R. 127

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clusion as was arrived at in the Alumaco Case. These two cases decided about same time were based on remarkably similar facts.[7] In the Esso Case, the Commissioner of income tax confirmed an assessment on the Appellant, an American company, of income tax on interest received by it in respect of a loan made available to a Kenya company for the construction of a refinery in Mombassa and for working capital. The loan agreement made in New York was for dollars and all repayments were to be made in New York in dollars.

The question at issue was whether the interest on the loan accrued in, or was derived from Kenya.

The Court of Appeal held as follows: (1) That the expressions "accrued in" and "deprived from" are synonymous[8] and interpreted them to mean "source",[9] (2) that the source of income is the place from which it is derived and that this is a question of fact. Applying these principles to the problem before it the Court decided that the source of the interest in this case was the contract made in New York, that the location of that source was New York and that the interest neither accrued in nor was derived from Kenya.

Following the decisions in the Alumaco Case and the Esso Case it is now settled law both in Nigeria and East Africa that the "source" of interest payment is the agreement for the loan and that the location of that "source" is the place of the agreement.

Our first objection to these tests for resolving the problem of liability on interest payments is the ease with which they can be manipulated to avoid tax.

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7. The Esso Case was decided on the 5th of June 1970, whereas the Alumaco Case was decided on the 15th of January, 1971. It is surprising that no reference at all was made to the Esso Case at the Supreme Court.

8. I.e. following Lord Davey in C.I.R. v. Kirk 1900 A.C. 588 at p. 592

9. The Court followed Lord Davey's statement in Liquidator Rhodesia Metals Ltd v. C.O.T. [1940] A.C. 774 at 789. Approved by Briggs, J.A., in C.O.T. v. P. Co. Ltd. 1 E.A.T.C. 131 at 162.

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For instance, loan agreements may be concluded in "tax havens" thus localizing the "source" of interest in territories where little or no tax is payable. Furthermore, loan capital already in a country may become subject to an agreement overseas thus localizing the source of the interest abroad.

Secondly, even where no tax avoidance motives are involved, is it not true that under present conditions most loan agreements are concluded overseas? The fundamental point here is whether or not a developing country can afford not to levy tax on interest payment on the principle that the "source" of such payment is localised where the loan agreement is concluded.[10]

The opinion of this writer is that principle or no principle the place where capital is productively employed should have either an exclusive or at least a concurrent right to levy taxes on interest payments. The U.N. Group of Tax experts came to this conclusion too.

At this juncture, we wish to refer to the rather intriguing concept of the "source" of interest payments in the Republic of South Africa, as established by the case of C.I.R. v. Lever Bros. and Unilever Ltd.[1] In that case, it was held that the originating cause of interest in the case of a loan of money was not the debt but the services which the lender performs for the taxpayer viz. the "supply of credit" in return for which the borrower pays him interest. Watermeyer, C.J., puts it this way:[2]

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10. The objections of the developing countries to the OECD Draft Double Taxation Convention on Income and Capital may be noted here. Article 11 gives the primary right to tax interest to the home country of the investor with a limited withholding tax allowed in the home country of the borrower. The trend today, however, is towards revenue-sharing. That is, following the work of the U.N. Ad Hoc Group of Tax Experts. (1970) Second Report Part One, pp. 17, 18, paras. 98 - 105.

1. [1946] A.D. 441; 14 S.A.T.C. 1.

2. Ibid., A.D. at p. 451

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"In the case of a loan of money the lender gives the money to the borrower, who in return incurs an obligation to repay the same amount of money at some future time and if the loan is one which bears interest, he also incurs an obligation to pay that interest. As a rule, the lender either gives credit to the borrower or transfers to him certain rights of obtaining credit which had previously belonged to the lender, and this supply of credit is the service which the lender performs for the borrower, in return for which the borrower pays him interest. Consequently, this provision of credit is the originating cause or source of the interest received by the lender."[3]

According to A.S. Silke,[4] since the true source of interest on a loan in terms of the Lever Bros. Case is the provision of credit, once this takes place in the Republic of South Africa the source of the interest is in the Republic. Thus, if the loan creditor has made the money available to the debtor in South Africa, the source of the interest is in the Republic irrespective of where the debtor resides, the debtor productively employs the capital, the interest is payable or the loan contract is concluded. That is, if A in South Africa agrees to lend money to B for use in his business in Botswana and A makes the money available to B in South Africa then the source is in the Republic even though B may have transferred the capital to Botswana for use in his business there. The position would, however, be different if A remitted the loan through his bankers to B in Botswana. In such a case, the credit would have been provided in Botswana and not in the Republic.

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3. Emphasis supplied.

4. Op. cit., at page 134

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The South African approach has been adopted in New Zealand following the leading case of C.I.R. v. Philips Gloeilampenfabrieken.[5] This was a case involving the determination of the source of interest payment on a loan made available in the Netherlands to a company in New Zealand. Essentially, the facts were similar to those in the Esso and Alumaco Cases.

As far as Nigeria is concerned, it is questionable whether the South African concept of the source of interest (i.e. the place of supply of credit) is appropriate. Invariably, the place of supply would be the home country of the lender or alternatively any other locality nominated by him. Like the "situs of obligation" test therefore, the "credit supply" test is capable of easy manipulation to avoid tax. It is, therefore, rejected for precisely the same reasons that the approach adopted in the Alumaco and Esso Cases was rejected

What then is the solution?

One thing is clear looking at the decided cases in most Commonwealth countries; viz. that the interpretation and application of the "source" principle is a matter of the utmost difficulty. The real point at issue here is this: What would (or should) a practical man in a developing country regard as the real source of interest? And in this connection, is there any difference between the "real source", the "intermediate source" and the "ultimate source"? Furthermore, is interest payment capable of having more than one "source"?

In the words of Schreiner, J.A.:[6]

> "in the case of an investment by way of loan, the creditor is leasing his money to make an income from it: he is generally

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5. 1958 N.Z.L.R. 868

6. Op. cit. at page 460 et. seq. Lever Bros Case.

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speaking not anxious to have it back so long as his debtor is sound and his security ample. His object, in the first instance, in lending the money was to get what annual payments the borrower was prepared to pay for its use. Essentially, therefore, the interest is the fruit of the money and comes from where the money is, irrespective of where the contract was made or the interest is payable".[7]

This writer is inclined to agree with the above statement.[8] To hold that the "originating cause" of interest is the agreement for the loan as was done in the Alumaco and Esso cases is an approach unlikely to be adopted by any practical man in a developing country.[9]

Relating the above specifically to Nigeria, a developing country obliged to borrow overseas, can anything be more practical than to regard the "source" of interest payments as located within the country and hence liable to taxation — that is, once loan capital has been productively employed within the country? With this in mind, can it not be argued that Sowemimo, J's judgement in the Alumaco Case was a more practical and realistic one than that adopted by the Supreme Court?

In view of the special economic circumstances of the country as outlined in the introductory parts of this chapter, and the arguments already advanced,

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7. Emphasis supplied.

8. The dissenting opinion of Schreiner, J.A., is of some significance because of the very interesting propositions of law in it. These proposition have, in fact, been relied on (although not successfully) in a number of cases, e.g. in the New Zealand case of C.I.R. v. Gloelampenfabrieken [1958] N.Z.L.R. 868 at pp. 889 - 891. Also in Esso Standard v. C.O.T. [1971] E.A.L.R. 127 at p. 139.

9. It may be recalled that the generally accepted rule is that the source of income is not a legal concept but something which a practical man would regard as the real source of income, the ascertainment of which is a practical hard matter of fact. - Nathan v. Fed. Com. of Tax [1918] 25 C.L.R. 183. Isaacs, J. at p. 189 - 190.

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the following recommendations may be made:

(1) That interest payments on capital productively employed in Nigeria should be deemed at all times to have a Nigerian "source" and hence liable to the country's taxation.[10] It is, of course, appreciated that this unilateral measure may render the recipients of such income liable to double taxation especially when resident overseas where tax is levied on the basis of residence or domicile. Double taxation could arise too where the home country of the investor holds that the source of interest payment received by its residents is the contract or agreement or the "supply of credit" which would invariably take place overseas.

As we shall discuss in subsequent chapters this can either be eliminated or mitigated by the selective use of unilateral reliefs or bilateral reliefs as may be agreed upon in tax treaties. What must be emphasized here is that Nigeria cannot afford to abdicate her right to levy taxes on interest payments on the grounds of legal technicalities.

(2) Secondly, that the deeming provisions of s.17 CITA restricting the ambit of the charging provisions over interest payments which are considered to be of little value should be scrapped. In future, irrespective of whether or not interest is from a "source" in the Republic of Nigeria, once it is payable by debtors (companies or individuals) ordinarily resident or carrying on business in the country to non-residents, it should be subject to a withholding tax of say 25 per cent to be deducted by the payer and paid over to the Revenue. With this approach, the whole question of "source" of interest would be of greatly diminished significance.

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10. Compare our proposal with the provisions under the Capital Gains Tax Decree where a debt is deemed to be situate at the place of residence of the creditor. s. 25(c) CGTD. 1967.

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(3) Finally, it is submitted that wherever possible the law should be interpreted to reflect economic reality and not in accordance with abstract concepts of justice. Afterall, the tax law is not an end in itself but a means to an end.

Attention is now focussed on some other aspects of the tax treatment of interest payments under the Nigerian law.

C. Computation of Profits: Interest as an Allowable Deduction.

In order to ascertain the profit or loss of any company, interest payable on money borrowed and employed as capital in the production of profits is an allowable deduction.[10a] Interest as a specie of business expenditure is, therefore, subject to the usual tests for deductibility viz. "wholly, exclusively and necessarily incurred". In other words, "interest" is an allowable deduction from gross profits only if incurred on capital which was borrowed and used wholly, exclusively and necessarily for the production of income.

As was pointed out in the previous chapter, these tests are extremely difficult to apply.[1] For example, whereas interest on money borrowed to finance the day to day transactions of a company would be allowable, it is very doubtful whether interest on moneys borrowed to build a new factory would be an allowable expenditure.[2] There are, of course, a lot of borderline situations and so no hard and fast rule can be laid down.

10a. s.17(1)(a) ITMA; s. 27(a) CITA 1961.

1. See Chapter Four, supra, and the cases discussed therein.

2. In this circumstance, the sum would be a capital expenditure. What should be noted is that the factory may qualify for a capital allowance under the Capital Allowances Schedule.

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The Rhodesian Case of "T" v. C.O.T.[3] is quite helpful here. The point at issue in that case was whether interest paid by the appellant on money borrowed by him to enable him to buy a house in which to live so as to permit of his letting at a profit a second house owned by him was deductible or was simply a domestic expense. The court rejected the contention of the appellant and held that the borrowing of money to buy a house for the taxpayer to live in so that he could let at a profit the house he already owned could not be regarded as the obtaining of a loan for use "in the production of income" (e.g. trading) as required by law. The court was of the opinion that while the appellant's course of conduct allowed him to retain his income producing asset, it also allowed him to acquire a private residence for himself, and that it was to the latter result that the loan to the appellant was directly related.

One matter of practical difficulty is now referred to. That is, the prevention of tax fraud (e.g. the charging of exorbitant interest rates etc.), where there is a transfer of funds between related companies.[4] Although the Revenue has a general power to disregard "artificial or fictitious" transactions there is very little evidence that this power is being used effectively at present.[5] In any case, what is an artificial or fictitious transaction? The fact that Company A is willing to borrow from B at exorbitant interest rates does not

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3. [1959] Rhodesia and Nyasaland Law Report. p. 349.

4. Except for the purpose of financing the import and export of goods the permission of the Federal Ministry of Finance is required by an individual, firm or company resident in Nigeria in order to borrow money from outside the country. Application for such permission must be accompanied with the following information. (i) The amount, duration and purpose of the loan (ii) the rate of interest payable (iii) the arrangements proposed for repayment - "Doing Business with Nigeria" page 23, published by the Standard Bank, February 1970. This procedure helps to eliminate some of the problems in this area.

5. s.25 CITA; s. 14 ITMA.

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necessarily make the transaction artificial or fictitious. There may be legitimate business reasons why this should be so e.g., the inadequacy of the collateral, the extended time for repayment etc.

For the future, it is submitted that interest may not be deductible from gross profits where money is borrowed from an affiliate unless the tax authorities are satisfied that the interest arises from a normal market investment and that the companies concerned have been dealing at arm's length. The presumption should be that affiliated companies are not dealing at arm's length unless the contrary is proved. This approach which is already applicable to Petroleum Companies can be extended to cover all kinds of companies.[6]

That notwithstanding, a lot still depends on the Revenue to determine whether or not a purported interest payment is a genuine business expense incurred wholly, exclusively and necessarily in the production of income. Any failure in this regard would result in sizeable profits being reduced to marginal ones by the deduction of bogus expenses.

In the past no difficulty normally arose with regard to the allowance of management fees, interest, royalty or service charges or to the apportionment of any expenditure or income between a foreign parent company and its Nigerian subsidiary, provided that the basis adopted was realistic and was not altered from year to year.[6a] In general, this continues to be the case but recently the taxation authorities have adopted a firmer attitude and will very rarely

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6. Petroleum Profits Ordinance (1959) s. 10(1)(b) and s. 11(2).

6a. The approval of the Federal Ministry of Finance is required for the repatriation of corporate profits, dividends, management fees, royalties, and the like. Application to the Ministry is usually made by the company's bankers. The kind of remittances in qestion fall under Category C.

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concede that a payment of interest is not taxable in the hands of the lender. Similarly, they now seek to tax any profit element included in management and service charges unless they are satisfied that these are strictly reinbursements of actual expenditure or the true cost of service rendered.

D. The "Expense" Component of Interest: Taxation Gross or Nett? - Deduction at Source.

Any company in Nigeria making a payment of interest, management fee or royalty to another company has to deduct tax at the standard company rate of tax from such payment and account promptly to the Federal Board of Inland Revenue for the tax so deducted.[7] But curiously enough, there is no provision in the law as to how and when the tax is to be paid. In practice, therefore, the Revenue collects such tax by means of a special notice of assessment.[8]

The Board at its discretion may authorise a company in writing to deduct tax from a particular payment of interest, management fee or royalty at a particular rate of tax or to deduct no tax at all.[9] But the experience so far appears to be that permission to pay without deducting tax will be granted only in very exceptional circumstances.

The above method of tax collection on interest payments (i.e. deduction at source by the payer) is admirable, and in line with what obtains in several other countries. Having said that, two issues connected therewith are worth

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7. s.9 Income Tax (Amendment) Decree 1966. No. 65 of 1966 providing for a new s.61A CITA.

8. Provision is made in s.61 CITA as to the time which payment is to be made i.e. as regards other categories of income.

9. s.61(A)(2) CITA. Note that where the tax deducted exceeds the company's liability the Board on application by the company must refund the excess. s.61(A)(3) CITA.

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discussing. Firstly, the rather high rate of withholding tax on interest (40 per cent); and the fact that the tax is levied on gross interest payments without any regard for the costs incurred by the lender. Surveys show that these costs are particularly high in the case of institutional lenders (banks etc.) leaving only a relatively small profit margin.[10]

Theoretically, taxation on a net basis is the logical thing to do and was so agreed by the Ad Hoc Group of Tax Experts who reviewed the problem recently.[1] But the truth is that taxation on a explicit and accurate net basis does not offer a practical solution from the administrative point of view. In the circumstances, the best solution, perhaps is for the tax in the payer's country to be computed on the gross interest at a rate roughly comparable to the average effective rate on a net basis. This is only possible assuming, of course, that the expense component in the various types of interest is determinable.[2] But to determine the expense component of an interest receipt and whether or not such expense is justifiable is a matter of the utmost difficulty.

What, then, must Nigeria do? Ignore the expense component of interest completely or reduce the present rate of tax on this specie of income?

Looking elsewhere, the following solutions have been adopted by some developing countries. In Argentina, for example,[3] there is an automatic fixed

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10. Tax Treaties Between Developed and Developing Countries. 1969. First Report Part One, page 20 para. 90; (1970) Second Report Part Two, pp. 57,58.

1. Ibid., (1970) Second Report, Part Two, pages 57, 58.

2. No universally acceptable method has yet been devised to determine the expense component of interest payment as lawyers, accountants and economists differ so much on methodology.

3. Tax Treaties etc. (1970) Second Report, Part Two, p. 58.

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50 per cent deduction allowed from gross interest income thus reducing the 41 per cent withholding tax by half. The Israeli solution is also interesting.[4] In that country, gross interest is taxed to non-residents at the rate of 25 per cent and to banks at a rate of 15 per cent. If, however, the foreign bank wishes to prove additional expenses, it may do so and will then be taxed at 49.5 per cent on the net.

It is the view of the present writer that Nigeria can successfully ignore the expense component of interest payments and retain the present high rate of tax (i.e. 40 per cent) on gross interest payments without adverse effect on the inflow of capital into the country. We hold this view for two reasons. Firstly, the fact that any hardship may be mitigated because of the provision in the law whereby a total or partial exemption from tax can be granted on a selective basis; secondly the fact that foreign investments have continued to pour into the country unabated.[5]

The next sub-section looks critically at the exemption granted to a number of interest payments.

At this juncture, a word or two must be said about the tax treatment of imported interest payments; that is, interest payments received by residents of Nigeria from overseas. What is important to note here is that at present the persons receiving this kind of income are insignificant in number because of the restrictions on foreigners raising funds from or within Nigeria and the scarcity of loan capital anyway.

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4. Ibid., at page 58

5. Supra. Introductory section showing some Central Bank figures. The rate of inflow of new foreign investments has constantly been on the increase.

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Where interest is imported, it is computed as part of the income of the recipient,[1] and credit is given for any tax paid at source in accordance with the appropriate formula for relief under the Nigerian law depending on whether the income is from a Commonwealth country, a treaty country or from a country which is neither.

The double taxation implications are pursued further in the appropriate chapters.[2]

E. "Interest" Exempted from Tax

Certain interest payments are exempted from Nigeria tax in the hands of the recipients. These fall under two broad categories. In some cases the exemption granted is of general application, while in other instances this exemption is on a more selective basis. In order to encourage the inflow of capital, there is an obvious bias in favour of non-residents in the tax treatment of interest payments accruing to them from Nigeria.

For example, interest accruing to any person who is not resident in Nigeria[3] is completely exempted from tax in the following circumstances: (i) Where the interest is on a loan charged on the public revenue of the Federation and raised in the U.K.; (ii) if the interest is on any bond issued by the Government of the Federation to secure repayment of the loan raised from

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1. See s.21(1) ITMA; s. 31 CITA dealing with the computation of "total income" and "total profits" from all sources in respect of an individual or company as the case may be.

2. See Chapters VI, VII and VIII, *infra*.

3. For the purposes of this exemption a person shall only be deemed to be resident in Nigeria if present in the country for a period or periods amounting to 183 days or more in that year of assessment. Third Schedule ITMA para. (e). Enacted as a supplement to s.16 ITMA.

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the International Bank for Reconstruction and Development under the authority of the Railway Loan (International Bank) Ordinance 1958; (iii) if it is interest of any monies borrowed by the Government of the Federation or of a state upon upon terms which include the exemption of such interest from tax in the hands of the non-resident person.[4]

Furthermore, where the Federal Commissioner of Finance so consents, interest may be exempted from tax on any monies borrowed outside Nigeria by a corporation established by law in Nigeria upon terms which include the exemption of such interest from tax in the hands of a non-resident person. To this effect, the Commissioner has exempted a number of interest payments on loans borrowed by some public companies from the provisions of the tax code.[5] The merits or demerits of these exemptions are matters on which no intelligent criticism can be made because all the facts are unknown.

Apart from the above, there is a general exemption granted on interest payments made by the Nigerian Post Office.[6] This is only reasonable considering the need to cultivate the saving habit among the local people and to generate internal resources. Regrettably, however, up till the present time it would seem that not enough effort has been made to mobilise internal capital; capital, which according to S.P. Schatz, should be enough for economic development.[7]

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4. Third Schedule ITMA para. (e), sub-paras (i) - (iv).

5. E.g. Loans granted to the Nigerian Ports Authority. See Income Tax Interest on Loan Granted to the Nigerian Ports Authority (Exemption) (No.2) Order 1963: Loans granted to the Nigerian Sugar Company. See Income Tax Interest on Loans granted to the Nigerian Sugar Co. Ltd (Exemption No. 2) Order 1962.

6. Third Schedule ITMA para. (O); s. 26(1)(f) CITA.

7. "Obstacles to Nigerian Private Investment", op. cit.

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That there is still a great need for foreign capital is evidenced by the provisions of the Companies Income Tax (Amendment)(No. 3) Decree 1971.

According to this law, where on, or after 1st January 1971, a company incorporated outside Nigeria grants a loan of at least £75,000 either abroad in foreign currency or out of monies brought into Nigeria from abroad, to any person carrying on a trade, business, profession or vocation in Nigeria for use in such trade, etc., the interest derived on such loan is with effect from the 1970/71 year of assessment:(i) exempted from Nigerian income tax in the hands of the foreign company if the loan is not repayable by the borrower until after the expiration of at least a period of ten years;[8] (ii) liable to Nigerian income tax at half the current company rate if the loan is not repayable until after the expiration of a period of between five and ten years.[9]

Any exemption or relief granted under this law can be withdrawn by the Inland Revenue if the loan is repaid before the expiration of the relevant qualifying period.[10] Also, the Federal Executive Council may order that exemption or relief should not be granted in respect of the interest on any particular loan or that any exemption or relief previously granted be withdrawn.[1] Any additional assessment necessitated by the exercise of the above powers may be made at any time.[2]

Equally of interest in the context of our present discussion is the fact that the Federal Ministry of Finance will consider from non-residents wishing

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8. s.17A (1)(a) CITA as amended.
9. s. 17A (1)(b) CITA as amended.
10. Ibid., s. 17A(2)(3).
1. Ibid., s. 17(A)(4).
2. Ibid., s. 17A(5)

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to invest capital directly in Nigeria applications for the grant of "Approved Status" for such investment. This is just another incentive to encourage the inflow of fresh capital and simply means that sympathetic consideration will be given to the repatriation of capital directly invested in Nigeria to the extent of any distribution of a capital nature arising from a realisation thereof. Although an unconditional guarantee is not given, approval for repatriation would be withheld only in exceptional circumstances.[3]

III. ROYALTIES, RENTS AND SIMILAR PAYMENTS

A. Definition and Concept

In Nigeria, tax is payable for each year of assessment upon the profits of any company or individual in respect of:

"rent or any premium arising from a right granted to any other person for the use or occupation of any property".[4]

The precise scope of this provision is unclear as no pronouncement on it has been made by the courts and no official guide explaining its meaning can be found. However, if the word "property" is construed in its broadcast sense to include all species of property (i.e. moveable or immoveable, tangible or intangible), then the provision is wide enough to cover royalties and other analagous payments which on a cursory reading of the tax code appear not to be charged to tax at all.

For our purposes, therefore, the use of the term "royalty" should be understood to include payments of any kind received as consideration for the use of, or the right to use any literary, artistic or scientific work (i.e.

3. Doing Business in Nigeria - A Standard Bank Business Aid - February 1970 page 22.

4. s. 17(b) CITA; s.4(1)(c) ITMA emphasis supplied - "any property."

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copyrights); payments received as consideration for the use or the right to use any patent, trade mark, design or model, plan, secret formula or process; or for the use of or the right to use industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience. Our working definition should also be construed to cover "management fees", headquarters expenses, consultancy fees and the like.[5]

Whether or not this definition should be extended to cover compensation or damages paid for fraudulently copying or infringing intellectual or industrial property rights is debateable. It has been strongly suggested especially where there is a double taxation agreement in existence that these kinds of damages should be included in the term "royalty."[6] This writer agrees, but would go on to add that the term "royalty" need not be restricted to damages paid for the infringement of industrial property rights etc. where there is a double taxation agreement but to all instances of such infringement. Thus, where such damages are awarded by Nigerian Courts, it is clearly in Nigeria's interests to regard them as sufficiently akin to royalty payments and, hence, taxable as such.

In principle, royalties in respect of a licence to use patents and similar industrial or intellectual property are income to the recipient from a letting. Although classified here as an "inventment income",[7] royalties all too often

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5. Our working definition is based on the OECD Model as approved and amended by the U.N. Ad Hoc Group of Tax Experts. Where a tax treaty is in force between two countries the precise ambit of a royalty payment is clearly defined. It should be noted that the term royalty does not include payments for Oil Concessions etc. That is, the term royalty as used in this context.

6. Commentary on Article 11 OECD Draft, page 118 Report of the OECD Fiscal Committee 1963.

7. This classification is also adopted by the U.N. Ad Hoc Group of Tax Experts. First Report 1969, Part One, Chapter VI. See too G.S.A. Wheatcroft's classification (1957) B.T.R. 310 at p. 317: "<u>What is Taxable Income</u>?"

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appear to be the profits of a trade. Whereas, royalties paid by instalments are considered revenue receipts in the hands of the recipient and so taxable, difficulties often arise in the case of an outright sale of a patent, copyright or know-how for a lump sum particularly where such payment is neither clearly of a capital nor revenue nature.

What must be pointed out here is that a payment which is clearly of a capital nature will not become a revenue receipt merely because it is one of a series of payments of the same kind, just as a revenue receipt will still be treated as such even though it is the only one of that type that the taxpayer will ever receive.[8]

To illustrate the position we refer to a few English authorities. In Evans Medical Supply v. Moriarty,[9] an English company which manufactured medical supplies by a number of secret processes sold its products in Burma. Faced with the possibility of the Burmese government setting up its own factory and laboratories, the company undertook to disclose secret processes to that government and to provide other information in consideration of the payment of a "capital sum of £100,000". The company also undertook to provide certain services and to manage the proposed factory in return for an annual fee, which was admitted to be subject to tax. No similar agreement had been entered into

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8. MacNaughten, J., in Glasson v. Rougier 26 T.C. 86 at 90 "a sum of money paid in commutation of annual sums which are 'income' for the purposes of the Income Tax Acts is chargeable to income tax, just as in the computations of the profits of a business a sum paid in commutation of an annual 'expense' is allowed as an expense".

9. [1957] 37 T.C. 540

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by the company with any other foreign government or any other party.

The House of Lords by a majority held that the £100,000 was not taxable as it was a receipt on capital account. Viscount Simonds stated the position vividly observing that:[10]

> "the company parted with something for which the government was prepared to pay no less than £100,000 i.e. an asset which was the source or one of the sources of its profits .... The company has parted with its property for a purchase price .. .... and when I say 'its property' I mean .... a capital asset".

The same principle was applied in Wolf Electric Tools Ltd. v. Wilson,[1] where the appellant company which had previously traded in electric power tools in India agreed to provide an Indian company with all present and future drawings, designs and technical knowledge as well as data necessary for the establishment of a factory for the production of certain ranges of portable electric tools. It also assigned all its Indian patents to that company. It was held that shares issued by the Indian company to the appellant company as consideration for the drawings etc. were received by the appellant company as part of a comprehensive agreement whereby, as to the selected tools, the company gave up its business in India. Accordingly, the shares were considered a capital asset of the appellant company and not taxable.

The Evans Medical Supplies Case was distinguished by the House of Lords

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10. Ibid., at page 579

1. (1968) 45 T.C. 326.

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in Rolls Royce Ltd v. Jeffrey[2] where engineering "know-how" was sold on a number of occasions to different countries. In this case, the appellant company embarked on a deliberate policy of licensing companies in other countries to manufacture its engines on terms which involved the payment of capital sums (so-called) and royalties. The House of Lords held that the lump sums were trading receipts on revenue account. The engineering "know-how" sold in this case was regarded as a regular product of the trade and was treated as more transient and less permanent than the "know-how" relating to medical supplies in the former case which could be applied in manufacturing for a long time.

The test to be applied to the type of cases under discussion was spelt out by Bankes, L.J., in British Dyestuffs Corporation (Blackley) Ltd v. I.R.C.[3] in these words:

> "Looking at the matter, is the transaction in substance a parting by the company with part of its property for a purchase price, or is it a method of trading by which it acquires this particular sum of money as part of the profits and gains of that trade?"

Somewhat similar problems have arisen to those considered under this head in connection with patent rights and copyright payments.

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2. (1962) 40 T.C. 443. N.B. The principles established in the last three cases have been followed in the Rhodesian case of Vacu-Lug (Pvt) Ltd. v. C.O.T. [1963]R and N.L.R. 194. Agreement by Co. A to provide Co. B with "know-how" and rights to use a patented process and a trade mark. Whether consideration was a receipt of a capital nature or a gain in carrying out a scheme of profit making, and thus taxable? Held that the test to be applied was whether the whole agreement was analogous to a final cession of rights or a continuing sub-lease of those rights. The Rolls-Royce case has also been followed in Musker v. English Electric Co. Ltd. 41 T.C. 556.

3. (1924) 12 T.C. 586 at p. 596.

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Relating the above to Nigeria, it would appear that the present income tax law is inadequate especially as regards the tax treatment of lump sum payments obtained from the sale of patent, copyright or know-how.[4] Clearly, these payments cannot be regarded as "rent or premium arising from a right granted to any other person for the <u>use</u> or <u>occupation</u> of any property". And neither are such receipts strictly a category of "trading income" since most vendors of these rights do not trade in these items. Furthermore, it is doubtful whether they are caught by the sweeping up provisions of the tax code.[4a]

The uncertainty of the tax treatment of dealings in know-how etc. is not peculiar to Nigeria. It was not until 1968 for example, that an attempt was made in the U.K. in the Finance Act 1968 (now s. 386 ICTA 1970) to codify the subject against the background of the existing case law discussed above. But the Nigerian situation, although not appreciated by many, remains rather unsatisfactory.

To put the whole problem in its proper perspective the first thing to be recalled is the one way flow of know-how (i.e. from the developed to the developing countries), and the corresponding flow of royalty payments in the opposite direction. What is important here is this: Can Nigeria afford to allow lump sum payments on the sale of know-how to escape tax on the grounds of legal technicalities? Where a parent company overseas sells "know-how" etc, to its subsidiary in Nigeria and a lump sum payment is made, of what significance is

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4. The effect of the Capital Gains Tax Decree 1967 is ignored here but referred to presently. The point we are making here is of crucial importance especially in those developing countries where a Capital Gains Tax has not been introduced, e.g. Ghana.

4a. E.g. s.4(1)(f) ITMA; 17(e) CITA.

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it whether or not the amount accruing to the taxpayer is technically a "revenue" receipt, or a "capital" receipt? How is the Nigerian Revenue to discover whether the taxpayer overseas is trading in know-how, thus making any receipts from Nigeria taxable (Jeffreys v. Rolls-Royce); or whether the taxpayer overseas has simply parted with a valuable asset, (an isolated transaction), under conditions whereby any receipts accruing to him are not taxable on the principle established in Evans Medical Supplies v. Moriarty and Woolf Electric Tools v. Wilson?

Where so-called capital receipts are not taxable in the above circumstances is it not simple enough to avoid tax or, indeed, to transfer profits out of the country illegally by an arrangement whereby a subsidiary company in Nigeria buying worthless "know-how" from its overseas parent company agrees to pay an exorbitant lump sum? Since a royalty payment is an allowable deduction from gross profits, the subsidiary company would be allowed to deduct the cost of this bogus know-how from its gooss profits while the recipient of such payment at least up till 1967 may escape tax liability completely if the lump sum in question is technically a "capital" sum. The result, of course, is the shifting of profits across national frontiers without the payment of the necessary tax.

Are companies likely to take advantage of any lapses in the law? The answer is an unequivocal "yes". This is because the management of an international group is naturally anxious to see that the group as a whole pays as little tax as possible. Seen from their angle, the crucial point is to look at the tax rates on various categories of income and to decide which is more advantageous to the parent company - viz payments from a subsidiary in form of

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dividends or in form of royalties.[5]

What must be remembered is that in the case of dividends, the profits distributed have already been subjected to tax in the hands of the subsidiary; royalties on the other hand, being consideration paid under a contract, are allowed as deductions in computing the subsidiary's taxable profits and have thus not been burdened with tax paid by the subsidiary. Consequently, experience has shown that there is a temptation wherever possible to show payments by the subsidiary to the parent company as royalties rather than dividends. However, the opposite may be desirable; if for instance, the parent company is exempt from tax on the dividends which it receives and the amount of tax which would be payable by the parent company on equivalent royalties is higher than the additional tax which the subsidiary would have to pay in its country of residence in the event of its declaring a dividend rather than paying royalties.

Although the Revenue may disregard artificial and fictitious transactions especially between "connected person"[6] it is doubtful whether the Nigeria Revenue is sophisticated enough to recognise transactions which are not genuine. The position becomes very difficult where no market price is

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5. The underlying issues are well articulated in the General Report of Helmut Debatin to the 23rd Congress of the International Fiscal Association held in Rotterdam in 1969 on the subject of- "The Recognition of Services and Licence of Incorporeal Rights between Parent Companies and their Foreign Subsidiaries: Avoidance of Double Taxation in the Case of Non-recognition by Tax Administrations". Cahiers de Droit Fiscal International. (1969) Vol. LIVa p. 1/31 et seq.

6. s.25 CITA; s. 14 ITMA. For a possible meaning of "connected persons" within the Nigerian law see s. 24 Capital Gains Tax Decree 1967. (referred to hereinafter as CGTD.)

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ascertainable[7] for the kind of know-how transferred between related entities.

Investigating this phenomenon, Olaseni Akintola-Bello[8] made a number of important observations: (1) That "the payment for receiving know-how can be an increasing function of the recipient's relative ignorance" and the "less familiar its entrepreneurs (developing countries) are with a given technology, the higher the price it pays for that particular technology it imports".[9] This tremendous increase in costs arises by means of a "transfer price mechanism". That is, discretionary pricing of intra-company transfer of goods and services at a higher or lower amount than for value received. (2) Secondly, this author concluded that the cost of technology purchase can be classified into two, the implicit cost and the explicit cost. Whereas, the latter is connected with payments for royalties, charges against income such as interest, management and various technical fees, after tax payments such as dividends to foreign shareholders; the former relate to the overpricing of the intermediate products, captialisation of know-how etc.

Like most countries, the Nigerian tax provisions are concerned with the explicit cost of technology transfer - an approach based more on convenience rather than logic. But then what must always be remembered is

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7. The sale in the "open market" formula suggested by s. 22 of CGTD 1967 may not be very useful especially where the kind of asset in question is not readily marketable.

8. Transfer of Industrial Technology to Developing Countries through Direct Private Investment - M.A. Thesis, Sussex. 1971 (unpublished)

9. Ibid., at page 109

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that inherent in a technology transfer arrangement are substantial implicit costs which may have a detrimental effect on a country's balance of payments position.

With the hidden costs not taxed, it is only reasonable that the explicit costs - i.e., the royalty payments - should be adequately taxed irrespective of the technical quality of the receipt in question. It was probably for the above reason that the U.K. in 1968 thought it necessary to bring about a change in the law.

Whatever impression might have been given thus far, the Nigerian law is not as deplorable as would at first appear to be the case. With the introduction of the Capital Gains Tax in 1967 any gains from the disposal of a chargeable asset is now liable to a Captial Gains tax at twenty per cent.[10] For the purposes of this tax all forms of "property" incorporeal or otherwise, including any property created by the person disposing of it are liable to the tax.[1] The new provisions definitely cover the disposal of "know-how", patent rights etc. for a capital sum.

Whereas the law has gone a long way to remedy the awkward pre-1967 situation, it is regrettable that it has been restricted in its application.[2] Companies disposing of chargeable assets anywhere within the Federation are expressly liable but, individuals and partnerships outside the federal

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10. ss. 1, 2 CGTD 1967, No. 44 of 1967

1. s.3(a); 3(c) CGTD 1967. No. 44 of 1967.

2. The shortage of skilled manpower has been responsible for this.

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territory of Lagos are not.[3] And, if we are correct in our interpretation, non-resident persons other than companies are similarly not liable to any capital gains tax for chargeable assets (patents, know-how etc.) disposed of in Nigeria except within Lagos.

While this writer would not advocate the application of the Capital Gains Tax Decree throughout Nigeria bearing in mind the limited resources of the Nigerian Revenue, there is no reason why non-resident individuals deriving capital sums should not be liable to capital gains tax. The administrative problems involved do not seem overwhelming.[4] And as is the case for residents, the overseas vendor should be allowed to deduct from the sale price any expenditure incurred in the acquisition or development of the thing disposed of as the case may be.[5] The question of the "expense component" of royalty payments receives further attention presently.

B. Liability to Nigerian Tax: The "Source" of Royalty Payments

Any royalty payment "accruing in, derived from, brought into or received in Nigeria" is liable to the country's tax.[6] No difficulty would

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3. s.46(3) CGTD 1967. No. 44 of 1967.
4. Especially with the foreign exchange mechanism and the deduction of tax at source.
5. s.14 CGTD 1967. Inherent in our suggestion is the problem of determining the quantum of expenses incurred by a non-resident and whether this was incurred "wholly, exclusively and necessarily".
6. s. 17 (b) CITA; s. 4(1)(c) ITMA.

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normally arise as regards the tax treatment of royalty "received in" or "brought into" the country, but if example elsewhere is anything to go by, the determination of the "source" of royalty payments and its place of location is not so easy.[7]

In the case of Nigeria, this is extremely difficult because the law does not contain any guidance for determining the "source" of royalty payments similar to those for interest payments[8] and despite the great amount of know-how etc. imported in the country, the courts have never been called upon to determine any matter relating the tax treatment of this specie of income.

Essentially, our task here is to establish the most suitable criteria for determining the "source" of royalty payments drawing on the experience in other Commonwealth countries. Once more at the heart of the matter is the perpetual conflict of interest and jurisdiction between the licensor countries and the licensee countries. Whereas, the latter seeks to levy tax on royalty payments on the ground that "know-how" is productively employed in its territory, the former resorts to the taxation of these payments on the basis that its "source" is located where the contract of supply is concluded or else where the supplier is resident.

The Australian case of <u>Federal Commissioner of Taxation</u> v. <u>United Aircraft Corporation</u>[9] helps to illustrate the problem. In that case, the

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7. The expressions "accruing in" and "derived from", we may recall, have been held to be equivalent to "source".

8. I.e. the deeming provisions of s.17 CITA; s.11 ITMA.

9. (1943) 68 C.L.R. 525.

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question facing the court was to determine whether the source of payments of royalties to an American corporation in a practical business sense was the making of the contract agreement in America and acts done by the American corporation in America in the performance of the agreement; or the manufacturing of aircraft engines in Australia in the manner contemplate by the agreement; or partly the one source and partly by the other.

By a majority, the High Court decided in favour of the taxpayer holding that the source of royalty payment was the agreement and the supply of information pursuant to that agreement both of which took place in New York.

With due respect, this writer disagrees with the findings of the majority and is more inclined to go along with the minority judgement.

The judgement of Latham, C.J., (one of the majority judges) is worth examining closely. In his Honour's opinion, knowledge is valuable, but knowledge is neither real nor personal property. On this premise, therefore, he concluded that the knowledge that the Australian company obtained (e.g. drawings, designs etc.) in the manufacture of aeroplane engines cannot be described as the "property" either of the person who originally had it or of any other person to whom it had been communicated whether under and in pursuance of a contract or otherwise.

According to this reasoning, since the American company did nothing in Australia where it did not own any "property", it could not be held liable to taxation in that country.

Rich, J., who came to the same decision as the Chief Justice, adopted a slightly different line of reasoning. He conceded that "property

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existed in the plans and drawings etc. supplied to the Australian Company" but went on to hold that "the moneys in question, part of the consideration paid to the respondent company, could not be regarded as derived from property used by the latter company or on its behalf in Australia". In his Honour's view, these monies were derived not from the pieces of paper, but from the "supply in America" of the information recorded on the pieces of paper, information which was capable of being used in Australia or elsewhere.

The main objection to the majority judgements (of the C.J. and Rich, J.) is that, though sound in law and logic, they are out of touch with economic reality.

Is it not true that the conventional basis of the agreement was that the American company had made the Australian company the usufructuary in Australia for a limited period of knowledge which was capable of being regarded in a business sense as the property of the American Corporation? According to Williams, J., it was this valuable knowledge "which represents so to speak the capital" which produces the income. The main theme of his minority judgement was that the American corporation was making a profitable use of its "property" in Australia. His Honour, therefore, concluded that if royalties had to be paid from Australia in respect of the exercise in Australia of a licence to use a process there, such royalties should be regarded in a practical business sense as derived from a source in Australia.

It is interesting to note that Rich, J., also acknowledged the validity of the "situs of use" test. In his opinion, as far as so-called royalty

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payments are concerned, the source as a question of fact should:

> "be regarded partly as the contract and partly as the things done in pursuance of the contract. These things included the handing over in America by the American company to the Australian company of property belonging to the American company; the user in accordance with the contract by the Australian company of this property or its rights in the same in Australia;[10] the payment in America by the Australian company for the user in Australia of this property or the rights therein by that company.[1]

Yet, in spite of the above, Rich, J., refused to draw the inference that the payment of so-called royalties was a payment derived from a source in Australia. He thought the relevant facts, including the making of the contract, suggested that the payments had an American source. Furthermore, while more or less accepting that income may be apportioned between two or more logical sources, His Honour rejected this line of action as being inappropriate in this particular case.

For a greater elucidation of the problem involved here, let us look at the South African example where not only is the source concept well articulated, but the courts have laid down a number of principles for the determination of the "source" of various kinds of income.

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10. Emphasis supplied.

1. (1943) 68 C.L.R. 525, at page 539.

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In Millin v. C.I.R.[2] it was held that the source of royalties accruing to a novelist was his wits, labour and intellect so that if these were employed in the Republic, the source is in the Republic. In that case, the taxpayer had written a book in South Africa, but the right to publish was granted to an English publisher under contract concluded in England. It was held that the source of the income accruing to the taxpayer was not the grant of the publishing rights in England but the place where she productively employed her skill and time in the business of writing books - that is, South Africa.

The principle in Millin's Case applies equally to royalties from patent rights, secret processes etc. accruing to inventors. So that if an inventor applies his wits, labour and resources in the Republic then the income accruing to him from the exploitation of his rights is from a Republic source. The act of registering patent rights in a country, it would seem, is to provide protection to the holder and is not the real source of the royalty.

In theory, the above approach is desirable for Nigeria and would probably be adopted were the Revenue confronted with the kinds of problems under discussion. But then, what must be emphasized is that at the present stage of Nigeria's development, most of the books used in the country are written and produced by non-residents who are also responsible for imported know-how etc. from overseas. In other words, what the Nigerian courts are likely to be asked to determine is not the source of a royalty payment where the creative activity takes place within Nigeria (e.g. the writing of a book or the invention of a machinery), but rather the more complex question of the source of royalty payments from the sale or letting of equipment, know-how etc. within Nigeria,

2. [1928] AD 207; 3 SATC 170

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where the taxpayer is himself non-resident, and where the creative activity resulting in the invention etc. took place outside the country.

The principle in Millin's case (i.e. the situs of creative activity test), therefore, cannot from a pragmatic point of view be applied readily in Nigeria as little scientific or literary activity has taken place or is taking place in the country presently. As importers of "know-how" etc., this criterion for determining the source of royalty payments is clearly unacceptable. The Southern Rhodesia case of C.O.T. v. British United Shoe Machinery (S.A.)(Pty) Ltd.[3] is relevant here. In that case, the question for determination was the source of income from rentals of machines located and used in the then Federation of Rhodesia and Nyasaland. The appellant company which was registered, managed and controlled in the Republic of South Africa, had no branch office in Rhodesia and did not carry on business there.

Young, J., at first instance at the High Court of Southern Rhodesia held that since the evidence did not reveal any activity in the Federation which "gave or added value" to the machines, the source of the rental income derived from their use in the Federation was not within that country. The reasoning adopted by the learned trial judge appears similar to that in Millin's case although it was not cited.

The Supreme Court of South Africa reversed the decision of Young, J., holding that where a company leases machinery for a long duration so that the emphasis is on the "property" and not on the business of the lessor, the source of income derived from the "property" is where the property is used. This brief passage from the judgement of Clayden, C.J., helps to drive home the point.

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3. [1964] (3) S.A.L.R. 193 (F.C.), 26 S.A.T.C. 163.

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"it is .... the machines, and not the capital which was invested in the machines, which by being let out to use, produce the income. The source of the income is because someone is using the machines, the property of the respondent. With the hire of smaller things for a more limited period, for example motor cars, it is rather the business of the lessor than the property leased which is the source".[4]

This writer agrees with the findings in the above case and, with due respect, submits that as far as developing countries are concerned, the "situs of use" test is the most realistic criterion for determining the source of royalty payments either in the case of a lease or letting of machinery etc. or the grant of a patent right for the exploitation of an invention, know-how or other secret process.

Looking at the strict wording of the Nigerian Law, what, if any, is the discernible criterion applicable in establishing the source of royalty payments? This would depend on a correct interpretation of the charging provisions which provide that tax is payable upon the profits of any company "accruing in, derived from, brought into or received in Nigeria, in respect of ..... rent or any premium arising from a right granted to any other person for the <u>use</u> or <u>occupation</u> of any property".[5]

From the words underlined it could be argued that the applicable test for determining the source of royalty payments is the "situs of use", or else, something quite akin to that. This would seem to be a more rational inference from

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4. <u>Ibid</u>., (3) S.A.L.R. at page 196

5. s. 17(b) CITA; s.4 (1)(c) ITMA

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the charging provisions than either the "place of the contract" test, or the "place of supply" test.

However, in order to avoid any controversy, some clarification is necessary. In future, royalty payments should be deemed to be from a Nigerian source if it accrues to a person by virtue of the use in the Federation of any knowledge directly or indirectly connected with any patent or design as defined in the relevant law, or any copyright as defined in the Copyright Decree 1970; or, indeed, the use or the permission to use any other property in the country which is of a similar nature. "Know-how" payments and management or consultancy fees must also be expressly liable to tax.[6]

The overall effect of our suggestion is that an inventor may perform all the work in connection with the creation of his patent overseas, yet because he allows its use in Nigeria any income derived is deemed to be from the country's source. The position would, of course, be different if the inventor sells his patent out and out to an indigenous manufacturer since in that event the payment would not be received for the "use" or the "right to use" such property, but for its complete alienation so that the proposed amendment would not be applicable. But recalling our discussion on the tax treatment of payments from the disposal of chargeable assets, capital sums received from the sale of know-how would be liable to a capital gains tax at twenty per cent.[7]

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6. Payments for unpatented secret processes should also be taxable. But the truth is that not much is known about this aspect of international economic relations. Our suggestion here is along the lines of the provisions in South African law. s. 9(1)(b) of 1966 Income Tax Act of South Africa.

7. s. 2; s.3(a) CGTD 1967.

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C. Computation of Profits. "Expense" Component of Royalty. Taxation Gross or Nett? Deduction at Source

In this brief section we examine the other aspects of the taxation of royalty payments under the Nigerian law.

From the payer's standpoint, royalty, like interest payment, is an allowable deduction in the computation of taxable profit.[8] That is, if it is technically of a revenue character. Where the royalty payment made by the taxpayer is of a capital nature, he is apparently not allowed to deduct it from his gross profits. Such disbursement not being regarded on general principles as an expenditure incurred "wholly, exclusively and necessarily" in the production of income; but rather, as something spent on the acquisition of a capital asset.[9]

Turning our attention now to the payee of a royalty payment what do we find? Where the kind of royalty payment in question is clearly of a revenue nature, no difficulty arises as the recipient is liable to tax at 40% per cent deducted at source by the pay r.[10] Where, however, the receipt is of a capital nature the recipient may be assessed to a capital gains tax.[1]

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8. s.27 CITA; s.17 ITMA.

9. This point is well illustrated by the Indian case of C.I.T. v. C.I.B.A. India A.L.R. 1968. S.C. 1131. In that case, the Supreme Court of India, after considering the Rolls-Royce and the English Electric cases and distinguishing Evans Medical Supplies Ltd. v. Moriarty, held that payments to obtain and use exclusive pharmaceutical information for a period of five years were income expenses. Case reviewed by L. Lazar (1969) A.S.C.L. Chapter on Taxation, p. 237 at 243.

10. s.61 A(1) CITA as amended.

1. ss. 1, 2, 3 CGTD 1967. This is because the thing disposed of is a chargeable asset under the express provision of the decree - especially s.3(a) CGTD.

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Again, like interest payments, it is worth noting that tax is levied on "gross" royalty payments. Whereas, the capital gains tax decree contains a provision allowing the taxpayer to deduct items of expenditure from the sums obtained on a disposal before subjecting the remainder to tax,[2] nothing of the sort is permitted under the income tax acts where the royalty is of a purely revenue nature.

Theoretically, difficulties could arise affecting the flow of "know-how" to Nigeria because royalty receipts are in the main cost recovery charges and not pure income. What is often forgotten is that taxation of royalties on a "gross basis" without consideration for the cost and expenses incurred in connection with the development of the technology as well as the licensing thereof, amounts to a tax on the payments as "pure income" which, of course, they are not. Also unknown to the tax authorities of developing countries is the pressure exerted by the tax authorities of the industrialised countries on licensors of know-how to recoup research, advisory and administrative cost for each individual business operation at home or abroad.[3]

The question of taxation "net" or "gross" on royalty payments received the attention of the U.N. Ad Hoc Group of Tax Experts at their meeting in Geneva in 1968. The main argument advanced by the developing countries for levying tax on "gross" royalty payments was that the licensing of patents in developing countries normally took place after all costs had been recovered or

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2. s.14 CGTD 1967. The kinds of expenditure allowed include sums spent for acquisition of the asset, for enhancing its value, for establishing or preserving the taxpayer's title and any other incidental costs of making the disposal.

3. The reason for this is the tax exemption granted for the development of know-how in the home countries of licensors.

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their recovery had been assured. The high royalty rates charged, it was further contended, usually led to a speedy recovery of capital.[4]

The developed countries, on the other hand, emphasized that patents were developed for the world market and that the costs should be fairly shared by all countries benefiting from the patents. They pointed out that long before a patent came to fruition considerable development costs were incurred, which had reduced the tax in the home country, especially since in many cases special tax incentives were given for research and development expenses.[5]

Although the principle of taxation on net profits was generally found to be more rational, it was agreed at the Geneva meeting that further progress could only be made after studies had been concluded on the average "net - gross" relationship.[6] The administrative problems inherent in any attempt to tax this specie of payment on a net basis as outlined above in the case of interest cose not underscored.[7]

In Nigeria, there is no evidence that the 40 per cent withholding tax on royalty payments has had a detrimental effect on the inflow of technology. There is, therefore, no need for a change in the status quo. But considering that what is needed on the long run is the development of indigenous technical and managerial skill, more publicity should be given to the current spate of research activities engineered by the Federal government. For instance, the

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4. Tax Treaties between Developed and Developing Countries. First Report 1969 page 21 para. 95.

5. Ibid., page 21 para. 96. The recent controversy between La Roche and the U.K. government over excessive profits made on drugs illustrate the problem.

6. Ibid., page 21 para. 97

7. Supra, at pages 42 - 45.

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establishment of research institutes etc; and especially the fact that the government is willing to provide funds for worthwhile research projects. Finally, it is urged that the favourable tax treatment of funds for research purposes must continue.

In the next major section we examine the taxation of dividend payments which probably constitute the most important category of income accruing to the foreign investor.

IV. DIVIDENDS AND OTHER COMPANY DISTRIBUTIONS

A. Definition and Scope

In Nigeria, the term "dividend" is a very comprehensive one. In relation to a company which is a going concern it means "any profits distributed whether such profits are of a capital nature or not, including an amount equal to the nominal value of bonus shares, debentures or securities awarded to shareholders". And in relation to a company that is being wound up or liquidated, the term "dividend" means "any profits distributed, whether in money or money's worth or otherwise, other than those of a capital nature earned before or during the winding up or liquidation".[8]

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8. s.4(3) ITMA; s.17 CITA as amended by s. 2(2) of the Income Tax (Amendment) Decree 1966. Decree No. 65. The question whether or not a deemed "dividend" embracing capital receipts can be treated as "income" may depend on legislative competence under a country's constitution. Such a matter has never arisen in Nigeria but the Supreme Court in India in Punjab Distilling Industries Ltd. v. C.I.T. [1965] I.T.J. 110; A.I.R. 1965 S.C. 1862, has held that a provision defining dividend under that country's law was not ultra vires the Central Legislature embodying as it did a law to prevent the evasion of tax.

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The first point to note here is that a dividend is quite independent of the "business profits" of the company out of which it is paid;[9] and that from the shareholders' standpoint, dividends are "income" from capital which they have made available to a company as its shareholders.[10]

From the definition of dividend given above, it is obvious that the word "distribution" in this context has a technical meaning.[1] Its significance is two-fold. Firstly, whereas all company dividends are distributions not all distributions are dividends. Secondly, as an anti-avoidance measure, certain acts or omissions by a company which normally would not be regarded as a distribution are deemed to be such and the beneficiaries held to have received "income" for tax purposes.

A close analysis of the definition of dividend and the implications thereof is now considered.[2]

By company law, a dividend is usually paid out of profits.[3] But the

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9. Hassan Kassim Lakha v. The Voi Sisal Estates Ltd. [1965] E.A.L.R. 387 Reviewed by L. Lazar in 1966 A.S.C.1, p. 483 at p. 509.

10. This is the true economic situation as should be clearly recognised. See, for example, Commentaries on OECD Draft, p. 96.

1. In the New Zealand case of Campbell v. I.R.C. (1967) 10 A.I.T.R. 444 (S.C.) N.Z. for example, here a company released taxpayers from their indebtedness this was held to be a "distribution". The Nigerian law specifically covers this point.

2. Since 1966 not a single case has arisen in Nigeria as regards the interpretation or application of the provision. This is regrettable considering the fundamental nature of the issues involved here. Once more, we are obliged to rely on Commonwealth authorities for guidance.

3. Cf. L.C.B. Gower, Principles of Modern Company Law, 3rd ed., p. 353. To do otherwise would amount to a return of capital, something which is not permitted as long as the company is a going concern.

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trouble is that not all profits are chargeable so that where dividends are paid out of non-chargeable profits they are themselves usually not taxable except where there is an express provision in the law to the contrary.

In practice, it is interesting to note that companies do not distribute all their trading profits to shareholders preferring to capitalise the same either by a transfer of profits to a reserve fund or by the issue of bonus shares to members credited as fully paid-up in the company's books. Often, the question is whether such issue of bonus shares is technically a distribution to shareholders of "income" in which case it is taxable; or a distribution of "capital" in which case it is not taxable.

Following the House of Lords decision in C.I.R. v. Blott,[4] it is now more or less settled law in most Commonwealth countries that where bonus shares are issued and credited as fully paid-up, the distribution is of capital and not income and, hence, not taxable. Except, of course, where it is provided to the contrary by the law as has been done in Nigeria where a dividend is deemed to "include an amount equal to the nominal value[5] of bonus shares, debenture or securities awarded to shareholders".[6]

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4. [1921] 2 A.C. 171; 8 T.C. 101. Followed in the Ceylonese Case of C.O.T. v. Macammarker, Ceylon Tax Cases Vol. 1, p. 154 especially at p.157 per Hearne, S.P.J. It was held in that case that fully paid up shares issued to shareholders of a company by way of capitalisation of profits from the reserves of the company do not constitute a "dividend" as defined by the Ceylonese law. At that time a dividend was defined as a distribution of profits which may take the form of shares. In other words, shares issued to a taxpayer could be a dividend only if they came to his hands as a profit.

5. By the use of the "nominal value" serious problems of share valuation has been avoided.

6. s.4(3) ITMA; s. 17 CITA as amended.

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The true effect of the Nigerian provision is to levy the same amount of tax on distributed and undistributed profits.

But is there no case, as A.O. Philips[7] has argued, for a developing country to discriminate in the tax treatment of distributed and undistributed profits? Surely, in a country where it is relatively difficult to obtain funds on the capital and money markets, retained earnings can become a major source of investment finance, compensating for the deficinecies of other sources. Moreover, this could give a fillip to the development of the local capital market as retained earnings not used for a company's expansion seek other investment outlets.[8]

It is in the light of the above that we must examine the provisions of s.24 CITA 1961. This section treats certain undistributed profits of a company as though they were distributed. Thus, where it appears to the Revenue that a "Nigerian Company"[9] controlled by not more than five persons has failed to distribute profits which could have been distributed without detriment to the Company, with a view of reducing the taxable in-

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7. "Nigeria's Companies Tax" (1968) N. Jnr. of Eco. and Soc. Studies. Vol. 10, No. 3, p. 321 at pp. 330 - 331.

8. Even without any compulsion it is significant to note that foreign concerns operating in Nigeria in the 1960's voluntarily retained about 40 per cent of their earnings in Nigeria - Central Bank of Nigeria - "Economic and Financial Review" 1965 pp. 9-11. It must also be noted, however, that the retention of profits is not the same as reinvestment of profits since retained profits may be held in the form of idle reserves. But it may be argued that idle reserves are desirable in times of inflation as the neutralisation of capital which results would reduce inflationary pressures. For the purposes of development however, as distinct from anti-inflationary measures, it is necessary that surplus profits be reinvested in worthwhile projects.

9. The power to order a distribution is limited to "Nigerian companies" - that is, companies whose "management and control" are exercised in Nigeria. s.2 ITMA. s.2 CITA. After 1968, when all companies have to be incorporated in Nigeria, the provision probably applies more generally.

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come of the persons concerned, the Revenue may direct that such profits be treated as distributed. And where such profits are so held, the distribution is deemed to be the profits or income from a dividend accruing to the members in proportion to their respective shareholdings. Their liability to tax is thus increased by such amount in respect of tax deemed to be deducted at source (grossed up) as the Revenue may determine.

Ignoring the economic arguments for a moment, it would seem that the intention of the above provision is to prevent tax avoidance or the postponement of tax liability. Its effectiveness is, however, doubtful. What prevents a private company determined to avoid tax from increasing its members from five to six, seven or more, in order to be able to accumulate profits and hence reduce the individual tax liability of members? Would the law not have been more effective if no particular number were prescribed; but instead a more general power granted to the Revenue to order a distribution where in its opinion this can be done without detriment to the company? Strictly speaking, who can decide whether or not the distribution of profits hitherto undistributed would be to the detriment of a company? Surely, neither the Revenue nor the courts should substitute their judgement in these matters for those of the directors of a company.

When it comes to a decision as to whether a larger dividend than that declared by the assessee company could reasonably have been distributed, what emerges from the decision of the Supreme Court of India in the case of C.I.T. v. Gangadhar Banerjee and Co. (Private)[10] is that a tax

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10. [1965] 2 I.T.J. 339; A.I.R. 1965 S.C. 1977. Case reviewed by L. Lazar (1966) A.S.C.L. Chapter 14 on Taxation, p. 483 at p. 507. See also C.I.T. v. Williamson Diamonds Ltd. [1958] A.C. 41 especially at 49.

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officer had to come to a commercial decision, putting himself in the place of the directors of the business. The yardstick of the reasonableness of a distribution, the court held, was that of the prudent businessman taking an overall picture of the financial position of the enterprise.

In practice, there is no evidence that the Revenue has been using its power to order private companies to distribute more profits. This is not at all surpiising knowing the administrative limitations of the Nigerian Revenue. In the prevailing circumstances, this writer is of the opinion that the Revenue's power to order a distribution of profits should be curtailed except in cases of suspected fraud or blatant abuse.

The economic argument also supports our suggestion. Since retained earnings appear to be in the long term interest of Nigeria, it is clear that companies ought not to be goaded to distribute all their profits, especially where to do so would result in a substantial outflow of funds from the country to overseas shareholders. While the intention should not be to "lock in" profits, it would seem that a discrimination in favour of undistributed and reinvested profits is necessary to ensure that the bulk of profits made by companies remain in Nigeria.[1]

Next, we examine the second arm of the definition of a "dividend" under the Nigerian Law.

In relation to a company that is being wound up or liquidated, it may

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1. Where a government's policy on repatriation of profits is too rigid this could in itself act as a disincentive to the foreign investor.

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be recalled that a dividend is held to include:

> "any profits distributed, whether in money or money's worth or otherwise, other than those of a capital nature earned before or during the winding up or liquidation"[2]

This definition takes cognisance of the well known rule of company law that a return of capital to shareholders is not a "profit" as it represents what the shareholders themselves have pooled together to generate profit. In practice, of course, things are never so clear cut. Usually, on a winding up of a company, the distinction between the assets and the accumulated profits disappears. Often, the amount distributed to members by a liquidator are distributed as capital so that the sums received by the shareholders cannot be attributed to income as dividends.[3] The consequences for the Revenue on the question of liability are clearly severe.

The decision in C.I.T. v. Girdhardas & Co.[4] illustrates the operation of the provision of the Indian Income Tax Act designed to overcome this problem.[5] In that country, although the liquidator has only one fund in his hands from which he makes a distribution, for the purposes of tax

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2. s.4(3) ITMA and s. 17 CITA as amended.

3. I.R.C. v. George Burrell [1924] 2 K.B. 52 at p. 63. The decision is based on the provisions of the English company legislation which lays down the general principle in tax law. The position in most Commonwealth countries is more or less the same.

4. [1967] I.T.J. 81 (S.C. India).

5. Indian Income Tax 1922. s.2(6-A)(c) in the definition of "dividend" as (amended by the Finance Act 1956 s.3) reads - "Dividends include - (c) any distribution made to the shareholders of a company on its liquidation to the extent that the distribution is attributable to the accumulated profits of the company immediately before its liquidation whether capitalised or not."

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liability, the amount distributed may be dissected into tts capital and income components as they existed immediately before the commencement of the liquidation. A distribution to shareholders, insofar as it is attributable to the accumulated profits of the company, is thus taxable as a deemed dividend. A tax officer must, therefore, in the first instance, determine the capital and the accumulated profits of the company (whether capitalised or not) immediately before liquidation. From this data he determines the ratio of capital to accumulated income, and then applies it to distributions made to shareholders by the liquidator in order to arrive at their taxable incomes.

In Girdhardas Case, the Income tax officer treated the whole distribution on a winding up as a "dividend"; but the Supreme Court held that the distribution had to be attributed to capital and income on the basis of the ratio prior to the liquidation in terms of the statutory provision.[6]

The important practical point to observe is that the Indian provisions go behind the actions of the company prior to liquidation in capitalising its accumulated profits. This seems to go further even than the drastic and wide definition of "distributions" for the purpose of corporation tax liability in the United Kingdom.[7]

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6. The factual dispute between the liquidator and the Income Tax officer was whether the reserves of income had been exhausted, due to earlier distributions by the former, prior to the present disputed distribution - an incorrect approach from both sides in view of the provisions of the Act.

7. Ex parte Westburn Sugar Refineries [1951] A.C. 625. Under the Nigerian law a reduction of capital can occur following a special resolution of the company to that effect which is subsequently confirmed by the Courts. Nigeria's Companies Decree 1968 ss. 67 - 73.

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On a close reading, the Nigerian provision is very much akin to the Indian Law in spite of differences in phraseology. So that if our interpretation is correct, the distributable fund in a winding up must be similarly dissected into its capital and income components and the ratio applied to the distributions in question in order to arrive at an appropriate figure which is the taxable income.

Whereas the position is clear as regards distributions made when a company is a going concern or is being wound up, the tax position on a reduction of capital is obscure. The difficulty stems from the well established rule of company law that in the course of a reduction of capital, more can be paid out to shareholders than a nominal amount whereby the capital paid-up upon their shares is reduced.[8] The question then is whether or not this excess is a taxable distribution.

Such a problem has never arisen in Nigeria but has recently benn the subject of litigation in Australia. The decision in Uther v. Fed. Com. of Taxation[9] shows that a method exists in that country whereby a company can distribute capital profits without attracting tax in the hands of the recipient.

In consequence of certain transactions which need not be detailed, the company in question was, early in 1961, in a financial position to

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8. Finance Act 1965, s.47(5) and Schedule 11 allows an exemption here. It simply provides that distributions in respect of share captial in a winding up do not constitute a distribution for the Corporation tax.

9. [1965] A.L.J.R. 326. (High Court of Australia, Sydney) affirmed in 39 A.L.J.R. 184. (Full Court of Australia). Case reviewed by L. Lazar [1965] A.S.C.L. 461-2; (1966) A.S.C.L. 510. Other aspects of the problem in Australia, discussed by F.C. McCay: "Income Tax Distributions by Liquidators" [1938] 12 A.L.J. 74.

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reduce its capital by extinguishing the unissued shares and cancelling one-half of the issued shares of each class in the capital of the company. The directors recommended that an amount of £499,663. 10s be paid to shareholders in respect of the cancelled preference, ordinary and deferred shares at rates specified according to the class of share. This sum exceeded the paid-up capital of the company. The capital of the company was duly reduced by an order of Court and the appellant received over £30,000 which the Commissioner assessed as taxable income. The full Court confirming the decision of Owen, J., at first instance, held that the receipt was of a capital nature,[10] and so was not within the definition of "dividend"[11] (which includes "any distribution made by a company to its shareholders .... but does not include a return of paid-up capital").

The crucial point to note is that although the sum in question was received in a partial distribution of a mass of assets (which in a colloquial sense contained profits), nevertheless, the sum received was technically a distribution of capital.

Relating the above specifically to Nigeria, might it not be possible to escape tax by a reduction of capital and the return of excess amounts to shareholders?

The true position, it seems, would depend on one or two things:

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10. Income Tax and Social Services Contribution Assessment Act 1936. 1963 s.44(1)(a) provides that "the assessable income of a shareholder in a company shall .... if he is a resident .... include dividends paid to him by the company out of profits derived by it from any source".

11. Ibid., s. 6(1)

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(1) Whether in a reduction of capital, the company is strictly speaking still a "going concern", or is in actual fact one step towards being wound up or liquidated. (2) If the former is the true legal position, then any amount received is technically a return of capital and although in excess of the nominal value of the capital contributed is, nevertheless, not taxable. But if the latter is the case, then according to the first arm of the definition of a dividend which includes "any profits distributed whether ..... of a capital nature or not" - the amount in question is taxable.

In order to avoid any possible argument about liability or no liability on a reduction of share capital, the law probably needs to be clarified.

One other issue of practical difficulty must be mentioned before concluding this section. This relates to the question of tax liability on payments from overseas where the Revenue purports that they are "dividends" and hence taxable income, and the taxpayer contends that they are not.[1]

The conflicts of law problem which may arise because of the differences in the company laws of the various countries is usually resolved as follows: the court applying the relevant foreign law adjudicates on two problems which are related.[1a] Firstly, the <u>nature of the taxpayer's right</u> to receive money or money's worth from property overseas e.g. shares;

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1. Note that there is liability to Nigerian tax on any income "<u>received in</u>" or "<u>brought into</u>" the country. These provisions have more or less been equated with the "remittance rule". s. 4 ITMA; s.17 CITA. See discussion above in Chapter Two.

1a. The court applies foreign law where there is evidence before it as to what the foreign law is. Where this is not proved, the Court assumes that this is the same as local law.

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and secondly, on the character of the receipt in the taxpayer's hands. Thereafter, the courts apply the local law to determine whether the sums received are capital or income.

The Nigerian courts in this regard would probably follow the English rule as outlined above. A discussion of the U.K. cases[2] is, however, not considered necesaary in the context of our present discussion because of the infinitesimal number of Nigerians deriving income from overseas and the little possibility of issues of conflict of law arising.

To summarise briefly, this writer is of the opinion that the definition and scope of the term "dividend" in Nigeria is sufficiently comprehensive. The need to bring all kinds of company distributions within the country's tax jurisdiction is obvious, especially since the bulk of such distributions accrue to foreign investors. In one or two respects the law probably needs to be amended, and, in particular, with regard to: (1) the tax treatment of excess distributions on a reduction of capital, and (2) the possibility of more discrimination in favour of undistributed profits.

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2. To cite just a few examples see, Rae v. Lazard Investment Co. Ltd. 1963 41 T.C.1 (H.L.). A distribution of shares without any reduction of capital under the law of Maryland which was applied, held to be a capital distribution and hence not liable to tax in the U.K.; Courtaulds Investments Ltd v. Fleming [1969]T.R. 345. Distribution from share-premium reserve under Italian law - held to be a notional capital distribution and liable to U.K. tax; Lawson v. Rolf [1969]T.R. 537. Distribution of Stock dividend under Californian law held to be of a capital and hence not liable to U.K. tax.

   Other relevant examples illustrating the conflicts of law principle are- Baker v. Archer-Shee [1927]A.C. 212; 15 T.C. 693; I.R.C. v. Reid's Trustees [1949]A.C. 361; 30 T.C. 431; Inchyra v. Jennings 42 T.C. 388 (Ch.D).

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B. Liability to Nigerian Tax: Source of Dividends - The Situs of Shares Test.

Liability to tax on a dividend payment would depend on whether its "originating cause" and its place of location can be found within the territory of Nigeria. But what would a practical man regard as the "originating cause" of a dividend payment?

Since, according to company law, dividends can only normally be paid to shareholders it seems fairly obvious that a practical man would regard the taxpayer's "shares" as the source of his dividend income.[3] Indeed, this seems to be the accepted rule in many other places.[4] However, what may not be so obvious is the "situs" of the shares themselves being a specie of incorporeal property.

Like most other countries, the favoured approach in Nigeria is that shares are situated where they are registered; i.e. where they can be effectively dealt with irrespective of the source from which the company derives its income. For example, the Capital Gains Tax Decree 1967 categorically provides that:

> "registered shares or securities are situated where they are registered, and if registered in more than one register, where the principal register is situated".[5]

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3. This is an important point. The directors cannot make any payment to a person who has not furnished any consideration.

4. E.g. South Africa. In Boyd v. C.I.R. [1951](3) S.A. 525 (A.D.) 17 S.A.T.C. 366 for example, it has been held that the shares are situated where they are registered.

5. s.25(e) (emphasis supplied). For all other purposes shares are probably deemed to be situated at the place where they are registered just as in the case of the purposes of the Capital Gains Tax.

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This provision may be contrasted with the earlier approach in South Africa, as established in the case of Moore v. C.I.R.[6] in which it was held that shares were situated at the place of "central management and control" of the company.

The "place of registration" test as the criterion for determining the situs of shares and hence the source of dividends, is preferable for Nigeria for the following reasons: (1) Its simplicity. In addition, there is little room for manipulation since all companies operating in Nigeria have to be incorporated and are obliged to keep their register of shareholders in the country, whether or not another register is maintained overseas.[7] (2) Secondly, and as a corollary to what is already stated, the "place of registration" test enables the Nigerian government to levy taxes effectively on foreign shareholders in companies operating in Nigeria.

With our suggestion, the kind of anomaly that arose in the South African case of Lamb v. C.I.R.[8] cannot occur.

Where a company keeps a branch register in a foreign country in addition to its principal register in the country of incorporation the question may arise as to the source of dividends in respect of shares in the branch register in the foreign country. Thus, in Lamb's Case, it was held that a dividend received from Nchanga Consolidated Copper Mines Ltd., a company incorporated in England

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6. [1938] T.P.D. 369; 10 S.A.T.C. 20

7. Part X of the Companies Decree 1968 compels all foreign companies to be incorporated as "domestic companies" before commencing business. s.370 et seq. Note in particular that s. 108 (2) of this Decree provides that "the register of members shall not be kept in the case of a company registered in Nigeria (all companies are now so registered) at a place outside Nigeria".

8. [1955] (1) S.A. 270 (A.D.); 20 S.A.T.C.1. Note that the Companies Acts of South Africa, the United Kingdom, Rhodesia, Zambia and South West Africa all provide that a branch register is deemed to be part of the principal register.

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with its central management and control in Northern Rhodesia, was from a source in England notwithstanding that the taxpayer's shares in respect of which the dividend was received were registered in the Johannesburg branch register of the company and not in the principal register in England.

To adopt an alternative criterion in Nigeria viz, the situs of "management and control" as the geographical location of shares in a company would be to open the way to fraud and fiscal evasion. Because most companies operating in Nigeria are managed and controlled from abroad, dividends paid by these companies would be from a non-Nigerian source as shares would be technically located overseas. This, it seems, is an unrealistic approach as companies would be able to split or shift their situs of management and control around the world in order to avoid tax.

In practice, not much difficulty has arisen as regards the "source" of dividend payments. This, as must be pointed out, is probably due to the method of tax collection on dividend payments i.e. deduction of tax by the payer at source who accounts for it to the Revenue.[9] With the changes in the law brought about by the Finance (Miscellaneous Taxation Provisions) Decree 1972, the mode of tax collection on dividends has been altered. The implications of this change and the difficulties it might create in future are examined below.

C. Direct Assessment or Deduction at Source? A Total Exemption for the Foreign Shareholder?

As from the 1st April 1972, a "Nigerian company"[10] is no longer required

9. s.34 CITA as it stood before the recent amendment.

10. Nothing is said about a non-Nigerian company. Presumably, what the draftsman intended was to bring in all companies operating in Nigeria. A "Nigerian Company" is defined as one the management and control of whose activities are exercised in Nigeria, s.2 ITMA; s.2 CITA. This definition notwithstanding, the majority of shareholders in companies operating in Nigeria are foreign. (i.e. majority in terms of the number of shares held).

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to deduct tax from dividends paid to shareholders. Such companies paying out dividends now only have to issue a certificate to the shareholder setting out the amount to which he is entitled, the profits out of which the dividend is paid, the accounting period in respect of which the dividend is declared to be payable and the date on which payment is due.[1]

There are a number of doubts about the reasonableness of the amendment introduced by Decree No. 47 of 1972. In the first place, what was wrong with the machinery of tax collection on dividends which the new law seeks to rectify? In a developing country like Nigeria, is it not easier and cheaper to ask companies to collect tax from shareholders at source and then to account for this to the Revenue? Secondly, since the majority of shareholders deriving dividends from Nigeria are non-residents is it the objective of the law to exempt them from the country's taxation?

Where a shareholder is resident in any of the twelve states of the Federation, any dividend accruing to him would presumably be taxable as part of his assessable income (i.e. as part of his "total income" from all sources). But for the taxpayer who is non-resident, what is the machinery for assessing and collecting tax on any dividend payments accruing to him from Nigeria? If he is completely exempt from local taxation, does he enjoy a "tax sparing credit"[2a] in his own country?

These, indeed, are fundamental questions.

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1. s.34(2) CITA i.e. as amended by 1(c) of the Finance (Miscellaneous Taxation Provision) Decree 1972.

2a. The question of tax sparing credit is explored more fully in the subsequent chapters on Double Taxation. In this context it is sufficient to note that a "tax sparing credit" is a credit granted to the investor in his own country for the tax spared in the host country.

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The need to allocate more revenue to the component states of the Federation was probably responsible for the recent changes in the law relating to dividends. Because the taxation of individuals is specifically reserved to the states,[2] tax on dividends would now presumably go directly into state coffers rather than to the Federal Exchequer as has hitherto been the case. But one wonders whether the same result could not have been achieved were the tax on dividends payments to be collected at the centre and then distributed to the states.

Is it not true that in an attempt to solve one problem another has been created?

It does not appear that there is any justification whatsoever for a total tax exemption on dividends accruing to a foreign investor if indeed that is the correct interpretation of the 1972 law. With the current rate of growth of the economy and the inflow of investments, a general tax exemption on dividend payments is an unwarranted revenue sacrifice - especially when one considers the present exemption on certain dividends.[3] Also, where there is no tax on dividends, companies tend to distribute more as there is no incentive to reinvest profits.

All things put together, the general scheme of taxation appears to be unduly generous. Company profits are taxed at the rate of forty per cent on the first £5,000 of their profits and at forty-five per cent on the excess above that figure.[4]

What, then, is to be done?

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2. s.86 1963 Federal Constitution

3. E.g. "pioneer dividends" and "petroleum dividends". Note also that there is no tax on inter-company dividends.

4. s. 32 CITA as amended.

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This writer is of the opinion that the Nigerian authorities do not take a sufficiently broad view of the economic situation in the country before making laws. Certainly, what is needed is more, rather than less, scrutiny of the tax treatment of dividends accruing to the foreign investor. To that effect, it is submitted that a special officer is appointed within the Revenue with duties similar to the U.K. Inspector of foreign dividends. Such officer will be charged with the duty of keeping track of the inflow and outflow of dividends and similar payments into the country and ensuring that taxpayers *fulfil their obligations.*

Our suggestion which inevitably involves issues of double taxation, is considered in more detail in the chapters dealing with that subject.

D. <u>Exempted Dividends: Unjustified Revenue Sacrifice?</u>

As indicated above, certain dividends are specifically exempted from tax in the hands of the recipients. Of these two are noteworthy - pioneer dividends, and petroleum dividends.

Pursuant to the Industrial Development (Income Tax Relief Decree) 1971 certain companies have been granted "pioneer status". The profits made by these companies are exempted from tax for a specified number of years, and so also are the dividends paid from these profits.[5]

The object of this arrangement is to encourage investors to venture into new areas of industrial activity. No data is available from which to judge the usefulness or otherwise of these measures and even if there were, such

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5. ss. 16, 17.

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task is more appropriately dealt with by the economist rather than the lawyer.

The exemption granted to dividends paid by companies in the petroleum industry.[6] is difficult to justify on any grounds. According to one government official this exemption was granted to oil companies in 1959 in order to encourage them to come to Nigeria. At that time it was probably reasonable to do so, but in the light of more recent developments this is no longer necessary. Oil has since been found in Nigeria in great quantities and the scramble for it is on already

With the increasingly short supply of oil in the world it is only logical that archaic tax provisions be reviewed in order to ensure that Nigerians are adequately compensated for the loss of a most valuable asset.

The revenue aspects of the oil industry are considered in our chapter nine.

V. CONCLUSION

Several important conclusions emerge from this chapter. In this brief section we do no more than reiterate a few.

(1) It was emphasised that rules for the taxation of "property" or "investment income" must take cognisance of the true economic position of Nigeria as an importer of capital and technology and of necessity an exporter of interest, royalty and dividend payments. As we observed in several instances

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6. s. 51 Petroleum Profits Tax Ordinance 1959.

7. Nigeria is a member of OPEC.

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in the course of our discussion, this is something not yet fully appreciated by the Nigerian authorities.

(2) The scope and definition of "interest" payments were fully explored. It was submitted that these should be as broad as possible encompassing not only interest payments on loans, premiums, discounts and other charges of a profit nature arising from the granting of credit, but also interest on damages awarded by courts and perhaps the interest element on deferred credit sales where possible.

(3) Of the several logical criteria for the determination of the source of interest payment "the place of use" was favoured. The "source of obligation" test, and the "place of supply of credit" test were rejected as being unduly legalistic and out of touch with economic reality.

(4) The expense component of interest received considerable attention. While it was agreed in principle that the taxation of interest should be on a net basis, immense difficulties of administration did not encourage us to recommend this approach.

(5) It was recognised that the question of taxation "gross" or "net" was even more important in the case of royalties. In principle, it was accepted that taxation on a "net" basis was the best thing. But this was again rejected because of the administrative problems involved.

(6) As regards the tax treatment of royalties, Nigeria, like most other countries, is concerned with the explicit cost of technology transfer. Where royalties for know-how are clearly of an income nature they have always been taxable. However, since 1967 capital receipts for the disposal of "know-how" are covered by the provisions of the Capital Gains Tax Decree. This is how it should be. For the future, this Decree should be made applicable throughout Nigeria.

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(7) Of all the possible criteria for determining the source of a royalty payment the "situs of use" was preferred. Not only is this difficult to manipulate, it is also the most suitable considering the world economic situation. Nigeria as an importer of "know-how" cannot afford not to tax royalties just because contracts for such know-how are concluded overseas.

(8) The definition and scope of the term "dividend" were considered to be sufficiently comprehensive. The need to bring all kinds of company distributions (i.e. whether of capital or income) within the country's tax jurisdiction is obvious, especially as the bulk of such distributions accrue to foreign investors. But as indicated above, the law needs to be amended in one or two respects; and, in particular, as regards the excess distribution on a reduction of capital, and the possibility of more discrimination in favour of undistributed profits.

(9) Whereas, the "place of registration" was accepted as a useful criterion for determining the situs of shares and hence the "source" of dividends, much criticism was voiced about the new method of tax assessment and collection introduced by the Finance (Miscellaneous Taxation) Decree 1972. In order to keep an eye on the inflow and outflow of dividends, an Inspector of foreign dividends is desirable.

(10) As was pointed out above, the logic of granting an exemption on petroleum dividends is simply outrageous. We call for an immediate review of these provisions.

Finally, one thing which ought to be manifest by now is the question of double taxation. The importation of capital and technology and the repatriation of profits in respect of the same often implies that the same payment is subject to taxation in more than one country. In the next three chapters we examine the problems more closely.

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CHAPTER SIX

DOUBLE TAXATION (1)

DEFINITION, SCOPE OF CONVENTIONS AND OTHER PRELIMINARY ISSUES:

1. INTRODUCTION

This chapter, and the subsequent two,[1] are devoted to a thorough analysis of Nigeria's Double Taxation Agreements. A very detailed exposition has been considered necessary for several reasons. Firstly, no serious study of the country's tax treaties has been undertaken by anybody since independence in 1960. The Revenue and other government officials concerned with fiscal matters are hardly aware of the existence of these treaties, much less of their provisions and the implications thereof.

Writers on Nigerian taxation have made casual references to the country's tax treaties[2] but a comprehensive analysis and evaluation has never been attempted.[3]

In this study, therefore, not only are the provisions of the Tax Agreements examined, but some value judgement is made as regards their usefulness or otherwise, within the overall context of the country's

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1. These chapters are written in the light of experience gained on a study tour of Nigeria and Ghana from January - April 1972.

2. For example, S.O. Fashokun, Personal Taxation in Nigeria, Ph.D. London (unpublished) - Chapter VIII, pages 680 - 685; I.S.L. Agboola, Company Taxation in Nigeria - with Special Reference to the Anti-Avoidance Provisions and to the Investment Incentives - 1968, Ph.D. London (unpublished), pages 153 - 160; P.G. Willoughby and Brian W. Harvey, A Guide to Income Tax and Capital Gains Tax -(Nigeria Practice Notes), pages 61 - 62, 1969, Sweet and Maxwell.

3. There is a suggestion in a government publication that these treaties have been studied, but this writer is sceptical about the quality and thoroughness of any purported study. See our discussion infra at page 413 et seq.

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economic development programme. Among other things, there is an attempt here (a), to determine the extent that Nigeria's tax treaties have influenced and are influencing investment decisions of foreign investors (i.e. the inflow of capital); (b), how the lack of treaties may have deterred the inflow of foreign investments in particular instances[4]; (c), whether, indeed, the provisions in Nigeria's tax treaties are sufficient or adequate to safeguard the country's revenue interests.

It is interesting to note that Nigeria has never been represented at any of the recent international conferences dealing with tax problems; in particular, the meetings of the United Nations Ad Hoc Group of Tax Experts, the meetings of the International Fiscal Association (IFA) etc.

This probably explains why there is a general lack of awareness in high quarters of the recent trends in international fiscal law, notably, the significance of the OECD Draft Double Taxation Convention on Income and Capital and the proposed amendments to it by the developing countries.

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4. Nigeria has only nine Tax Treaties. Since 1960, the country's trade has been extended to countries with whom she has no tax agreement and which are not members of the Commonwealth and so do not benefit from the Commonwealth Income Tax Relief Scheme, as explained below. For instance, Nigeria has no tax treaty with Japan, Western Germany, Italy and Holland. The important point to note here is that private capital from these sources into Nigeria has been on the increase.

   Capital inflow from Western Europe (excluding the U.K.) rose from £6.8m in 1961, to £23.7m in 1966. Figures from The Financial and Economic Review - (1968), Vol. 6, No. 2 at page 11 - published by the Central Bank of Nigeria. See also (1971), Vol. 9, No. 1 of the same journal, pages 77 - 92, indicating the almost universal extent of the country's foreign trade.

   The conclusions that may be drawn from these facts are as follows: (a) that the profit margin of enterprises from non-treaty, non-Commonwealth countries are so large that they are prepared to suffer tax twice. (b) that unilateral measures to avoid double taxation of income in the host country of the investor are highly effective; or simply, (c) that taxation as a whole is not a critical factor in investment decision making.

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Irrespective of whatever conclusions may be arrived at as regards the above, a detailed analysis of Nigeria's tax treaties is relevant for a completely different reason. With the increasing move towards a West African economic union, the question of tax harmonisation and international double taxation are bound to be major issues. With this in mind, the country's Treaties are examined against the background of the _de facto_ economic relationship between developed and developing countries and between developing countries _inter se_.

Finally, an extended discussion of the problem of international double taxation has been deemed necessary in view of the general bias of this study - where the effort has been to analyse tax problems in the light of the country's programme for economic development and the role of foreign capital and technology in achieving that objective.[5]

In this chapter, the first of three, the phenomenon of international double taxation is defined and explained. The origin of Nigeria's tax treaties is discussed as well as the place of such treaties within the overall scheme of the country's taxation. The scope, personal and fiscal, of these conventions are examined, while a word or two is said about the Commonwealth Income Tax Relief Scheme.

Chapter VII is devoted to a number of central issues; _viz_ the "permanent establishment" concept in relation to business profits; problems of computation; and the treatment of investment and other species of

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5. Sheldon Fink, "_Tax Treaties as a Means of Encouraging Investment in Developing Countries_" - (1971) Vol. 6, Israel Law Review, page 198 et seq. In this beief article the author sums up some of the fundamental points.

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income as provided for under the Tax Agreements. The main relief methods, the significance of the tax-sparing credit, the exchange of information and other miscellaneous matters are examined in Chapter VIII.

II. WHAT IS INTERNATIONAL DOUBLE TAXATION?

The phenomenon of international double taxation can be defined as the imposition of comparable taxes in two or more states on the same tax-payer in respect of the same subject matter and for identical periods.[6] Its potentially harmful effects on the exchange of goods and services and the movement of capital and persons became fully recognized after the second world war.[7]

The fact is that where any investment or business transaction transcends the frontiers of two or more countries, such operation necessarily comes within two or more tax jurisdictions; namely, that of the investor's country of residence or domicile, and that of the country in which the

6. Draft Double Taxation Convention on Income and Capital. Report of Fiscal Committee of the Organisation for Economic Co-operation and Development 1963, page 9. The Report, in two parts, contains the draft articles hereinafter referred to as the OECD Model; and the Commentaries on the same, hereinafter referred to as the "Commentaries."

7. For a historical account of the development of International Double Taxation Agreements see Robert Willis, "Great Britain's Part in the Development of Double Taxation Relief" (1965) B.T.R. p. 270; Ke Chin Wang, "International Double Taxation" - Vol. 59, Harvard Law Review, page 73 - 116; Philip Shelbourne, "Double Taxation and its Improvement" (1957) B.T.R. 48.

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investment is made or the business transaction takes effect. Theoretically, since the cumulative taxation of the same income by the country of domicile and the country of source is likely to be prohibitive, thus, acting as a deterrent to the flow of foreign investments and the expansion of international trade, measures have to be taken to eliminate or mitigate the effects of charging the same income to tax twice. (i.e. double taxation).[8]

Although individual countries provide unilateral, statutory and administrative measures for relief against double taxation, experience has shown that such measures are not sufficient by themselves to provide adequate relief.[9] In order to reconcile conflicting tax claims, it has been recommended[10] that countries may enter into bilateral or where possible multilateral conventions. Double taxation agreements, it is pointed out, permit a degree of mutual accomodation which is not possible under unilateral statutory schemes of general application.

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8. Summary of the Statement of the International Chamber of Commerce on Double Taxation - published in the International Bulletin for Fiscal Documentation. (1960) Vol. 14, page 51.

9. Foreign Investment in Developing Countries - U.N. Publication. Sales No. E. 68:11:D;2, page 22 para. 92; Sheldon Fink, op. cit. at page 200. It is interesting to note that J.H. Christiaanse takes the opposite view. He argues and with logic, that unilateral measures by developed countries are of great importance to developing countries especially where there is no tax treaty between them. See, "Tax Treaties Between Developed and Developing Countries" - 1970, Cahiers de droit Fiscal International, page 31 at para. 38.

10. Foreign Investment in Developing Countries - ibid. para. 99.

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In a treaty, there is opportunity for compromise where there are differences in concepts of "taxable income" and their geographical "source", while at the same time exclusive tax jurisdiction over certain incomes may be assigned to one party or the other. It is also possible to decide on a basis for revenue sharing between governments where neither is willing to relinquish its claims to the full extent. For example, developing countries often insist that the primary right to tax income should be in the "source country" - that is, where the income accrues, while the developed countries insist that this right should be exercised by the country of residence or domicile of the investor.[1]

Both contentions are, of course, logical and legally arguable.

Lastly, tax treaties may provide for reciprocal assistance and exchange of fiscal information among contracting parties in order to prevent fiscal evasion. With the non-discrimination clause which is usually incorporated, the foreign investor can be placed on the same footing as the local entrepreneur.[2]

In an ideal world where all countries are equally developed, and there is a reciprocal flow of capital, labour and know-how; tax treaties as a

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1. Tax Treaties Between Developed and Developing Countries U.N. Publication E/4614. ST/ECA/110. Sales E. 69 XVI. 2. Page 37, para.4. This report is referred to hereinafter as Tax Treaties etc. 1969.

2. Ibid., page 37, para. 3; Sheldon Fink op.cit. at p. 201

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mechanism for solving problems of double taxation are more likely to succeed. But we do not live in a perfect world nor in a world where all states are equally developed. Therefore, unless special care is taken, difficulties arise where the contracting parties to a tax convention are in different stages of economic development.

It is against the above background that we examine Nigeria's arrangements for relief against double taxation. Without attempting a historical review of the development of international tax law and the growth of tax treaties, where necessary, notice is taken of the findings of previous studies and in particular those of the fiscal Committee of the Organisation of Economic Cooperation and Development, the International Fiscal Association and the United Nations Ad Hoc Group of Tax Experts.[3]

III. ORIGIN OF NIGERIA'S TAX TREATIES

By an exchange of notes at independence between the British High Commissioner in Nigeria and the Prime Minister of the Federation, the Federal Government of Nigeria agreed as follows, that:

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3. The Ad Hoc Group of Tax Experts was set up by the Secretary-General of the United Nations in response to Ecosoc Resolution 1273 (XLIII) of the 4th August, 1967. The task of this group is to study the international tax relations between developed and developing countries, especially problems of double taxation and its mitigation or elimination.

   The OECD Draft Model to which much reference will be made is not the first attempt on the international level to produce a Model. Mention must be made of the earlier endeavour in this field which resulted in the Mexico Draft of 1943 and the London Draft of 1946. These Drafts were due largely to the pioneering work of the League of Nations. Also notable is the Commonwealth Draft of 1964, produced by the Commonwealth Chamber of Commerce spearheaded by the United Kingdom. For text of the Draft see (1964) Vol. XVIII of the Bulletin for International Fiscal Documentation.

   Of all these Drafts, it is the OECD Model that has been more widely followed in recent years.

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(a) all obligations and responsibilities of the government of the U.K. which arises from any valid International Instrument shall henceforth insofar as such Instrument may be held to have application to Nigeria, be assumed by the Government of the Federation of Nigeria;

(b) the rights and benefits hereto before enjoyed by the Government of the United Kingdom by virtue of the application of such International Instrument to Nigeria shall henceforth be enjoyed by the Government of the Federation of Nigeria.[4]

In all, there are some 334 Conventions and other International Agreements deemed to be binding on Nigeria by virtue of the Exchange of Notes. Among these, are the country's Double Taxation Agreements.

Today, Nigeria has only nine Agreements all of which are nearly twenty years old and pre-independence. The Treaties are with the United Kingdom,[5] the United States of America,[6] Sweden,[7] Norway,[8] New Zealand,[9]

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4. Exchange of Notes (No. C. 02737/60) of October 1960. See U.N. Treaty Series 1961, Vol. 384/5 page 207

5. The Double Taxation Relief (Taxes on Income) (United Kingdom) Order in Council, 1948. No. 5 of 1948

6. The Income Tax (Double Taxation Relief) (U.S.A.) Order, 1958. L.N. 207 of 1958.

7. The Income Tax (Double Taxation Relief) (Sweden) Order, 1954. L.N. 176 of 1954.

8. The Income Tax (Double Taxation Relief) (Norway) Order, 1956. L.N. 64 of 1956.

9. The Double Taxation Relief (Taxes on Income)(New Zealand) Order in Council, 1951, No. 43 of 1951.

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Ghana,[10] Sierra Leone,[1] Gambia[2] and Denmark.[3]

The treaties with the United Kingdom, Sierra Leone, Ghana and Gambia based on a Commonwealth Model, are identical word for word. For our purposes, therefore, reference to the U.K. treaty would invariably mean reference to these other treaties. As regards Nigeria's tax conventions with Norway, Denmark, Sweden, the U.S.A. and New Zealand; these are in actual fact treaties negotiated with the United Kingdom and then made applicable to Nigeria by Enabling Orders.[4]

What should be observed from this state of affairs is that Nigeria as an independent country has not negotiated any tax treaty since the attainment of independence in 1960.[5] But why is this so? Is it because the country has economic relations with only NINE countries? Or, is it because the Commonwealth Income Tax Relief Scheme has been very effective? Since Nigeria has accepted the colonial tax treaties, does this mean that the terms are satisfactory? Is it not true that the interests of direct negotiating parties are paramount in concluding international agreements without much thought being given to the possible extention of the terms to third parties? Indeed, were Nigeria to have negotiated the Treaties

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10. The Double Taxation Relief (Gold Coast) Order in Council, 1950 No. 16 of 1950.

1. The Double Taxation Relief (Sierra Leone) Order in Council, 1950, No. 17 of 1950

2. The Double Taxation Relief (Gambia) Order in Council, 1950 No. 18 of 1950.

3. The Income Tax (Double Taxation Relief) (Denmark) Order, 1955. L.N. 110 of 1955.

4. The text of nearly all the Treaties are published in Nigeria's Treaties in Force. Vol. 1, October 1960 to June 1970, pages 215 - 295. Somehow, the Treaties with Ghana, Sierra Leone and Gambia are omitted from the Publication. It may be noted that the Treaties in general are nearly all identical word for word. However, material differences where they exist are highlighted.

5. There was negotiation between Italy and Nigeria some years ago but but nothing concrete resulted.

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in the first instance or to re-negotiate them would the present provisions have been considered acceptable?

Following the proposition that tax treaties are to accommodate and adjust the conflicting tax claims of the Contracting Parties, it is submitted that a treaty between States A and B is not likely to safeguard adequately the interests of State C especially where A and B are developed countries and C is a developing country.

The "state practice in Nigeria is to study each treaty or other international agreement with a view to its adoption with or without modification or to renegotiate it with the other contracting parties".[6] The introductory note to the official publication - "Nigeria's Treaties in Force 1960 - 70" states categorically that it is only those conventions which have been studied and adopted that are incorporated. This suggests that the colonial tax treaties incorporated therein have been closely scrutinised and found acceptable.

Be that as it may, this writer remains sceptical as to the quality or thoroughness or any purported governmental study of these treaties. All available data show that tax treaties as such have not been a crucial factor in encouraging the inflow of foreign capital and technology. Rather than safeguard Nigeria's revenue interests, the provisions of these treaties appear to be very much biased against the country so as to amount to an unwarranted revenue sacrifice.

The issues raised here are examined in greater detail when the substantive provisions of the treaties are reviewed.

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6. Introductory Note to the official publication: "Nigeria's Treaties in Force.

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IV. DOUBLE TAXATION TREATIES AND THE NIGERIAN LEGAL ORDER

A. Adoption of Treaties

In international law, the parties to a treaty are the respective States and not their subjects. Since a treaty is a contract and not law, for a treaty which purports to affect the private rights of a subject to take effect, it must be incorporated into the domestic law of the state concerned. The manner of incorporation varies from country to country.[7]

In Nigeria, the treaty must receive parliamentary approval or Supreme Military Council approval since 1966, and be expressly enacted and incorporated into the statute book.[8] This procedure may be contrasted with the American practice where a treaty does not require a separate enactment but is automatically regarded as law.[9]

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7. D.P. O'Connell, International Law - Vol. 1, 2nd edition 1970, Chapter Two - "Relationship Between International Law and Municipal Law" especially at pages 38, 54, 56 and 61; Brierly, Law of Nations - 6th edition pages 89 - 90. See also J.D.B. Oliver - "Double Tax Treaties in U.K. Tax Law" - (1970) B.T.R. p. 388. What may be noted here is that the making of treaties, at least as far as the U.K. and Nigeria are concerned, is a prerogative power which the executive may exercise without theconcurrence of the legislature so that if a treaty were ipso facto to become part of a country's domestic law, it would mean that the executive could legislate for the country.

   A principal authority in the U.K. regarding the operation of treaties is the Parlement Belge (1878 - 79) 4 P.D, reversed in (1879 - 80) 5 P.D. 197. In this case, Phillimore, J., held inter-alia and at first instance that no immunity from the attachment of ships other than warships could be granted by treaty without parliamentary consent. See also Republic of Italy v. Hambros Bank Limited (1950) 1 All E.R. 430. In this case, the question was whether a treaty, which was actually termed a Financial Agreemnnt, between the U.K. and Italy had become part of the law of the U.K. so as to affect the rights of the defendants to the action, Vaisey, J., held that because there was no express incorporation into U.K. law, the Agreement was not cognisable in that country's court.

8. 1963 Constitution s.76 as amended. The Nigerian law follows U.K. practice.

9. Article VI, Clause 2 of the U.S.A. Constitution as amended.

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The Nigerian double taxation agreements as a genus of treaty are subject to the above stated principle - a principle which is considered to be of the utmost importance in the case of such treaties because each and every provision which they contain is intended to affect the private rights of the subjects of the respective states.

Considering that every tax treaty and every amendment thereof requires legislation in Nigeria in order to take effect, and in view of the potentially large number of such treaties, a convenient procedure is laid down in s.24 ITMA and s.37 CITA which provides for legislation by way of Statutory Instrument in the form of an Order-in-Council. For instance, s.24 ITMA provides that where the:

> "Minister of Finance (now Federal Commissioner of Finance) of the Federation by Order declares that arrangements specified in the Order have been made with the government of any country outside Nigeria with a view to affording relief from double taxation in relation to tax imposed on income charged by this Act and any tax of a similar character imposed by the laws of that country, and that it is expedient that those arrangements should have effect, the arrangements shall have effect notwithstanding anything in any enactment."[10]

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10. s.24(1) ITMA, Emphasis supplied.

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In addition, the Commissioner may make rules for carrying out the provisions of any arrangements made pursuant to the above provision.[1] Such Order may include provisions for relief from tax for periods commencing or terminating before the making of the Order, and as to income which is not itself liable to double taxation.[2]

To enable the Federal Government to succeed to double taxation agreements entered into on its behalf before the independence and in accordance with the Exchange of Notes, an Order applicable throughout Nigeria is deemed to have been made under s.24 ITMA with effect from the year of assessment beginning the first day of April 1961.[3]

Initially, the relief from double taxation was for income tax of individuals and companies but in 1967 this was extended to cover Super Tax[4] and then to cover the Capital Gains Tax[5] introduced in the same year. The Petroleum Profits Tax Ordinance 1959 has provisions allowing Nigeria to enter into double taxation agreements with other countries or to extend the existing ones as may be appropriate.[6] Even though the country is now a major oil producer, no arrangement with any other country for relief against double taxation has been deemed necessary.[7]

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1. s.24(4) ITMA 1961
2. s.24(5) ITMA 1961
3. s.24(6) ITMA 1961
4. s.10 of the Super Tax Decree 1967. This tax has now been abolished. See s.3, Finance (Miscellaneous Taxation Provisions) Decree 1972.
5. s.43 Capital Gains Tax Decree 1967
6. ss. 52, 53 Petroleum Profits Tax Ordinance 1959
7. The simple explanation of this is that Oil Companies operate in a seller's market. The issues are more fully investigated in our Chapter on Oil Company Taxation.

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B. Tax Treaties and the Federal Set Up

As outlined in Chapter One, there is a division of taxing powers in Nigeria between the Federal Government and the State Governments; the former having the exclusive jurisdiction to levy taxes on the profits and gains of companies, and the latter having jurisdiction over personal income taxation.[7a]

Inherent in this type of constitutional set up where double taxation agreements also concern taxes levied under State laws, are potential conflicts with regard to international treaty obligations.[8] It is perhaps with a view to resolving or preventing such conflicts that the Federal Government is empowered to "make laws for Nigeria or any part thereof with respect to taxes on income and profits other than the income and profits or companies" for the purpose of:

(a) implementing any treaty, convention or agreement between the Federation and any other country or any arrangement with or decision of any international organisation of which the Federation is a member with respect to taxes on income and profits

(b) securing uniform principles for the taxation of income and profits accruing to persons in Nigeria from countries other than Nigeria and of income and profits derived from Nigeria by persons outside Nigeria."[9]

7a. 1963 Constitution s.76

8. W.R. Cotter, "Taxation and Federalism in Nigeria" (1964) B.T.R. 97 at page 98. See also Nigeria: Report of the Fiscal Commission 1958 Cmnd. 481, page 20, para. 88.

9. s.76 (2)

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In other words, what obtains in Nigeria is that the power of the states to levy taxes is subject to an overriding constitutional provision enabling the Federal Government to regulate such taxes in accordance with its international treaty commitments. Hitherto, no difficulty has arisen because the governments of the twelve component states of the Federation have behaved reasonably by regarding Agreements between the Federal Government and other countries as binding on them as though they were Agreements to which each was a direct party.[10]

But suppose such co-operation was lacking?

Two things were likely to happen. The Federal Government, though legally competent, might be unable to implement tax treaties internally where matters of personal taxation were concerned.[1] Secondly, if the states are in breach of Federal treaty obligations it may not be clear who should be held responsible.

The answer to this problem would probably depend on whether or not the "states" retain sufficient international competence - a matter which in turn depends on the type of federal system in question. According to D.P. O'Connell,

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10. British Tax Encyclopaedia Vol. 5, paras.13 - 294. Commentaries on the Nigeria - U.K. Double Taxation Agreement. Note that where the subject matter of any treaty is not included in the legislative lists, the Federal Government may nevertheless legislate for the whole country subject to the proviso that such a treaty is not binding on a state until it has received the consent of the Governor of that state. See also T.O. Elias, Nigeria: The British Commonwealth the Development of its Laws and Constitutions (1968), 1st edition, pages 270 - 271

1. D.P. O'Connell op. cit. Vol. 1, page 318. An extreme example of what is alluded to here is Australia which does not ratify I.L.O. Conventions save those which can be implemented within the Constitutional powers of the Federal government. See R. v. Burger ex parte Henry [1936] 55 C.L.R. 608.

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where states have exclusive or residual powers over certain matters, these are sufficient attributes of sovereignty under international law.[2] This may be so; but what is not clearly spelt out by this author, nor indeed by any other, is the precise position of liability in the given situation.

C. Conflicts of Tax Treaty with Internal Law

As must be evident from our discussion above, upon entry into force, arrangements for relief against double taxation take effect notwithstanding anything to the contrary in any other enactment.[3] Thus, where there is any conflict between existing law and any treaty arrangements the latter provisions will prevail.

No Nigerian case has ever arisen on this point but the judicial authorities in several other Commonwealth countries support our contention. In the case of Ostine v. Australia Mutual Provident Society[4] for instance, it was held that in computing the amount chargeable under Schedule D, Case III, on a life assurance business carried on by a non-resident through a branch in the U.K., the relevant provisions of the Income Tax Act 1918 were superseded by the provisions of the United Kingdom - Australia double taxation treaty as contained in the schedule to an Order-in-Council.

2. Ibid., at page 318

3. s.24(1) ITMA 1961; s.37(1) CITA 1961

4. (1959) 38 T.C. 492; (1959) T.R. 211

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Furthermore, as we understand it, not only do tax treaties supersede internal law, the latter cannot be amended subsequently in a manner inconsistent with the treaty provisions.[5] The only exception to this rule, it would seem, is where there is tax evasion.[6] In this circumstances, "neither the comity of nations nor rules of international law can be invoked to prevent a sovereign State from taking what steps it thinks fit to protect its own revenue laws from gross abuse."[7]

Even though according to our general proposition tax treaty provisions supersede internal law, there are certain limits on the extent to which they take effect. Problems can arise concerning the definition of these limits. The first difficulty that may arise concerns the relationship between relief measures available under treaty provisions and any existing unilateral relief measures.[8] The second concerns the extent to which the treaty provisions can create a charge to tax, where one does not exist; or, alternatively, to increase or decrease an existing tax liability.

Considering that Nigeria does not have a scheme for unilateral relief from double taxation the first point does not arise. But examining the U.K. position,

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5. For example, see Woodend (K.V. Ceylon) Rubber and Tea Company Ltd. v. C.I.R. (Ceylon), [1970] T.R. 115. (P.C.). In this case, subsequent changes in the Ceylonese Tax Law, imposing a tax on dividends due to non-residents were held to be in breach of the express provisions of the U.K.-Ceylon Tax Treaty.

6. Collco Dealings Ltd. v. I.R.C. [1962] A.C.1. This case involved a dividend stripping operation. The U.K. Revenue refused exemption to a resident of Eire in accordance with an Agreement of 1926 which provided for mutual tax exemptions to residents of Eire and the U.K. The Revenue's refusal was based on a statutory provision which came into effect in 1955. The Appellant's contention was that the U.K. amendment could not derogate from his rights under the Treaty of 1926.

7. Ibid., per Viscount SIMONDS at page 19.

8. A distinction must be drawn between a unilateral relief and a unilateral exemption.

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it has been argued[8a] that bilateral treaty provisions will not displace unilateral measures in circumstances where the latter are more favourable despite the fact that tax treaty provisions are supposed to take effect "notwithstanding anything in any enactment".[9] This suggestion is quite logical and is, therefore, supported by this writer.

As regards the second issue, what must be remembered is that the power to levy taxes is an attribute of sovereignty or, stated differently, that the power to levy taxes can only be exercised by sovereign states.[10] Usually, bilateral treaty provisions do not create a charge to tax and neither do they increase existing tax liability. On the contrary, what may be observed in practice is that double taxation agreements restrict the charge to tax. To illustrate the point, where there is a convention, only the "business profits attributable to a permanent establishment" are liable to be taxed in Nigeria,[1] whereas, under the general law, all business profits whether or not so attributable are taxable. Similarly, Nigeria's tax treaties restrict the tax charge on interest, royalty and dividends by providing for a complete exemption from tax for the first two categories of payments[2] and forbidding any with-

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8a. J.D.B. Oliver op. cit., 388 at 392.3

9. As provided in s. 24(1) ITMA; and s.37(1) CITA. According to Max Beathudevig " a double taxation convention can only improve the taxpayer's position vis-a-vis the national law. It cannot worsen it." - (1973) Cahiers p 1/55 at p 1/65.

10. D.P. O'Connell : op cit Vol. 2 p. 715 et seq.

1. Nigeria - U.K. Agreement Article 3(1). The concept of "permanent establishment" is explored in great detail in the next chapter.

2. Ibid., Article 7(1); 7(2)

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holding tax on dividends in addition to any tax chargeable in respect of the profits or income of the company out of which the dividend is paid.[3]

Two things may be noted here: (a) The definite bias in Nigeria's tax treaties in favour of the country of residence of investors. (b) The unilateral revenue sacrifice due to the lack of reciprocity in the flow of capital and technology between Nigeria and her treaty partners. These, as we shall show, are issues central to our analysis.

D. Entry in Force and Termination of Tax Treaties

Double taxation agreements usually contain provisions setting out the date of entry into force of the treaty. This is often the date on which instruments of ratification are exchanged or a certain period often thirty days thereafter.[4] To ensure continuity and simplicity, all Nigeria's present tax treaties are deemed to have come into existence as from the 1st of April 1961 subsequent to an Order made under the Income Tax Management Act 1961.[5]

Like other kinds of treaties, tax agreements contain provisions setting out the procedure for giving notice of termination and the date on which such termination becomes effective. In spite of this, it is interesting to recall that the tax treaty between Nigeria and Canada was revoked by decree instead of termination in accordance with the provisions of the treaty itself.[6]

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3. Ibid., Article 6(1)
4. e.g. Nigeria - U.K. Agreement Article 15(1)
5. s. 24(6) ITMA; s.37(6) CITA 1961
6. s.22 Income Tax (Amendment) Decree 1966. Decree No. 65. There is a possibility that notice was given in accordance with the terms of the Agreement but there is no public evidence of this. Furthermore, there is some confusion as to whether the tax agreement with New Zealand has been terminated as suggested by the U.N. Tax Agreements which are in conflict with the Nigerian records which indicate that the Agreement is still operative.

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One other matter of significance must be mentioned here, viz, where a double taxation agreement with a Commonwealth country is revoked what happens? Is the Commonwealth Income Tax Relief automatically revived?[7] Recent example is not instructive because when the Nigeria - Canada agreement was revoked, the enactment was silent on the question of whether or not relief in respect of Commonwealth Income Tax is revived.

In the opinion of this writer, it is probably correct to hold that the Commonwealth Income Tax Relief is revived. In other words, with the revocation of tax treaties between Commonwealth countries, the parties should be deemed to have reverted to the position in which they were prior to the treaty, unless the instruments of revocation provide to the contrary.

V. THE COMMONWEALTH INCOME TAX RELIEF

In a sense, this form of income tax relief is gradually becoming a matter of academic interest. Its significance lies mainly in the past - in the hey-day of the British Empire and then the Commonwealth. It was a form of relief granted in respect of taxes charged under the laws of any Commonwealth country or the Republic of Ireland upon the income of an individual or the profits or gains of a company, where such income, profits or gains were also liable to taxation in another Commonwealth country in the same year of assessment.[8]

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7. Usually, where there is a treaty, it takes precedence over the Commonwealth Tax Relief which is thereby suspended.

8. s.23(1), s.23(2) ITMA 1961; s. 36 CITA

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The relief was available on a reciprocal basis and ceased to apply when two Commonwealth countries concluded a full bilateral tax agreement which is considered to be more advantageous than any other alternative scheme. With the growth of these treaties, the Commonwealth Tax Relief programme has become rather archaic. Its diminished significance may also be explained by the loosening of economic ties between the Commonwealth countries in recent years.

VI. SCOPE OF THE CONVENTIONS

An important function of any tax convention is to settle the question of jurisdiction between the contracting parties. For this purpose, the contracting parties themselves must be clearly identified.[9] Also, to be identified are the taxes and the persons intended to be governed by the conventions.

Before turning our attention to the potential areas of conflict and the allocation of taxing powers under Nigeria's tax treaties, it is pertinent to emphasize again that a double taxation agreement is an instrument designed to eliminate or mitigate the harshness of the multiple tax burden which results where a person has sufficient contact with two or more tax jurisdictions so as to make his income or gains simultaneously liable to taxation in two places

It is against this background that we must proceed.

A. Identity of the Contracting Parties

In the U.K. - Nigeria Agreement, the term "United Kingdom" is defined

9. e.g. Article 2(1)(a). Nigeria - U.K. Agreement. In practice, the identity of the parties to a tax treaty is ever hardly in doubt.

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to mean "Great Britain and Northern Ireland excluding the Channel Islands and the Isle of Man,"[10] while the term 'the Colony' is defined to mean "the Colony and Protectorate of Nigeria including the Cameroons under United Kingdom Trusteeship."[1]

While the political identity of the United Kingdom has remained unaltered since the Convention was concluded in 1946, from 'the Colony' has evolved the Federal Republic of Nigeria with a political character fundamentally different from the 1946 set up.[2] A unitary system of government has since been abandoned in favour of a twelve-state federal structure, and the then British Cameroons has become a part of another country.[3]

It is not being suggested that the identity of the parties to the U.K.-Nigeria Convention is in doubt, rather, what is suggested is caution in this area of treaty succession. As indicated above, with the substantial and exclusive powers given to the states of the Federation in respect of certain taxes,[3a] their co-operation is of the utmost importance in the successful implementation of any double taxation agreement entered into on behalf of the whole country by the Federal Government.

The implications of the current set up are further explored in the following sub-section.

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10. Nigeria - U.K. Article 2(1)(a)

1. Ibid., Article 2(1)(b)

2. It is not necessary to trace the Constitutional developments in the country from 1946 to the attainment of independence in 1960, and the subsequent developments after independence especially the changes brought about by the Military.

3. The present position was achieved by the States Creation Decree 1967. It is interesting to note that the Cameroons regards herself bound by the tax treaties entered into on its behalf by the British when the country was jointly administered with Nigeria.

3a. Power over Personal Taxation including Partnerships is reserved to the states.

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B. Taxes Covered

On the entry into force of the U.K. - Nigeria treaty as an example, the following taxes were subject to the treaty: As regards the U.K., Income Tax (including Surtax) and Profits Tax collectively referred to in the Agreement as "United Kingdom tax",[4] and as regards Nigeria, Income Tax, referred to in the Agreement as "Colonial Tax".[5] In addition, the Agreement is deemed to cover

> "any other taxes of a substantially similar character imposed in the United Kingdom or Nigeria ....".[6]

subsequent to the commencement date of the Agreement.

In relation to the United Kingdom, it is not difficult to infer that the Convention as at present covers Income Tax, Capital Gains Tax and Corporation Tax; but with a change from a unitary to a federal system of government how accurate is it to hold that taxes levied by the political sub-divisions of present Nigeria are "substantially similar" to the then existing "Colonial Tax" payable throughout the country?

The issue is perhaps academic because of the provisions of s.76(2)(a) and (b) of the 1963 Constitution which ensure that the states do not frustrate the

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4. Article 1(1)(a)

5. Article 1(1)(b)

6. Article 1(2). Emphasis supplied. In terms of elegance, the equivalent OECD wording is preferable. E.g. Article 2(4) of the OECD Model provides inter-alia that "the Convention shall also apply to any identical or substantially similar taxes which are subsequently imposed in addition to, or in place of, the existing taxes".

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treaty obligations of the Federal Government. Nevertheless, the point is worth making. Were the Nigerian constitutional arrangements inadequate in this regard, an alternative solution would have been to provide in the treaty itself that taxes covered include not only the taxes of each Contracting Party, but taxes levied by their "political sub-divisions or local authorities". Provided, of course, that these taxes are clearly identified or identifiable and that a list of them are exchanged periodically between the Parties.

The need to identify the taxes covered in a Convention and for which a tax relief can be granted is well illustrated by the case of Ashanti Goldfields Corporation Ltd. v. Merrifield.[7] In that case, the appellant company contended that a royalty payment on the output of gold or precious stones and other minerals in the Gold Coast (now Ghana) was the equivalent of an "income tax" and so qualified for relief against U.K. taxation by virtue of the provisions in the U.K. law granting relief from "any income tax ......charged under any law in force in any dominion". Even though the Court rejected the taxpayer's submissions the point involved here is worth noting.

Similarly, in a New Zealand case,[8] the taxpayer contended that amounts deducted at source as contributions to Indian Military Widows' and Orphans'

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7. 19 T.C. 52. See also McCalmond v. C.I.R. 22 T.C. 533. One of the questions at issue in this case was whether relief from double taxation extended only to "income tax" or to "income tax as well as supertax". The taxpayer was a resident of both the United Kingdom and Irish Free State.

   For a discussion of the problem of identifying the taxes covered by the Israel- German Double Taxation Agreement, see E.W. Klimowski, "Incongruencies in Double Taxation Conventions" - (1973) Vol. 8, Israeli Law Review, pp. 140 - 144.

8. 3 N.Z.T.B., Case No. 37, page 442.

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fund constituted a "foreign tax" and that being the equivalent of "New Zealand Social Security Income Tax", he was entitled to a credit by virtue of the unilateral relief provisions against double taxation under the New Zealand tax code. The Board of Review, following the observation of Dwyer, J., in an earlier case, held that the outstanding characteristic of a tax is that:

> "it is a compulsory contribution imposed by the sovereign authority on, and required from the general body of subjects or citizens as distinguished from isolated levies from individuals".[9]

That being so, the taxpayer's submissions were rejected on the grounds that the compulsory pension contributions deducted were applicable only to a class of persons and hence was not a tax.

Almost analogous to the problem of identifying the taxes covered, is the problem of identifying the various categories of income to which the tax treaties are applicable. As far as Nigeria is concerned, it is clear that they are applicable to various categories of income including "dividends", "interest", "royalties", "pensions", "captial gains" and so-called "industrial or commercial profits". The Conventions provide that the precise ambit of these undefined terms is to be determined in accordance with the laws of each Contracting State.[10]

Elsewhere in this study, the definition and scope of dividends, interests and royalties have been explored in relation to the Nigerian Law.[1] The

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9. Leake v. C.O.T.

10. e.g. Nigeria - U.K. Agreement Article 2(3)

1. Supra, Chapter Five.

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expression "industrial or commercial profits" which is nowhere defined in the tax treaties, save to the extent that it includes "rentals in respect of cinematograph films" is duly examined in the appropriate context.[2]

C. Personal Scope and the Question of Fiscal Domicile

Who may benefit from tax agreements or rather, to whom are the treaties applicable?

Whereas older Conventions in general were applicable to "citizens"[3] of the Contracting States, recent Conventions usually apply to residents of one or both Contracting States, without distinction of nationality. Some Conventions are of even wider scope inasmuch as they apply more generally to "taxpayers" of the Contracting States. They are, therefore, also applicable to persons, who, although not residing in either State, are nevertheless liable to tax on part of their income or capital in each of them.[4]

The Nigeria - U.K. Agreement, like most of the country's other treaties, is applicable to "persons"[5] deemed to be resident for tax purposes in the territory of one or the other of the Contracting Parties. Each state is allowed

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2. Nigeria - U.K. Article 2(1)(j). The scope of the expression "industrial or commercial profits" is examined in the next chapter in relation to Business Profits and the concept of a "Permanent Establishment".

3. e.g. See Article 2(1)(g) of the Nigeria - U.S.A. Agreement. The kind of anomaly which may arise is highlighted by the cases of Lord Strathalmond v. I.R.C. and Oppenheimer v. Catermole discussed presently.

4. Commentaries on OECD Draft at page 61.

5. "Persons" are defined to include any body or persons, corporate or not corporate - Article 2(1)(e) U.K. - Nigeria Agreement.

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to prescribe its own criteria for determining the question of residence,[6] but the Convention is quite unhelpful when it comes to settling the problem of jurisdiction arising from "dual residence" - that is, where a taxpayer is technically resident in both Contracting States. From the wording of the Agreement, it would in fact appear that relief may be denied to an individual just because he is technically resident in both states.

The issue of "dual residence" was probably recognised at the time of the convention, yet it was provided in the Agreement that the :

> "terms 'resident of the United Kingdom' and 'resident of the Colony' mean respectively any person who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident[7a] in the Colony for the purposes of Colonial Tax, and any person who is resident in the Colony for the purposes of Colonial tax and not resident[7b] in the United Kingdom for the purposes of United Kingdom tax ...."[7]

How precisely this provision is to be construed is unclear, but it is questionable whether indeed relief would be denied to a taxpayer simply because

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6. The question of residence is of particular importance in the case of Nigeria for an additional reason. In a federal system where jurisdiction over personal taxation is given to the component states, internal double taxation has to be avoided. For this purpose,a preferential criteria is prescribed in the Third Schedule of ITMA for resolving any conflicts of jurisdiction where an individual comes into contact with two or more states in the Federation.

7. Nigeria - U.K. Agreement Article 2(1)(g).

7a. Emphasis supplied

7b. Emphasis supplied.

he is technically resident in the two countries. Such an absurd result could not have been contemplated by the parties.

Where an individual is a resident of both contracting States, the OECD approach is to prescribe a number of criteria, set out in order of preference for determining the matter of jurisdiction.[8]

These are commonsense rules designed to establish with which of two places a taxpayer has the closer contact. Where they fail to resolve the issue conclusively, then it may be determined by mutual consultation.[9] This writer is in accord with this approach.

Two cases may now be referred to.

In Strathalmond (Lord) v. I.R.C.[10] the main question at issue was whether the taxpayer's wife having an American nationality, was also a resident of the U.K. for the purposes of double taxation relief. The taxpayer's wife was an American citizen resident for United Kingdom taxation purposes in the United Kingdom. She was however not "a resident of the United Kingdom" within the definition of that term in Article 2(1)(g) of the Double Taxation Agreement between the United Kingdom and the United States,[1] scheduled to the Double

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8. Article 4(2)(a) - (c), OECD Model. The criteria stipulated in order of preference are the situs of permanent home, centre of vital interests, to wit; personal or economic interests, habitual abode and lastly nationality.

9. Article 4(2)(d)

10. (1972) 1 W.L.R. p. 1511

1. This provides as follows: That the term "resident of the United Kingdom means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States ......"

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Taxation Relief (Taxes on Income) (U.S.A.) Order 1966 because of her American citizenship. The taxpayer was assessed to income tax on her American dividends. He appealed on the ground that his wife was a "resident ..... of that other contracting party," (i.e. the United States) within the meaning of Article XV as amended by the Order of 1966,[2] the latter article falling to be construed in accordance with the former, and that her American dividends were therefore exempt from United Kingdom income tax. The Special Commissioners dismissed the appeal.

In the High Court, Chancery Division, Pennycuick, V.C., had no difficulty in allowing the appeal holding that the expression "resident ...... of that other contracting party" in Article XV of the Convention of 1946 as amended, imported the definition of "resident of the United Kingdom" and "resident of the United States". The taxpayer's wife was excluded from the former definition by reason of her being a citizen of the United States and was therefore exempt from United Kingdom tax on her United States dividends.

Stripped to its essentials, this case was not only an attempt to ascertain the persons to whom the U.K. - U.S.A. Double Taxation is applicable, but helps

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2. Article XV reads: "Dividends and interest paid on or after January, 1st 1945, by a United Kingdom corporation shall be exempt from United States tax except where the receipient is a citizen of or a resident of the United States or a United States corporation."

   The Convention of 1966 contained the following Article II: - "Article XV of the Convention", - that is the Convention of 1946 shall be deleted and replaced by the following Article XV ...... "Dividends and interest paid by a corporation of one contracting party shall be exempt from tax by the other contracting party except where the recipient is a citizen, resident, or corporation of that other contracting party. This exemption shall not apply if the corporation paying such dividend: or interest is a resident of the other contracting party".

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to illustrate the artificiality of some of the tax concepts. Since liability to U.S.A. taxation is on the basis of "citizenship" rather than "source" or "residence", it was possible for the taxpayer's wife to be physically resident in the U.K. and yet to be a U.S.A. resident for the purposes of double taxation relief.

The second case to which we wish to refer established the same principle even though the facts are materially different. In Oppenheimer v. Cattermole,[3] the taxpayer, a German subject, emigrated to England in 1939, became a naturalised British subject and continued to receive his annual pension from Germany. The main issue which arose in this case was whether or not he had retained his German nationality which entitled him to relief from United Kingdom tax under the provisions of Article IX of the Double Taxation Relief (Taxes on Income)(Federal Republic of Germany) Order 1955 and a similar Order of 1967.[4] The taxpayer's German pension was to be exempt from United Kingdom income tax if he was found to be a national both of the United Kingdom and Germany, but was not exempt if found to be a national of the United Kingdom alone.

Two German laws were proved before the Special Commissioners; a law of 1913 by which a German who was neither domiciled nor permanently resident in

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3. [1971] T.R. 507; [1972] 2 W.L.R. 1045; [1972] 3 W.L.R. 815 - C.A.

4. (S.I. 1955 No. 1203). Article IX(1) of the Convention is as follows: "Remuneration, including pensions, paid in respect of present or past services or work, out of public funds of one of the Contracting Parties shall be exempt from tax in the territory of the other contracting party, unless the individual concerned is a national of the other party without being also a national of the first mentioned party."

The 1967 Order is to be found in the Schedule to S.I. 1967 No. 25. For the purposes of this Appeal, it did not materially alter the relevant provision of the earlier Convention.

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Germany lost his nationality on acquisition of a foreign nationality - a decree of November 25, 1941, which enacted that a Jew of German nationality ordinarily resident abroad at the date of the decree should lose his nationality forthwith. The Commissioners held that the taxpayer ceased to be a German national not later than June 4th, 1948, and was not therefore entitled to relief from income tax under the double taxation relief provision.

Allowing the appeal by the taxpayer to the High Court, Goulding, J., held inter-alia: (1) that the German decree of 1941 should be disregarded for purposes of English municipal law during and after the war with Germany; that, the English Courts did not recognise the taxpayer's loss of German nationality by the decree of 1941; (2) and more importantly, that the German law of 1913 did not apply, since in 1948 when the taxpayer had acquired British nationality he had ceased to be a German national for the purposes of German law and that accordingly he was of dual nationality and was exempt from liability for income tax under the Orders of 1955 and 1967.

The Crown appealed on the grounds, inter alia, (1) that the question whether the taxpayer was a German national was to be determined by English law which provided that that question had to be decided according to German municipal law;[5] (2) that according to German law the taxpayer was not a German national after he became a British national in 1948; (3) that the principle that a foreign decree which altered the nationality of enemy aliens

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5. See Russell, J. in Stoeck v. Public Trustee [1921] 2 Ch. 67, p. 82. "Whether a person is a national of a country must be 'determined by the municipal law of that country. Upon this I think all text writers are agreed." Dictum cited with approval by Lord Denning in the C.A. 3 W.L.R. 815 at 819.

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in wartime would not be recognised by English courts applied only in time of war and could not be extended.[6]

The Court of Appeal in a unanimous decision,[7] upheld the submissions of the Revenue and reversed the decision of Goulding, J., at first instance.

This rather complex case has warranted some intelligent press comment. The decision of the Court of Appeal has been strongly criticised[8] in view of the well known facts which were before the Court concerning the 1968 decision of the German Constitutional Court which declared the 1941 decree void ab initio.

In fact, if the view expressed by Lord Denning that "a country is solely in charge of the nationality of its citizens" is to have any meaning at all, this would automatically mean that Germany had the right to decide who was, and who was not, a German citizen, and in this circumstance the German decision of 1968 meant that the German decision of 1941 depriving Oppenheimer of his German citizenship was, and always had been without effect.

Luckily, on appeal by the taxpayer to the House of Lords, the Court decided to send the case back to the Special Commissioners with the observation that:

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6. The general rule stated positively is that "English law would not recognise any decree of an enemy power which purports to deprive its citizens of their enemy nationality in time of war". - Rex v. Home Secretary Ex parte Henry [1945]K.B. 7; Lowenthal v. A.G. [1948] 1 All E.R. 295. Cited with approval by Lord Denning in the C.A. 3, W.L.R. 815 at 820 [1972]

7. [1972] 3 W.L.R. 815. It was stressed by Buckley and Orr, L.Js that the principle that a foreign law should not be recognised by English courts if penal or confiscatory did not apply to questions of nationality or citizenship.

8. One of such criticisms was by Bernard Levin. "Seasonal Goodwill for Citizen Oppenheimer" - The Times (U.K.) December 20th, 1973 at page 12.

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"there were grounds for thinking that the findings of the Commissioners as to the relevant German law might have been based on inadequate material, and that, in particular, Article 116 (2) of the Constitution of the Federal Republic enacted in 1949, before the years of assessment, might have a bearing on the point to be decided".[9]

By the time the Special Commissioners have had a second look at the facts of this case, there is very little doubt as to what their findings would be.

As regards companies,[10] the ascertainment of their fiscal residence is of the utmost significance since on this may depend their tax liability. The Tax Agreements under consideration are applicable only to companies resident in one or the other of the Contracting States. The prescribed test for residence is the situs of "management and control".[1] This test, which is undoubtedly a good one, is however subject to two qualifications.

Firstly, the provisions of the treaties under review do not seem to cover a situation where the management and control is divided over several countries as is generally the case nowadays with the growth of multinational companies. If, for example, the management and control of a U.K. company operating in

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9. Oppenheimer v. Cattermole reported in "The Times" U.K. of 14th December 1973.

10. The term "Company" is defined to include any body corporate. Nigeria - U.K. Article 2(1)(f).

1. Nigeria - U.K. Article 2(1)(g). In the U.K. as well as in Nigeria, there as no statutory definition of a company's residence as such. But the test adopted by the Courts is the place where the management and control of the company abide (and not the place of incorporation or registration). See De Beers Consolidated Gold Mines v. Howe 1906 A.C. 455; 5 T.C. 198.

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Nigeria is split between the two countries, where precisely is the company resident for the purposes of double taxation relief? Furthermore, assuming that a company is supposed to be managed and controlled in country A, but is de facto managed and controlled in country B, what is the legal position?

It would appear, at least as far as the U.K. is concerned, that it is the actual place of management and control of a company and not the place where it ought to be managed (as provided in its constitution) which fixes the residence of a company.[2] So that once a substantial degree of de facto control is exercised in the U.K. this is sufficient to make the company resident and liable to that country's taxation.

For the purposes of double taxation relief however, the principle established in Unit Construction Co. Ltd. v. Bullock is not very helpful because it fails to presecribe a scale of preferential tests to be applied in determining in which of two places a company is resident; to wit where there is a conflict of jurisdiction between the place of de facto control and the place where the company ought to have been controlled de jure.

The second qualification to the "management and control" test was spelt out in the case of Swedish Central Railway Company v. Thompson[3] which broadly speaking appears to be the converse of the Unit Construction Case. In the

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2. Unit Construction Company v. Bullock 1960 A.C. 351. Unauthorised management of a company outside country of incorporation. Held that it is the actual place of management of company and not the place where it ought to be managed which fixed the residence of a company. Applying this principle, a Kenyan subsidiary of a U.K. company was thus considered resident in the U.K. for tax purposes.

3. [1925] A.C. 495; 9 T.C. 342.

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Swedish Railway case, the decision was that a company was resident in England by virtue of the fact that it was incorporated in the U.K. and that certain administrative duties were performed there, even though the central "management and control" was in Sweden.

Again, this decision is not very helpful for resolving the question of company residence for the purposes of double taxation relief.

Relating the above discussion specifically to Nigeria, a number of points are worth noting. It may be recalled that while it is compulsory for all companies to be incorporated in Nigeria,[4] the management and control in most cases are exercised overseas. On this basis, it could be argued that several of them are resident overseas irrespective of their status in Nigeria. Contrariwise, following the principle in the Swedish Railway Case, it could equally be argued that companies incorporated in Nigeria are resident in the country because certain administrative duties are performed there - the fact that they may be simultaneously resident elsewhere notwithstanding.

What must be emphasized as far as double taxation relief is concerned, is the need to assign jurisdiction to one party where a company is technically resident in two Contracting States. It is precisely in relation to this that Nigeria's Treaties fail.

Where by the domestic laws of Contracting States there is dual residence, the OECD Model gives the right to the State where the place of "effective management" of a company is situated.[5] Theoretically, this would seem to be

4. i.e. since 1968. Companies Decree s.369 et seq.

5. OECD Model Article 4(3).

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a good way round the difficulty on the assumption that "effective management" as distinguished from ordinary "management" cannot be fragmented. Be that as it may, what must be borne in mind is that inherent in the OECD solution is the difficulty of proving what acts constitute "effective management", and what acts do not. In situations where the functions of management are exercised in two or more places this cannot be easy. The eventual solution may be by consultation between the parties.[6]

One other matter of considerable importance deserve mention. Namely, the attempt by the great maritime nations to extend the advantage of tax exemptions under their double taxation conventions to ships not operating under their flags. The point is certainly not academic.[7] The U.S.A. for example, in the recent past, introduced in some of its conventions a formula which seems to extend the benefit of exemption to all ships in U.S. ownership, whether direct or indirect, as well as to ships registered in the United States.[8]

This writer strongly disapproves of this trend. Not only does it represent a tacit acceptance of the practice of operating ships under so-called "flags of convenience", but it also makes it more difficult to identify the parties who may benefit under a tax treaty. With regard to carrier enterprises,

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6. A Procedure for Mutual Consultation is outlined in Article 25 of the OECD Model.

7. G. Johannsen, discusses the problem further in his article "Flags of Convenience" - (1961) B.T.R. 305

8. For example, U.S.A. - Japan Treaty of 1954. Article V provides inter-alia that an exemption from tax is granted to "an enterprise of one of the contracting states from the operation of ships or aircraft in a third country".

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what is advocated is that jurisdiction to tax must be assigned either to the State where the ship is registered, or to the State where the operator is resident,[9] or, to the State where the "effective management"[10] is situated as may be considered appropriate by the Contracting Parties. All that is emphasized here is that there must be a clear nexus between a shipping enterprise and the treaty-states for that enterprise to benefit.

VII. CONCLUSION

In this chapter, we have endeavoured to put the problem of international double taxation into perspective. The origins of Nigeria's tax treaties was established and their place within the country's legal order and general scheme of taxation outlined.

A substantial part of this chapter was devoted to the personal and fiscal scope of the Conventions stressing the need for the persons who may benefit under them to be clearly identified. The practice of extending tax treaties to cover ships under "flags of convenience" was strongly condemned.

The special difficulty created by dual residence was highlighted. The view advocated was that the question be settled by the adoption of a number of well defined criteria and that where these prove unworkable the issue

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9. This is the test adopted under Nigeria's Tax Treaties. Nigeria - U.K., Article 5.

10. This is the test adopted by the OECD Model - Article 8.

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should be settled by consultation.

Other main observations were as follows: (1) That the Contracting Parties themselves have to be clearly identified. (2) That a list of taxes covered be exchanged periodically so as to remove any doubt especially in the case of Nigeria where the so-called "Colonial tax" has been replaced by a multiplicity of taxes.

Finally, it must be repeated that this brief chapter has been devoted to preliminary issues, - serving as a background to the more intricate discussion in the next two chapters.

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CHAPTER SEVEN

DOUBLE TAXATION (II)

PERMANENT ESTABLISHMENT, BUSINESS AND OTHER INCOME

I. INTRODUCTION

Whereas the issues raised in the last chapter were important, they were hardly controversial. The developed and developing countries are very much in agreement as to how the problems highlighted therein are to be resolved. As a contrast to that, however, much of this chapter is devoted to the difficult and sensitive areas of international double taxation. Manifest from what is said hereafter, are conceptual and procedural differences which are difficult to reconcile.

The approach adopted in this chapter, is to examine Nigeria's treaty provisions in relation to various species of income. Namely, business income, investment income, and income from personal services and cultural exchange. The "permanent establishment" concept receives a great deal of attention; so also do problems of profit computation and profit allocation between branches of the same enterprise situate in different territories or between overseas affiliates and the parent company.

In general, our discussion is against the background of the OECD Draft Double Taxation on Income and Capital[1] and the amendments to it suggested by the U.N. Ad Hoc Group of Tax Experts. Cognizance has also been taken of the deliberations of the International Fiscal Association, noteably, the views expressed at their Congresses in Cologne 1954, Vienna 1957, Stockholm 1967, Washington D.C. 1971 and Lansanne 1973.

1. Circulated within the OECD under the symbol c(63)87.

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The methods of eliminating or mitigating the effect of double taxation and other procedural matters are considered in Chapter VIII.

In relation to business income, two matters fall to be determined: (1) The exact circumstance under which a foreign enterprise finds itself liable to local taxation and (2) the ascertainment of the quantum of profits so taxable.

II. BUSINESS INCOME AND THE CONCEPT OF PERMANENT ESTABLISHMENT

A. Permanent Establishment in Nigerian Treaty Law

Crucial to any tax treaty, is the Article on "permanent establishment" - a concept developed over the years for determining the "presence" or otherwise[2] of a foreign enterprise in another country, and serving also as a convenient reference point in the computation of the taxable profits of the foreign entity. Stated differently, the permanent establishment concept limits the tax jursdiction of the contracting states in an agreed manner.[3]

For reasons of economic policy, as well as for convenience of administration, the activities of a foreign enterprise in a host country must reach a certain level of intensity to justify the imposition of tax. At one extreme, are cases in which the foreign enterprise is integrated into the domestic

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2. Raoul Lenz, "The Development in Different Countries of the Concept of Permanent Establishment Notably from the point of view of Harmonisation in future Double Taxation Agreements" - (1967) Cahiers de droit fiscal International. Vol. III page 285 at p. 290

3. This indeed is one of the objectives of the tax treaty itself.

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economy to such an extent that it's manufacturing, trading or servicing activities in the host country are not materially different from similar activities of domestic enterprises. At the other extreme, are cases of sporadic and intermittent business contacts in which it would be impractical as well as undesirable for a country to assert a claim to tax. As usual, the real problem is presented by the numerous and different situations between these extremes in which the "presence" of the foreign enterprise in the host country or the absence thereof is not clearly defined.

In one New Zealand case[4] for example, one of the issues which the court had to examine was whether or not an Australian company which periodically carried on theatrical activities in New Zealand had a "permanent establishment" in that country, thus making it liable to that country's taxation. Deciding the matter in favour of the taxpayer, the Board of Review based it's decision inter-alia on the fact that the taxpayer did not have a "place of business" in New Zealand which was "permanent" or "identifiable".[5]

From a theoretical point of view, and as is evident from the above case, it is clear that the permanent establishment concept amounts to a restriction of the "source" principle. In that regard, therefore, it has met with severe criticism from developing countries who argue, and with some validity, that "the criterion of taxation limited to the circumstances in which a

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4. Case No. 5, 3 N.Z.T.B.R. p. 49. Another ground for the decision that there was no permanent establishment in New Zealand was the fact that the touring agent of the taxpayer did not exercise a "general authority" to negotiate and conclude contracts in New Zealand.

5. It has been held that the word "permanent" is used in contradistinction to a merely "temporary or occasional use" for the purposes of a trade. See Transvaal Associated Hide and Skin Merchants (Pty) Ltd. v. Collector of Income Taxes Botswana 1967.

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permanent establishment exists favours the industrialised countries.[6] For instance, the Latin American countries whose objection to the concept of permanent establishment is well known, take the view that a state must have the right to tax all income accruing in its territory.[8] This, it is acknowledged, is very important considering that modern communication has made it possible to carry on extensive business activities in another state without maintaining a permanent establishment there.[9]

Adaptations of this concept in Conventions between developed and developing countries is now generally accepted as desirable, and indeed necessary, in order to achieve some compensation for the loss of fiscal receipts which the adoption of the traditional concept of a permanent establishment involves; and, in order to take account of the prepondering importance attached to the origin of income in the legislations of developing countries.[10]

Nigeria's tax treaties as a legacy of its colonial past, retain the traditional concept of a permanent establishment. In the Nigeria - U.K.

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6. Raoul Lenz, "The Development of the concept of Permanent Establishment etc." op. cit., p. 285 at p. 305. This fact is now more generally recognised even by the members of the OECD.

7. For a summary of their stand see, Ramon Valdes Costa, "Latin American Position on the Problem of Tax Agreements between Developed and Developing Countries." (1971) BIFD vol. 25 p. 283 et seq.

8. It is important to recall here that the International Chamber of Commerce in its Report: "Avoidance of Double Taxation" - (Brochure No. 180) recognised the sole right of the country of origin to tax income arising within its jurisdiction.

9. Adolpho Atchabahian, "Some Aspects of International Double Taxation Between Developed and Developing Countries." - p. 451 at p. 458.

10. Raoul Lenz, "The Development of the concept of Permanent Establishment etc." op. cit. at p. 305. The draft multilateral Convention between the French speaking African countries is interesting in this respect. It extends the idea of a permanent establishment to a number of cases in which the OECD Convention expressly stipulates that a permanent establishment shall not exist.

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Agreement for example, the term is defined as a :

"branch, management or other fixed place of business".[1]

maintained by an enterprise of one Party in the territory of the other Contracting Party.

The tax treaties with Norway,[2] Denmark [3] and the U.S.A.,[4] go a step further by including a "factory" among the criteria of what can constitute a permanent establishment; while the Agreement with New Zealand[5] includes a "factory", "mine" and a "farm" among the examples of so-called "fixed places of business" constituting a permanent establishments. However, it is only in the Agreement with Sweden[6] that the expression "permanent establishment" is defined in terms which in anyway approximates with the current thinking on the subject. In that Agreement, it is held to include a "branch","management", "factory" or "other fixed place of business"; a "mine", "quarry or other place of natural resources subject to exploitation", as well as "a

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1. Article 2 (1)(K) - Emphasis supplied. The treaties with Ghana, Sierra Leone and Gambia are identical word for word with the U.K. treaty. As already indicated, the word "permanent" is a relative term, not synonymous with "everlasting" - see du Parcq. L.J. in Henriksen v. Grafton Hotels Ltd. (1942) 24 T.C. 453 at 462. For the purposes of the U.S.A. - Canadian Tax Convention, the meaning of a p.e. on the Grafton Hotels Case was adopted. See Case No. 630 v. M.N.R. 22 Canadian Tax A.B.C. p. 91 at 94.

2. Article 2 (1)(K).

3. Article 2 (1)(K).

4. Article 2 (1)(L)

5. Article 2 (1)(K)

6. Article 2 (1)(J)

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place where building construction is carried on by contract for a period of at least one year".

From what has been said thus far, it is perhaps obvious that the wider the definition of the term "permanent establishment" the greater the scope of the tax jurisdiction of the Contracting parties over the profits of the enterprises operating in their respective territories.[7] Evident from the above too, is the fact that Nigeria neither has a comprehensive nor consistent definition of what constitutes a "permanent establishment".

In practice, what is required is a wide and flexible definition of a permanent establishment to include "fixed places of business" reflecting the peculiar or particular economic circumstance of the Contracting Parties. In other words, where a party to a Convention is an agricultural country it is only logical that a "farm" be included among the so-called "fixed places of business" deemed to be permanent establishments. The OECD Model, otherwise an excellent work, fails to take sufficient account of these points and hence has been the subject of much criticism by developing countries.

The Draft Convention defines a permanent establishment succinctly as a :

> "fixed place of business in which the business of the enterprise is wholly or partly carried on".[8]

This definition is then supplemented by a list of illustrative examples. These include a "place of management" - which need not necessarily be an

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7. Adolpho Atchabahian makes this point well in his review of the Latin American position - (1971) BIFD Vol. 25 p. 451 at pp. 457-458.

8. Article 5 (1)

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office - a "branch", "office", "factory", "workshop", "mine", "quarry or other fixed place of extraction of natural resources"; as well as "a building site or construction or assembly project which exists for more than twelve months".[9]

The purpose of providing a list of the more frequent kinds of permanent establishments is to secure some common ground in which member countries of the OECD could reach agreement with a minimum of discussion. The list, therefore, in theory, permits the inclusion of other types of permanent establishments which are important to one or both countries negotiating a tax treaty. But, in practice, countries have all too often adhered to the definition in the OECD Model where a slight modification of the same would have been more appropriate.

Relating the above specifically to Nigeria, an agricultural country, it is submitted that "farms" and "plantations" be categorically included among the items constituting permanent establishments. So also should a place for the extraction of natural resources, and in particular, an oil field.[10] This approach has already been adopted by several other countries.[1]

With the compulsory incorporation of all companies in Nigeria since 1968,[2] it could be argued that the question of permanent establishment or

9. Article 5 (2)(A - G).

10. Nigeria is a major producer of crude oil and is endowed with several other natural resources.

1. e.g. see Article 2 (1)(K) of the South Africa - South West Africa Convention signed at Cape Town on 13th February 1959. In D.H. Perry v. M.N.R. [1952] 6 Tax A.B.C. 310 a "farm" was considered to be a permanent establishment, in interpreting the provisions of the then existing Canada - U.S.A. Double Taxation Convention.

2. 1968 Companies Decree, Part X, ss. 368 et seq.

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no permanent establishment is now of somewhat diminished significance because subsidiaries of foreign companies are clearly liable to local taxation.[3] Although this is true, what nevertheless has to be remembered is that not all trade is carried on in Nigeria through the medium of a company.

Since joint stock companies are a recent phenomenon in Africa, and considering that a substantial amount of trade is carried on along the West African Coast by itinerant merchants, pedlars, hawkers etc.; the question that may have to be resolved in a treaty between Nigeria and a neighbouring African State is whether or not the concept of a permanent establishment should be extended to cover these categories of persons.

The fiscal Committee of the OECD recognised this problem[4] but concluded that the taxable income of such person would be small and that in any case should be taxed by the country of residence. Be that as it may for developed countries, it is usually not so for developing countries. Surely, the income derived by itinerant merchants etc. as a proportion of the national income of some African countries is highly significant.

In spite of that, however, this writer is inclined to support the OECD suggestion that the concept of "permanent establishment" should not be ex-

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3. Ibid., s. 140 et. seq. requires all companies to keep books of accounts and s.117 et seq. makes it compulsory for them to file Annual Returns.
4. Commentaries on the OECD Model at page 71.

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tended to cover petty traders and the like. We have taken this view not for the reasons advanced by the fiscal Committee of the OECD, but because of the difficulty of administration considering the great shortage of skilled personnel in developing countries.

In order to illustrate the artificialty of the concept of a permanent establishment, and the potential difficulty of its application in practice, let us refer to a Canadian case which is considered interesting in several respects. In Case No. 630 v. M.N.R.[5], the appellant (i.e. the taxpayer) was a long established corporation which specialised in heavy construction work. In 1949, it was one of several members (corporations) of three different partnerships carrying out work in Canada. During the period of several years that such work was being carried on in Canada the appellant reguarded itself as an American based corporation that was away from home so to speak, its head office being in the State of New York. While a member of a partnership functioning as such in Canada, it considered that the work being done was that of the partnership as in "identifiable entity" and not of the appellant as a corporation. Going a step further, the appellant argued that as a corporation it was not "carrying on its business" in Canada and that whatever was done was the effort of the partnership as such and not of the partners viewed separately.

Having regard to these submissions and to the relevant words of the then existing tax convention between Canada and the United States of America,[6]

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5. 22 Tax A.B.C. 91

6. The provisions of this Convention followed standard international practice.

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the Board of Review came to the following decision: To wit, that an office in Ontario set up by the four partners of which the appellant was one, must be deemed to be an office belonging to the appellant. The real point to note here according to the Board of Review is that a partnership, not being a separate legal entity under the Canadian Law, could not be deemed to be a "permanent establishment" that is not at the same time the like establishment of the several partners.[7]

While the concept of a permanent establishment is now universally accepted as necessary in a tax treaty, the exemption of certain activities or facilities from it often leads to controversy. The general rule of exclusion is that facilities in which activities of a "preparatory or auxillary" nature are carried on are not characterized as permanent establishments even though they are "fixed places" in which part of the business of the enterprise is conducted. The underlying reason for this is that some activities are considered too remote from the primary business of the enterprise to justify the imposition of tax.

B. Exclusions from Permanent Establishment

(i) Purchasing offices and other fixed places for Preparatory or Auxillary Activities

Like most other conventions, Nigeria's tax treaties provide that a "fixed place of business" maintained by an enterprise or a treaty partner in

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7. One other ground on which the decision was based was the "use of substantial equipment or machinery" in Canada - constituting without more, a "permanent establishment", as envisaged under the terms of the tax agreement. 22 Tax A.B.C. 91 at p. 95 et seq.

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the territory of the other shall not be deemed a permanent establishment provided that such place of business is used exclusively for the purchase of goods.[7a] To discover the logic of this, the question to be answered is whether or not the purchase of goods per se constitutes a business carried on in the host country so as to entitle the latter to tax profits attributable to those activities.

Where for instance, cocoa is purchased by a U.K. company through its Lagos office and sold abroad, it could be argued that a proportion of the profits obtained is attributable to the purchasing activities in Lagos. To consider such activities too remote to the income producing business of the taxpayer is contrary to the source principle and hence unacceptable to many developing countries.

Where, however, there is a substantial trade between two countries, there is probably a mutual advantage under a treaty if purchasing offices are excluded from the definition of a permanent establishment. In the special circumstance of Nigeria, a producer of raw materials and an importer of manufactured goods, it is fairly evident that a purchasing office in Lagos of a foreign enterprise is likely to help the export drive, bringing in foreign exchange, thus, indirectly being of greater benefit than any tax which may be exigible from profits purported to have been made by such a purchasing office.[8]

7a. e.g. Nigeria - U.K. Agreement Article 2 (1)

8. In some Latin American countries purchasing offices for cattle and agricultural produce are deemed to constitute permanent establishments. This writer has doubts about the usefulness of this approach for Nigeria.

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Indeed, our suggestion makes a lot of sense in the light of the recent move by the Nigerian Government to set up purchasing offices abroad.[9]

The OECD Draft Convention takes the exemption accorded to purchasing offices further. It stipulates that the maintenance of a fixed place of business "solely" for the purposes of storage, display or delivery of goods, for the purposes of scientific research, or "solely" for other similar activities which have a "preparatory or auxillary character" shall not constitute a permanent establishment.[10] Among such "fixed places" contemplated are warehouses, scientific research centres, information centres,[1] sales assistance centres, service centres and the like.

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9. The purchasing company of the Mid-West state government is an example in point. The Nigerian Supply Co. Ltd. owned by the Federal Government is another. These companies have been set up to handle bulk imports and to scout around the world for bargains. See Doyin Aboaba, "Nigerian National Company - Red Tape Versus Efficiency - Daily Times (Nigeria) February 12th 1974. The Ghanaians were a forerunner here with the purchasing office of the Ghana National Trading Corporation in London. From reliable sources, this office makes no other profit save the discounts obtained on goods purchased. This discount is either transferred to Accra or used in London to pay salaries, wages and other outgoings. By virtue of the Ghana - U.K. tax treaty, such a purchasing office is not deemed to be a p.e. and the profits connected therewith are not liable to tax. As a contrast to this, it may be noted that the U.K. "branch" of the Ghana Commercial Bank is liable to U.K. tax because its trading activity in the U.K. is conducted from a "fixed place" of business and the activity is neither of a "preparatory of auxillary nature."

10. Article 5 (3)(a), (d), (e). The words "similar activities which have a preparatory or auxillary character" have been recognised to be of potentially wide applicability. The real point here is that there is no finite list of preparatory activities.

1. Information or documentation centres as compared with purchasing offices are an innovation of the OECD.

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What must be emphasised here is that, in practice, the question of tax liability would depend on the actual function of the warehouse etc. That is, whether it is in essence a trading or business place, or, merely a distribution point or place for purely theoretical research etc. But the problem as usual is to draw a line between activities which are purely "preparatory or auxillary" and activities which are central to the business of the enterprise. This very often can be a matter of degree.

Apart from installations for "preparatory or auxillary" purposes, the maintenance of a "stock of goods" for storage, display, delivery or processing by another is not deemed to constitute a permanent establishment under the OECD Draft.[2] This practice is not altogether new, reflecting as it does, the hitherto discernible international practice prior to 1963.

At this juncture, it may be pointed out that the developing countries in general have not favoured the exemption of so called facilities for "preparatory or auxillary" purposes. At the meetings of the United Nations Ad Hoc group of Tax Experts they have argued strongly that the OECD Draft Convention should include in the term "permanent establishment", "a warehouse or other facilities for the maintenance of a stock of goods from which orders are filled". In their opinion, the presence of a stock of goods for prompt delivery facilitated the sales of the product and thereby the earning of profit in the host country by the enterprise having this facility. The supply of goods, it was urged, was a continuous connection which should constitute a permanent establishment leaving as a separate matter the determination of the proper amount of income attributable to that establishment.[3]

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2. Article 5 (3) (b) and (c).

3. Tax Treaties between Developed and Developing Countries - Second Report, 1970, (U.N. Sales No. E.71 XVI 2) Page 8, para. 33.

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In the light of the views aired by the Experts, the best solution, it seems, is to leave the matter open to bilateral negotiations so that nothing in the OECD Draft would be automatically construed as excluding from the definition of a permanent establishment the cases where deliveries are made from stocks of goods. In the same way, the OECD Draft Article 5 (3) should not be interpreted as implying that warehouses or other storage facilities are or are not permanent establishments just because they are "fixed places of business".[4]

With regard to service centres etc. a number of important observations must be borne in mind. Namely, that the decentralisation of an enterprise may be driven so far that these centres exercise in fact a function of management thus allowing a recognition of the existence of a "place of management", (i.e. a p.e.) at the locality where the centre has been established.[5] Similarly, technical aid particularly if it is given to licencees can change from having an auxillary or preparatory character to the practice of a true industry so much so that a branch ought to be deemed to exist.[6]

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4. Ibid., page 9, para. 34

5. Raoul Lenz, "The Development of the Concept of Permanent Establishments etc." op. cit., p. 285 at 297.

6. For example, the provision of "know-how" under the terms of a contract is one of the auxillary activities explicitly referred to in the Commentaries on the OECD Draft - pp. 73, 74. In this connection too, mention may be made of an "after sale organisation" which enterprises are often obliged to set up in a foreign country for the maintenance of goods that have been sold. Difficulties may occur where personnel stationed in these centres have a stock of spare parts at their disposal or make use of an "office" or "workshop". The functions of these "fixed places" would have to be determined precisely in order to settle the question of liability.

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Against future Nigerian tax agreements, special care must be taken to ascertain the actual or potential economic relationship with a prospective treaty partner with a view to determining what may or may not be deemed to constitute permanent establishments.

(ii) Building Construction or Assembly Projects

Until comparatively recently, it was not the practice in tax treaties for a building site etc. to be considered a permanent establishment of a foreign enterprise operating overseas. Out of nine treaties, only the Nigeria - Sweden agreement includes "a place where building construction is carried on by contract for a year or more" among the criteria of "fixed places" deemed to constitute a permanent establishments.[7]

Recalling the amount of construction work executed in the past and being executed at present by enterprises from treaty countries, it is clear that Nigeria has unwittingly lost and is losing substantial amounts of revenue. This is as a result of an absurd technicality of tax treaties generally, whereby profits from building projects are not taxable not being regarded as derived from permanent establishments.[8]

The majority of developing countries have also had similar experiences. In the past, they have often not been allowed to levy taxes on the profits from construction or assembly projects worth several millions of pounds either because of the limited duration of these projects or for some other illogical reason.

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7. Article 2 (1) (J)

8. The Nigerian Agreements are in general silent on the question of whether or not building sites are to be deemed to constitute permanent establishments.

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Where a foreign construction company is incorporated in Nigeria and carries on business therein, its liability on "Nigerian source income" is the same as any other indigenous company in a like situation.[9] It is as regards companies coming to the country for specific projects of limited duration that difficulties frequently arise. Until lately, it was not certain whether such companies had to comply with the provision of Part X of the Companies Decree 1968 before commencing operations. The position was even more obscure where money for a major development project is provided under a technical assistance programme with the donor nominating a contractor from abroad.[10]

However, following the Companies (Special Provisions) Decree 1973, the position has become clearer. A foreign company may now apply to the Federal Executive Council for exemption from Part X of the Companies Decree 1968,[1] if, (1) it is a company invited to Nigeria by or with the approval of the Federal Military Government to execute specific projects;[2] (2) if it is a company in Nigeria on behalf of donor countries or international organisations[3]; (3) where, it is a company owned by a foreign government and is

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9. s.4 ITMA; s.17 CITA

10. Where the loan provided under a technical assistance programme is to be repaid there is no reason why any contractor executing a project in Nigeria should escape tax. Where, on the other hand, the loan is provided gratis, there is no objection to the donor nominating a contractor with Nigeria forgoing any tax exigible from such person.

1. Part X, makes it compulsory for all foreign companies to be incorporated as subsidiaries. Prior to 1973, the Federal Government permitted foreign contractors working in Nigeria on governmental or quasi-governmental contracts of short duration to operate without incorporating local subsidiaries.

2. Companies (Special Provisions) Decree 1973 s. 1(1)(a).

3. Ibid., s.1(1)(b).

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engaged solely in export promotion activities.[4] In this regard too, exemptions can be granted to foreign engineering consultants and technical experts engaged on specialist projects under contracts with any of the governments in the Federation or any of their agencies; or, with any body or person where such contracts have been approved by the Federal Military Government.[5]

Two important suggestions have been advanced by some of the U.N. Tax Experts. Firstly, that a building site or assembly place be deemed to constitute a permanent establishment once it has existed for a period of more than six months. (i.e. instead of the twelve months prescribed by the OECD). Secondly, that the country of source be given the right to tax the profits from installation charges incidental to the sale of machinery or equipment - as if such "services" constituted a permanent establishment.[6]

While the developed countries have no objection to the first suggestion, since according to them it involves no question of principle, they are much less enthusiastic about the second because it is totally inconsistent with the idea of a permanent establishment as evolved by them.

That notwithstanding, it is the view of this writer that as far as Nigeria is concerned, installation charges (if above a certain amount) may

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4. Ibid., s. 1(1)(c)

5. Ibid., s.1(1)(d).

6. Tax Treaties between Developed and Developing Countries - First Report (1969). (U.N. Sales No. E.69. XVI. 2) page 12 paras. 36 - 42. These suggestions were put forward on behalf of developing countries by India. See J.H. Christiaanse op. cit., at p. 42.

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be deemed to constitute a permanent establishment and so also should the "use of substantial equipment or machinery" by a foreign enterprise within Nigeria.[7] In fact, it could be argued that these proposals are not inconsistent with the concept of a permanent establishment if it is recalled that this concept itself is purely an artificial formula for establishing the "presence" or otherwise of a foreign enterprise in another country; - and that as major recipients of "know-how", the specified criteria of permanent establishments must be such as to reflect the de facto economic relationship between developed and developing treaty partners.

One other matter of considerable significance is relevant here. That is, the fiscal treatment of offices set up by foreign enterprises for the purposes of administrative and technical control of work at the site, for supervising the importation and transport of materials, and for ensuring liason with sub-contractors. On this issue there are two schools of thought.

Some countries hold the view that these are activities included in the concept of a "construction site" and thus a part of the permanent establishment for tax purposes, while others believe that it is advisable to consider these offices in themselves, independently of the construction site, in order to decide on the fiscal rule that will be applicable to them.

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7. There is precedent for this. This test has been employed even in some of the older Conventions. e.g. the Canada - U.S.A. Convention of 1942 - Protocol Article 3(f) defining a permanent establishment. Also relevant here is the case of No. 630 v. M.N.R. 22 Tax A.B.C. p. 91 at 95 et seq., - decided on the basis that the American company used "substantial equipment or machinery" in Canada. This was deemed to constitute a permanent establishment thus making the company's profit liable to Canadian taxation.

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The former approach seems preferable because of the direct relationship which exists between a supervisory office and the actual construction site. The overall tax liability of a foreign enterprise is not likely to be affected provided the co-ordinating office does not earn profits per se. In this regard, one would have to look at the office more or less as a tool for performing a job and as an integral part of a whole. Contrariwise, were such an office to exist without any relationship with a particular building site, it would either have to be regarded as a place for "preparatory or auxillary" activities or as a permanent establishment of the foreign enterprise.

In conclusion, the principle of exemption of construction sites with limited duration is unacceptable. In future Nigerian treaties, a building site should be deemed to constitute a permanent establishment of a foreign enterprise irrespective of the duration of its existence.[8] In addition, new tax treaties should provide for taxation solely on the grounds that machines are used in the country by a foreign enterprise, or that the foreign enterprise agrees to carry out supervisory functions at a site in the country.[9] Similarly, installation charges ought to be taxable once above a certain amount, (e.g. above 10% of the equipment purchased).

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8. This suggestion is in line with the approach adopted by France in her treaties with Developing Countries. e.g. Dahomey - France Treaty 1965, Article 3(a)(gg). Raoul Lenz op. cit., at page 305.

9. Some Treaties concluded by the U.S.A. with developing countries follow this approach. Even some of the older U.S.A. Tax Conventions do e.g. the Canada - U.S.A. Treaty of 1942. See Case 630 v. M.N.R. discussed above.

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C. Commercial Representatives and the Concept of Permanent Establishment - Agents, Brokers, General Commission Agents.

National tax laws,[10] and several tax conventions even the relatively old ones, nearly always stipulate that a "commission agent", a "bona fide broker" or any other independent intermediary acting in the ordinary course of his business as such does not constitute a permanent establishment of the represented overseas enterprise so as to render it liable to local taxation. The exception generally made to this rule is where the representative has authority to conclude contracts in the name of the principal enterprise or where he maintains a stock of goods or merchandise from which he regularly fills orders.[1]

To illustrate the position, we refer to the case of Barclays Bank v. C.O.R.[2] decided by the Supreme Court of Guiana (now Guyana). In that case, the appellants, bankers in British Guiana, collected the sum of $.140 from the Government of that country during the year 1956, by encashing bearer

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10. E.g. s.79 TMA 1970 U.K. In that country, a non-resident person is assessable and chargeable to income tax in respect of any profits arising whether directly or indirectly, through or from any branch or agent. The exception to this rule are contained in s.82 of the same enactment - to the effect that a non-resident is not liable to tax in the U.K. if he carries on business through a "broker" or any other independent agent in the ordinary course of his business as suhh. A broker in this circumstance, is someone carrying on the business of a broker in the U.K., and to qualify, he must receive a remuneration no less than that customary in the class of business transacted through him.

1. As will become evident presently, the OECD text which is now generally accepted shows itself more liberal than the older conventions in granting an exemption to a dependent intermediary, acting in the ordinary course of his business with no account being taken of the existence of a stock of goods for delivery or samples. Canada has reserved its position on this point. See Commentaries at page 77.

2. (1958) L.R.B.G. p. 122. (Supreme Court).

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bonds sent to them for collection through a Bank in Barbados by one Mrs. Bailey a customer of the Barbados Bank.

The Revenue contended that the appellants were agents for Mrs. Bailey and therefore exigible to tax in respect of the year of assessment 1957, by virtue of the provisions of s.33(5) of the Income Tax Ordinance Cap. 299.[2a]

The court, unimpressed, confirmed that under the said provisions of the Income Tax Act, a non-resident instructing a broker or other casual agent in British Guiana is not chargeable in the name of the casual agent; being chargeable only in the name of a regular agent.

The general principle as stated above is not always conclusive for all States. The Nigerian internal law, like that of most countries that have adopted the "source" approach, does not make a distinction when a non-resident is trading in the country through an agent of an independent or dependent status. This is quite logical since liability to tax is on all Nigerian "source" income. To this extent, therefore, the country's tax treaty provisions which follow standard international practice amount to a great restriction of the country's tax jurisdiction.[4]

2a. This provided inter alia that "Nothing in this section shall render a non-resident person chargeable in the name of a broker or general commission agent or other agent where that broker, general commission agent, or agent, is not an authorised person carrying on the regular agency of the non-resident person ......"

3. Our discussion in Chapter Three above on the concept of "carrying on business" in Nigeria may be recalled here. The point to note is that where a foreign enterprise carries on business in Nigeria through a representative whether an attorney, factor or agent, such person is assessable to tax on any "Nigerian source" profits made by the non-resident. See CITA s.39(b); s.29(1) ITMA;s.23(1)(b) PITA.

4. Nigeria - U.K. Agreement Article 2(1)(k).

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In the attempt to determine what category of commercial representatives come under the tax jurisdiction of the host country, what is important is the distinction that has to be made between a "dependent agent" and a so-called "independent agent acting in the ordinary course of his business as such" - and in which category is a "broker" and a "general commission agent".[5]

The United Kingdom courts have been much puzzled by the undefined expression "general commission agent". Rowlatt. J., in Gavazzi v. Mace[6] differentiated agents accepting a bill of exchange (which enabled the seller to get their money in advance) from general commission agents. He rejected the submission that a man remunerated by commission for services rendered was ipso facto a general commission agent. Again, in Balfour v. Mace,[7] the same learned judge had to consider the question. The agent in that case did his entire business in most of the principal's goods, having precluded himself from acting for others in competition with his principal. In all, he had only six other employers, and the problem was whether or not he was a "general commission agent". The court held that he was not.

In Fleming v. London Produce Co. Ltd.,[8] Megarry, J., explaining the rationale behind the Balfour Case, emphasized that a "general commission agent" was one that held himself out to the public generally and was one either having or willing to have many principals. The agent company in the

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5. Under the U.K. Income Tax Act 1952 s.373(1), a "Broker" is deemed to include a general Commission Agent. (cf. s.82 ITMA 1970 U.K.)

6. (1926) 10 T.C., 698.

7. (1926) 13 T.C., 539

8. [1968] T.R. 97; [1968] 1 W.L.R. 1013. For a review of this case see L. Lazar 1968 A.S.C.L. p. 582.

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instant case more or less acted for only one principal,[9] a South African company; and the question for the court to decide was whether or not the South African company was trading, in the United Kingdom and hence liable to that country's taxation by virtue of its agent's activities in the United Kingdom.

The Commissioners decided that the South African Company was "not trading" in the U.K., but Megarry. J., rejected their conclusion holding that it was wrong on the facts of the case. According to his Lordship, the only conclusion possible was that the taxpayer company was neither a "broker" nor a "general commission agent" as it had contended. In this case, not only did the company perform many acts not characteristic of brokers, it was sadly lacking in generality of custom. In substance, what happened was that the South African company was carrying on bssiness in the United Kingdom through what was virtually a sole agency.

Since liability to tax under a double taxation agreement depends on the distinction between "dependent" and "independent" agents, the developing countries have expressed grave doubts about the fairness of this approach. The developed countries agree that this is a matter of the greatest difficulty[10] and that the distinction between various categories of agents can indeed be tenuous. But as this writer understands it, the real issue is that persons

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9. Strictly speaking, the agent company had other principals but 95% of its business was for the South African principal.

10. "Tax Treaties between Developed and Developing Countries" - (1971) Cashiers, page 43. In this article J.H. Christiaanse expresses support for the reservations of the developing countries on the question of dependent and independent agents.

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who may be deemed to constitute a permanent establishment of a foreign enterprises should not be limited to those who are dependent simply from a legal point of view but must be extended to cover those who are dependent from an economic point of view.[1] To do otherwise, would be to allow people to escape tax by the use of legal technicalities. For instance, in the Fleming case, it was possible for the court to hold that the South African company was not trading in the U.K. and hence not liable to local taxation. This is on the ground that it carried on business through an agent who in strict law was of independent status ignoring the fact that from the point of view of economic reality it was a dependent agent.[2]

To return to our main theme, it may be observed that all the Nigerian Agreements[3] reflect the hitherto followed international practice whereby certain groups of persons are treated as permanent establishments on account of the nature of their business activities. These categories of employees or dependent agents are such that in view of the scope of their authority and of the nature of their business dealings they participate to a particular extent in the business life of Nigeria. The test to be applied as provided

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1. This point was first recognised in 1928 by the Fiscal Committee of the League of Nations.

2. This decision is in line with the submission of Pakistan at the meeting of the U.N. tax experts where it was advocated that an agent whether technically dependent or independent who habitually secures orders for only one enterprise of affiliated group or firm should be deemed to constitute a permanent establishment in the host country.

   Tax Treaties Between Developed and Developing Countries - 1969, U.N. Sales No. E 69. XVI. 2 page 13 paras. 51 - 54. The U.S.A. - Phillipine (1964) Treaty for example, includes a proviso that an agent who acts exclusively or almost exclusively for only one enterprise is not an independent agent.

3. e.g. Nigeria - U.K. Article 2(1)(K); Nigeria - U.S.A., Article 11 (1)(f).

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in the Agreements is whether or not the dependent agent or employee has a "general authority" to negotiate and conclude contracts on behalf of the foreign enterprise. Or, alternatively, whether he maintains a "stock of goods or merchandise from which he regularly fills orders on behalf" of the represented enterprise.[4] Where either condition is fulfilled, an enterprise or agent is deemed to constitute a permanent establishment of the foreign enterprise.

The OECD Model shows some improvement on the existing bilateral Conventions by prescribing only one test. Namely, that a dependent agent or employee constitutes a permanent establishment only if he has authority, exercised habitually, to conclude contracts on behalf of the represented enterprise; the fact that he has a stock of goods for delivery or as samples being considered irrelevant.[5]

It should be noted that article 5(3) of the OECD Draft uses the term "authority" instead of "general authority" used in the Nigerian Agreements. This is based on the premise that in practice an agent is unlikely to have unfettered authority to conclude contracts. Also, for administrative reasons,

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4. Ibid.

5. OECD Model Article 5(4). The Draft Convention also does not deem a broker, a general commission agent or any other agent of an independent status to constitute a permanent establishment - Article 5(5). Canada has reserved its position on Article 5(4) of the OECD Draft. When negotiating Conventions with other member countries, the Canadian authorities would wish to alter paragraph 4 so as to reflect that country's position that if a person acting in Canada on behalf of an enterprise of the other contracting state has a stock of merchandise from which he regularly fills orders on behalf of the enterprise of the other contracting state he would be deemed a permanent establishment. R. Alan Short in his article, "Allocation of Income-Agencies" - (1964) Canadian Tax Journal, p. 135 at p. 137 et seq. explains the reason for Canadian reservation which he attributes to a fear of economic domination by the United States.

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it was thought advisable to avoid the difficulties which would arise if the question whether the dependent agent is a permanent establishment has to be decided by reference to the precise extent of his authority.

In the opinion of this writer, the OECD approach is commendable.

Like several others, the Nigerian Agreements provide that an agent of genuinely independent status does not create a permanent establishment of an enterprise of the other treaty country. And as we have discussed already, <u>bona fide</u> "brokers" and "general commission agents" acting in the ordinary course of their business are supposed to be examples of this type of person.

At this juncture one other matter of considerable importance must be mentioned. That is, the case of insurance companies doing business abroad through agents and various other intermediaries. It is interesting to note that where insurance activities are conducted through a so-called independent agent, the profit made by the foreign insurance company would not be taxable according to the principles already outlined.[6] And if on the other hand, the agent in question was "dependent", taxation could equally not take place in the host country because in the insurance business a dependent agent normally has no "authority" to conclude contracts on behalf of his principal.[7]

Developing countries have drawn attention to the desirability, as they see it, of making a special provision for insurance business. They feel that taxation of insurance profits in the country where premiums are collected

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6. i.e. on the principle that a genuinely independent agent does not constitute a permanent establishment of a foreign enterprise - see U.K. - Nigeria Agreement Article 2(k); OECD, Article 5(5).

7. Cf. Nigeria - U.K. Article 2(k); OECD Article 5(4)

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is desirable, and should take place independently of the status of the agent.[8] Furthermore, it is argued that since insurance companies operating in developing countries are nearly all foreign owned, the non-taxation of profits made by them is a great drain on the wealth of these already impoverished countries.[9]

The Nigerian Agreements and the OECD Model contain no provision as regards the special problems created by insurance agents. In view of this, it is submitted that future tax agreements must take account of the proposals put forward by the developing countries at the meetings of the U.N. Ad hoc Group of Tax Experts.[10]

On the question of reinsurance - which is negotiated from principal to principal - the general practice over the years is to exclude the profits derived therefrom from the ambit of tax treaties. However, since these principals are nearly always persons from developed countries it is clear that the non-inclusion of this kind of business within the scope of tax agree-

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8. The actual amendment to the OECD Draft put forward is that "an insurance enterprise of a contracting state shall be deemed to have a permanent establishment in the other state if it collects premiums in the territory of that state or insures risks situated therein, through an employee, or through a representative who is either a broker, general commission agent, or any similar intermediary of independent status". See, Tax Treaties between Developed and Developing Countries - Second Report 1970. U.N. Sales No. E.71 XVI 2 page 10, para. 48.

9 The developed countries have acquiesced to this suggestion provided a reasonable method could be devised for the allocation of profits attributable to a permanent establishment deemed to be constituted by an insurance agent.

10. As far as Nigeria is concerned, this may not be of great significance because the greater part of insurance activities are conducted through insurance companies which have to be incorporated in the country.

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ments is disadvantageous to developing countries.[1] But as must be admitted, the whole question is rather complex and concrete data is difficult to obtain. Consequently, it is now generally agreed that the problem warrants further study.[2]

One other observation may be made before concluding this section, viz., that the harmonisation of the concept and definition or a permanent establishment in recent years has not guaranteed a uniform practice in the various states that have adopted the conventional definition. This is not at all surprising being a direct result of the fact that a definition even if furnished with an official commentary cannot comprise all forms that a permanent establishment may assume in practice. The tax administrators, therefore, have fairly extensive powers of decision which understandably leads to divergencies of opinion particularly as regards the scope given to the exceptions expressly provided for in tax treaties. (i.e. to cases in which a permanent establishment is not deemed to exist within the terms laid down in the Convention)

The related problems of treaty interpretation and implementation are examined in the next chapter.

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1. To minimise the loss of revenue, foreign insurers are required to invest the entire proceeds from life insurance within Nigeria, and 40% of the profits from other businesses.

2. Neither the Fiscal Committee of the OECD nor the U.N. Tax Experts have proposed anything concrete on this problem. The IFA too is yet to examine the matter.

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D. International Carrier Enterprises and the Concept of Permanent Establishment - Shipping, Air and Road Transport

Carrier enterprises by their unique nature come under several tax jurisdictions.[3] For this reason, states have recognised that these enterprises must not be exposed to the tax laws of the numerous countries to which their operations extend. In other words, if international trade and communication between peoples are to continue, the traditional tests for a "permanent establishment" cannot be applicable. The criterion of "presence" of a carrier enterprise such as shipping or air transport must of necessity be based on compromise.

All the Nigerian Agreements follow the pre-1963 international practice.[4] Shipping and Air Transport activities are expressly excluded from the concept of a permanent establishment,[5] and any profits derived therefrom are taxable in the country of residence of the operator.[6] The reasoning behind this approach is well articulated in the memorandum presented for discussion to the International Chamber of Shipping at their meeting in London in 1953.[7]

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3. What may be noted here is that the mere fact that a person or his property is subject to double taxation, does not cast any doubt upon the legality of the taxation of his income or property by a foreign state. See Arnold D. McNair, "Double Taxation on Shipping" - 1925 Vol. 19 A.J.L.L. p. 569-573. In addition, the author traces the kind of conflict which may arise when shipping profits are subject to multiple taxation. The example chosen by him to illustrate the point is the conflict between the U.S.A. and the U.K. in the 1920s.

4. For example, in Article V of the London Model Convention closely followed by the earlier tax conventions, the taxation of shipping profits is reserved to the country where the fiscal domicile is situated.

5. E.g. Nigeria - U.K. Agreement Article 5.

6. The precise scope of shipping and airline profits and the manner of their computation have been considered in Chapter Three.

7. For a text of the Memorandum see (1953) BIFD pp. 62 - 64 entitled "Double Taxation of Shipping Profits" Also relevant here is the background information contained in "Taxation of International Air Transport" - (1951) Vol. 5 BIFD p. 297.

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In that document, it was argued that the actual income from sea carriage is produced only to a very limited extent in foreign countries, i.e. through the zone of territorial waters which on a mileage basis is negligible. This means that the specific shipping activity, namely, the carriage of merchandise and passengers from one port to another is fulfilled almost entirely outside territorial waters.[8]

In general, the argument continued, all major decisions affecting the operation of a shipping enterprise take place at the seat of management in the country of residence and not at ports of call. Whether or not a particular cargo should be carried, the determination of freight rates, where a ship shall load and discharge, how long she would stay in a port - these and a host of other matters all combining to produce a profit or loss on a voyage - are subject to the overriding jurisdiction of the head office in the country of residence.

The I.C.S. memorandum then went on to acknowledge that since some of a shipping concern's activities take place within the territory of the country of the port of call, a corresponding part of its profits may be said to be produced in that country. But instead of prescribing a formula for determining what percentage of net profits is allocable to the country of call, the I.C.S.

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8. Arnold D. McNair op.cit. at page 569 illustrates this point well. According to this author, where a "shipowner earns profit in respect of the service rendered by him of transporting passengers and cargo from the territory of State A to the territory of State B", the space in which the service is rendered is divisible as follows: (1) in the port of A and its adjacent maritime belt; (ii) on the high seas, and (iii) in the port of B and its adjacent maritime belt.

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document maintained that these profits can "hardly be other than infinitesimal" - thus implying that they should not be taxable.[8a]

In order to justify its stand that the taxation of shipping enterprises should only take place at the place of residence of the operator, the I.C.S. document pointed out that developing countries are not badly off from shipping considering that activities connected with a ship's call at their ports such as the receiving and storage of cargo and the provision of port facilities - pilotage, towage, bunkering etc. are carried out by persons whose profits are subject to local taxation. Also subject to local taxation are commissions paid to local agents for booking passengers and cargo, and for servicing the ship. Moreover, the document continued, dues and charges are levied locally for the use of the port itself.

Concluding, the I.C.S. was of the opinion that the non-taxation of shipping profits in countries other than those of residence should not be looked upon as a favour specially to international shipping but as the application of sound and acknowledged principles of taxation.

Luckily, views have changed since the International Chamber of Shipping prepared its memorandum.

In 1963, the OECD Draft Convention introduced an innovation. This was

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8a. The I.C.S. doubted the financial advantages to developing countries from the taxation of non-resident shipping. In its view, any such gains, if any, was "short term" and was "probably not as great as may be supposed". - 1953 BIFD p. 62 at p. 64.
The attitude of the International Chamber of Shipping in 1953 is hardly surprising. The members then were the rich developed maritime nations of the world.

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the principle that:

"profits from the operation of ship or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated".[9]

The place of effective management, of course, need not be the same as the place of registration of the ship or the place of residence of the operator.

Although the approach advocated in the OECD Draft is quite reasonable, the developing countries have not been able to accept it in its entirety. With respect to air transport profits, the consensus at the meeting of the Tax Experts in 1968 was that these should be taxable only in the country in

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9. Article 8(1). Emphasis supplied. Note that there are no criteria laid down in the Draft for determining the "place of effective management". But on the analogy of cases like De Beers Consolidated v. Howe [1906] A.C. the place of effective management of a shipping company would be the place where directors meet regularly.

Paragraph 2 of Article 8 of the OECD Draft provides that the profits of an enterprise engaged in inland waterways transport are to be taxable only in the state in which the effective management is situated. What may be emphasized here is that foreigners are usually barred from engaging in inland waterways transport except where there are treaty provisions to be contrary. (cf. U.K. - Japan Commercial Treaty Article.)

In general, the OECD formula is followed in limited double taxation agreements on Shipping and Air Transport. (cf. U.K.- Double Taxation Relief (Shipping and Air Transport Profits) (Brazil) Order 198; The U.K. Double Taxation (Shipping and Air Transport) (Argentina) Order 1949. Also Ghana - Switzerland Agreement of 6th December 1963 on income from Maritime and Air Transport.

This writer is of the opinion that the OECD formula adopted in limited treaties is only useful where there is a two-way trade between Contracting Parties whose shipping and air transport industries are equally developed.

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which the place of effective management is situated.[10] But with regard to shipping profits, the developing countries while recognising that there were considerable difficulties in determining a taxable profit in this situation, asserted that they were not in a position to forgo even the limited revenue from taxing foreign shipping enterprises as long as their own shipping industries were not fully developed.[1]

The position of these poor countries is, perhaps, more understandable when it is recalled that they are subjected to discriminatory freight rates on goods and merchandise originating from, or destined for, their territories.[2]

Following the deliberations of the U.N. Tax Experts,[3] there is now little serious opposition left to the basic hypothesis that the "source" country has a right to tax shipping profits. The developed countries have become more sympathetic to the views of the poorer ones than had hitherto been the case. They are ready to accede to their demands provided a suitable formula can be found for computing and allocating the profits earned abroad by an international shipping enterprise. The various proposals submitted for solving this problem are considered in detail presently.

Relating our discussion thus far specifically to Nigeria, we are of the

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10. Tax Treaties Between Developed and Developing Countries - U.N. First Report, 1969. Sales No. E.69. XVI. 2 page 15, para. 65.

1. Ibid., page 15, para. 67.

2. Some of the problems are currently being studied by UNCTAD. See Igbal Haji, " UNCTAD and Shipping" - (1973) Vol. 7., J.W.T.L. page 91.

3. Especially at their third meeting. See Tax Treaties Between Developed and Developing Countries - Third Report, 1972. U.N. Sales No. E.72. XVI. 4 - Chapter on Shipping Profits - page 7 et seq. paras. 13 - 70.

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opinion that adherence to the principle of taxation only in the country of residence has been very costly.[4] Since the majority of ships coming to and from Nigeria are owned by foreign enterprises, the provision in the country's tax treaties as regards shipping amounts to a unilateral exemption of shipping profits from taxation. There is clearly no basis for the application of the principle of reciprocity in these Agreements. The surprising thing, however, is that this incredible position has been allowed to persist for so long.

Bluntly put, how many Nigerians are deriving profits from shipping and aircraft business (operating) to and from a treaty country? Or, indeed, to and from any other country? Very few.

A provision in Nigeria's treaties with Ghana, Sierra Leone and Gambia deserves mention. Like profits from shipping and air transport, the profits derived by a resident of one treaty country from the operation of road vehicles[5] internationally,[6] is exempt from tax in the territory of the other. In other words, such profit is taxable only in the country of residence of the operator.

Whereas the residence test is unacceptable in the case of shipping or air transport enterprises, it is supported in the case of road transport

4. This view is probably correct although unsupported by statistics. Relevant statistics are non existent.

5. E.g. Nigeria - Ghana, Article 5.

6. Any exemption granted on road transport profits would not include the profits derived from the operation of road transport solely within the territory of one of the contracting parties.

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business among African treaty partners. Since there is no monopoly of this kind of activity by the nationals of any particular West African country, there is a mutual advantage in adopting the kind of approach in question. If there is to be a free movement of goods and persons by land - a necessity if the proposed West African Economic Community is to thrive - then the kind of provision in Nigeria's treaties with other West African countries is the right one.

E. Associated Enterprises and the Concept of Permanent Establishment

Considering that the concept of a permanent establishment is used to determine whether or not a sufficient "presence" has been established in a foreign territory for tax purposes, it might be concluded that all foreign subsidiaries are permanent establishments of their parent companies. Theoretically, one would have thought that a subsidiary company is the most obvious form of a permanent establishment. But this is not so. Tax treaties, following company law, regard subsidiary companies as distinct and separate legal entities from their parent companies.[7] Even the fact that the trade or business carried on by the subsidiary company is managed by the parent company does not constitute the former into a permanent establishment of the latter.

Where, however, a subsidiary company on behalf of its parent carries on an activity or an agency basis, such subsidiary company must be deemed to be a permanent establishment of the parent company. If for instance, the

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7. After 1968, foreign companies have to incorporate local subsidiaries in Nigeria. These subsidiaries are specifically required to submit separate accounts for tax purposes as distinct from Group accounts. - Co. Decree 1968 ss. 140 et seq.

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subsidiary company on the strength of an authority, concludes contracts of sale in the name of the parent company, the subsidiary company will be treated as a permanent establishment of the parent company. (but only in respect of its agency activities).

The parent company will thus be subject to tax on so much of the profits accruing from such sales as is attributable to that permanent establishment. This, of course, does not affect the separate taxation of the subsidiary's own profits from its other businesses.[8]

The Nigerian Agreements,[9] like the Mexico and London Drafts[10] before it, or the subsequent OECD Draft,[1] all follow the approach outlined above.

At this juncture, in order to put our discussion in its proper perspective, it must be pointed out that as far as the taxation of subsidiary companies are concerned, what is important is not their treatment as separate legal entities as such but the computation of their true profits where their activities are so inter-related with those of their parent companies as to be virtually indistinguishable - or, where distinguishable, if the dealings between them have not been conducted at "arm's length."

The applicable rules for the allocation of profits between branches or subsidiaries of the same enterprise located in different states are examined presently.

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8. Commentaries on the OECD Draft - at page 77.

9. E.g. Nigeria - U.K. Article 2(k)

10. Article V, paragraph 8 of the protocol.

1. Article 5(6).

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III. SCOPE OF BUSINESS PROFITS

A. "Effectively Connected with" or the "Force of Attraction Doctrine"?

As already indicated, the concept of a permanent establishment serves not only as the criterion for establishing the "presence" or otherwise of a foreign enterprise in another territory, but as a convenient reference point for the determination of the scope of taxable profits where presence has been established. It is the use of the permanent establishment concept in fixing the precise ambit of taxable profits that attention is now focussed.

Until recently, it was the view in some countries[2] that once a foreign enterprise has set up a permanent establishment in their territory it has brought itself within their fiscal jurisdiction to such a degree that they can properly tax all the profits accruing to the foreign enterprise whether or not linked with the activities of the permanent establishment.[3] This

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2. Among these were Belgium, Italy, Mexico, Uruguay, Portugual and the U.S.A. Max Beat Ludwig op.cit, p.1/55 at 1/63.

3. This would mean for instance that dividends, interest, royalties and capital gains are regarded as business income if they derive from property which effectively belongs to the permanent establishment. What must, however, be emphasized in this context is that the possibility of separate taxation of other species of income which may not be directly attributable to the permanent establishment is not ruled out in any of Nigeria's Treaties. In fact, this is expressly preserved.

   The OECD provisions are relevant here. The general rule as contained in Article 7(7) is that preference is given to those provisions which specify the treatment of particular types of income. However, where a taxpayer has a permanent establishment in the other treaty country, interest, royalties or dividends due to such taxpayer are to be deemed to be business income by virtue of such permanent establishment. (cf. Article 11(4), 12(3) and 10(4) respectively.)

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approach once championed by the United States is known as the "force of attraction doctrine".[4]

Accordingly, in the Nigeria - U.S.A. tax agreement, it is provided inter alia that:

> " A United States enterprise shall not be subject to Nigerian tax in respect of its industrial or commercial profits unless it is engaged in trade or business in Nigeria through a permanent establishment situated therein. If it is so engaged Nigerian tax may be imposed upon the entire income of such entérprise from sources within Nigeria".[5]

Theoretically, this formula should yield more revenue to the Nigerian government than the less comprehensive alternative approach whereby only profits "attributable" to a permanent establishment are taxable. In their application too, the former would appear to be simpler to administer than the latter.[6] This is because once "presence" is established it is much easier to levy taxes on all profits rather than on those profits which are "attributable" to the permanent establishment.

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4. Sidney I. Roberts, "The Force of Attraction Doctrine in U.S. Tax Law Today" 1967 IBFD page 487. Since the publication of the OECD Model and after the Foreign Investment Act 1966, the U.S.A. has started to follow standard international practice i.e. the "effectively connected with" principle.

5. Article 3(1). Emphasis supplied.

6. This point was also made by the U.N. Group of Tax Experts in their 1970 Report, Tax Treaties between Developed and Developing Countries - Second Report. U.N. Sales No. E.71 XVI.2 page 13, paras. 74, 75.

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For determining the scope to taxable profits, the "effectively connected with" formula is the one adopted in all the other Nigerian tax Agreements.[7] Indeed, it is now the almost universally accepted formula in bilateral conventions especially since its endorsement by the OECD in 1963.[8]

Unfortunately, the expression "effectively connected with" has not received much judicial attention anywhere. But if the opinion of writers is anything to go by, the expression envisages a "cause and effect relationship." In other words, taxable profits are those "caused or directly resulting" from the very presence of the permanent establishment in the host country. Clearly, what is required, is an economic connection rather than a mere "geographical" or "accounting" connection.[9]

In the past, there has been criticism that the taxation of only those profits attributable to a permanent establishment may lead to tax avoidance. It is argued, for instance, that a foreign enterprise might set up in a particular country a permanent establishment which made no profits, and was never intended to make profits, but existed solely to supervise a trade albeit of an intensive nature which the foreign enterprise carried on in the host country through independent agents and the like.[10] In that circumstance, the permanent establishment though carrying out very vital functions would at the same time show no taxable profits.

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7. E.g. U.K. - Nigeria Agreement. Article 3(1), (2), (3).

8. OECD Draft Article 7(1)

9. Max Beat Ludwig op. cit., p. 1/55 at p. 1/62.

10. Commentaries on the OECD Draft pp. 80, 81.

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Despite the validity of that argument, the fiscal Committee of the OECD rejected the "force of attraction doctrine" on the grounds that it might seriously interfere with ordinary commercial processes and thus be out of keeping with the avowed aims of tax treaties which is to promote international trade and the flow of foreign investments generally.[1] Whatever the truth of these suppositions, what must be borne in mind is that in circumstances where there is a non-reciprocal flow of investments, tax treaties may lead to a substantial revenue loss by one party unless account is taken in the treaty provisions of the actual, rather than the theoretical, economic situation prevailing in the territories of the treaty partners.

In spite of the current international trend, it is submitted that future Nigerian treaties ought to adopt the "force of attraction doctrine" in preference to the "effectively connected with" rule. In effect, once there is permanent establishment, all profits derived from "sources" within Nigeria should be liable to the country's taxation.

Although our suggestion may be termed a retrograde step, nevertheless, it is an approach that is considered to be in the best interests of Nigeria. Not only would it be in line with the basic philosophy of the Nigerian tax law (i.e. liability on all source income), but is a measure likely to reduce the opportunity for tax avoidance. In addition, the meagre resources of the country's Revenue need not be dissipated in trying to dissect "industrial or commercial profits" into component parts, and to distinguish between those which may be attributable to the permanent establishment and hence taxable, and those which may not be so attributable and so not taxable.

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1. Ibid., page 81

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As a result of the deliberations of the Tax Experts, it is even likely that the "force of attraction doctrine" would regain ascendancy.[2] This may however be in a modified form so that the principle is applied to the sale of goods, or merchandise and other business activities in the following manner: If an enterprise has a permanent establishment in the other contracting state for the purpose of selling goods or merchandise, sales of the same or similar kind of goods may be taxed in that state even if they are not conducted through the permanent establishment. The same rule would apply if the permanent establishment is used for other business activities and the same or similar activities are performed without any connection to the permanent establishment.

B. "Industrial or Commercial Profits" - what are they?

Although, the Nigerian Agreements like most others employ the term "industrial or commercial profits", the expression is nowhere defined.[3] It is apparently used in its general meaning of "business income" to the exclusion of "investment income" or income arising from the rendition of services. Our interpretation is perhaps correct in view of the fact that other categories of income are dealt with specifically in the various Agreements.[4]

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2. Tax Treaties between Developed and Developing Countries - Second Report 1970. U.N. Sales No. E. 71. XVI. 2, page 12, paras. 73 - 78.

3. Nigeria - U.K. Article 2(1)(j). The term "industrial or commercial profits" is said to include rentals in respect of cinematograph films.

4. For example, "investment income" which include dividends and royalties are dealt with in Article 6 and 7 respectively of the Nigeria - U.K. Agreement.

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Internal legislation in Nigeria is unhelpful because neither have the courts nor the Revenue had the opportunity to pronounce on it.[5] However, there is hardly any doubt that profits derived from a manufacturing or similar activity would be regarded as an "industrial" profit, while the income from a trade or business would definitely qualify as a "commercial" profit. But what is not so clear is the classification of profits from activities like farming, mining, ranching, property letting, etc.

The crux of the matter is this: If "farming" etc. are not within the expression "industrial or commercial profits", then a resident of treaty - country A, receiving this kind of profit from treaty-country B, would be taxable in the latter. In other words, the expression "industrial or commercial profits" must be interpreted in the widest possible sense just as must the permanent establishment concept to which it relates.[6] To do otherwise, would amount to an unwarranted or perhaps unintended limitation or extension of the tax jurisdiction of the contracting parties.

To drive home our point, we refer to the Southern Rhodesia case of C.O.T. v. Aktiebolaget Tetra Pak[7] where the Court had to decide whether or not the

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5. Words not defined in the Convention are supposed to be interpreted according to the internal law of the contracting parties - Article 2(3) Nigeria - U.K. Agreement.

6. Note that it is only the "industrial or commercial profit" which is attributable to a permanent establishment that is either exempted or taxed when a tax treaty is in existence.

7. [1966] Rhodesia L.R. p. 539. Similarly, see the New Zealand Tax Board Review Case No. 5, 3 N.Z. T.B.R. p. 49. One of the issues which arose in this case was whether or not the profits from "theatrical enterprises" carried on in New Zealand by an Australian company were "industrial or commercial profits" within the provisions of the double taxation agreement existing between the two countries.

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income derived by a non-resident from the business of letting machines was an "industrial or commercial profit". The respondent in that case was a Swedish company with no "permanent establishment" in Rhodesia. It manufactured and sold laminated paper board for use in making containers for milk and other liquids. It also assembled machines which converted the paper board into containers. It let six such machines to two firms in Northern and Southern Rhodesia. The liability to tax was governed by Article III(2)[8] of the Parent Convention between Britain and Sweden and depended on whether the income derived from letting machines was an "industrial or commercial profit". If it was, the respondent was exempt from tax. If not, it was liable. The Special Commissioners decided in favour of the taxpayer.

On appeal, the Court observed that the expression "industrial or commercial profit" is a part of the "international tax language" and had no counterpart in the taxing codes of the Contracting Parties.[9] In interpreting it, the Court held that the ordinary rules of construction applicable to the interpretation of a municipal statutory instrument must apply. Moreover, as the object of a statutory instrument is often a useful aid to interpretation, and as the object of the present statutory instrument was to avoid double taxation, the Court was of the opinion that an interpretation which achieved this object was to be preferred to one which did not.[10]

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8. The parent Convention was made applicable to Rhodesia by an extension Order. The relevant Article III(2) provided inter alia "that the industrial or commercial profits of a Swedish enterprise shall not be subject to U.K. tax unless the enterprise carries on trade or business in the U.K. through a permanent establishment situated therein. If it carries on a trade or business as aforesaid, tax may be imposed on those profits by the U.K., but only on so much of them as is attributable to that permanent establishment".

9. [1966] Rhodesia L.R. 539 at pp. 542, 543

10. Ibid., at 543, 544

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Since it was never contended in this case that the income from the leasing of machines was an "industrial" profit, if it was to be exempt from tax it had to be regarded as a "commercial profit".

Beadle, C.J., giving the judgment of the Court concluded that the word "commercial" in the context in which it was used was required to have a wide meaning and that "in ordinary commercial life, the enterprises of letting these machines for profit, (must) be regarded as a commercial one".[1]

The case of Ostime v. Australia Mutual Provident Society[2] which turned on a point of almost unimaginable difficulty and obscurity must be mentioned here. The respondent was a mutual insurance company incorporated in New South Wales with its head office in Sydney and a branch office in London. It was agreed that for the purposes of U.K. tax, the life assurance business should be treated as separate from any other business carried on by it.

The basic question which came before the House of Lords was whether the profits of the Provident Society calculated as a proportion of the life fund was technically a "business" or "commercial" profit and so exempt from U.K. taxation by virtue of the provisions of the U.K. - Australia Double Taxation Agreement; or, an "investment income" and hence taxable.

The House of Lords in a majority judgement held that the kinds of profits in question must be classified as "business profits". Again, what must be noted as Lord Radcliffe pointed out,[3] is that expressions like "enterprise",

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1. Ibid., at p. 545

2. [1959] 3 W.L.R. 410. See S.T. Crump's review of this case in (1959) B.T.R. 184 - This author's comments were from the point of view of the doctrine of precedent and in the light of the earlier decision of the House of Lords in I.R.C. v. Australia Mutual Provident Society [1947] A.C. 605, which appear to be inconsistent with the present case.

3. Ibid., at p. 419

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"commercial or industrial profits" and "permanent establishment" which are common place international tax language have no exact counterpart in municipal law.

Lord Denning's minority judgement is interesting in one particular respect. It drew the attention of the House to a number of cases[4] where it had been categorically decided that a mutual society carrying on a business of life assurance cannot make a "trading profit" but may have a "surplus" which is not taxable.

This restatement of the law throws into sharp focus the kind of problem which may arise in determining the precise scope of terms like "industrial or commercial profits".

One other matter of considerable difficulty must be mentioned: To wit, the classification of profits derived by companies providing "personal services". Whilst it has become usual today for artistes and public entertainers to perform their services as employees of corporations owned by themselves or others, the tax principles governing the situation are far from settled. The kind of problem alluded to arose in Case No. 5[5] decided by the New Zealand Taxation Board of Review in 1965. One of the issues which the Court had to decide was whether the income derived by an Australian company from periodical "theatrical activities" in New Zealand were technically "industrial or commercial profits" and so exempted from taxation in New Zealand on the grounds that the company did not have a "permanent establishment" in that country.

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4. Ibid at pp. 423 et seq. where the cases of New York Life Insurance Co. v. Styles [1889] 14 App. Cas. 381; and I.R.C. v. Ayshire Employers' Mutual Insurance Association were discussed.

5. 3 N.Z.T.B.R. p. 49.

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The Court, in a closely reasoned judgement, came to the conclusion that the profits came within the category of "industrial or commercial profits". This view, perhaps a correct one, is supported by U.N. Tax Experts. At their meeting in 1970 they were of the opinion that the "profits of a corporation were business profits regardless of the nature of the services rendered".[6]

But the matter is still unresolved in view of the fact that under the local law of some countries a corporation or other entity is held incapable of rendering "personal services".

In order to avoid any doubts some conventions attempt to define the term comprehensively. For example, in the Convention between South Africa and South West Africa, an "industrial or commercial" profit is said to include profits from activities or businesses like "mining","fishing", "agriculture", or other "pastoral enterprises", as well as income from "banking", "insurance" or "dealings in investments". On the other hand, it is said not to include "income in the form of dividends, interests, rents, royalties (including rent or royalties on cinematograph films), management charges, remuneration for personal services, or profits from the operation of transport services".[7]

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6. Tax Treaties between Developed and Developing Countries. Second Report 1970 U.N. Sales No. E.71. XVI.2 page 12 para. 60.

7. Article II(j). Agreement signed in Cape Town on February 13th 1959. By far the most comprehensive definition of the term is included in the U.S.A. - France Treaty of 1967. Article 6(5) reads: "The term 'industrial or commercial profits of a resident' includes income derived from manufacturing, mercantile, agricultural, fishing or mining activities, from the operation of ships or aircraft, from the furnishing of personal services., from the rental of tangible personal property, and from insurance activities and rents or royalties derived from motion picture films or tapes of radio or television broadcasting. It also includes income derived from real property and natural resources and dividends, interest, royalties .... and capital gains but only if the right or property giving rise to such income is effectively connected with a permanent establishment which the recipient, being a resident of one Contracting State, has in the other Contracting State. It does not include income received by an individual as compensation for personal services either as an employee or in an independent capacity".

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It is interesting to note that more recently, following the OECD Model, a new approach is being adopted internationally. Nowadays, not only is double taxation relief categorically stated to be applicable to dividends, royalties, interest, pensions etc.; this relief is also applicable to every kind of profit - whether commercial, industrial, agricultural, mining or other - subject to one qualification, that such profit is "attributable" to a permanent establishment.[8]

By this approach, which is favoured by this writer, problems of interpretation are avoided and an unnecessary restriction on the scope of tax conventions is removed.

IV. COMPUTATION OF PROFITS AND PROBLEMS OF ALLOCATION

A. Allocation of profits - The Direct Accountancy Method

In discussing the taxation of an enterprise having a permanent establishment abroad, the two main questions which arise are: (1) When is there a permanent establishment? (2) How is the share of profits, or of the capital of the whole enterprise attributable to the permanent establishment to be determined? Implicit in this, of course, is the problem of deciding what constitutes "business income" and what constitutes "capital" - a task rendered more difficult because of the infinite variety of business activities, the lack of uniformity in the tax laws of various countries and the absence of comprehensive definitions anywhere.[9]

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8. The OECD Draft does not employ the expression "industrial or commercial profits" but rather "profits of an enterprise" which presumably is a wider term encompassing all manner of profits - Article 7(1)

9. When the income attributable to a permanent establishment of a non-resident enterprise has to be ascertained, it must first be clarified in the light of the national law whether the provisions concerning the sources of specific categories of income allow of such attribution. This applies in particular to the United States, where the purchase and sale of goods and merchandise at the international level are governed by General Regulations details of which were given by the American Reporter at the Lausanne Conference.

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The first question has already been considered in detail. The task before us now is to probe the second.

Reviewing the matter at the 1973 Congress of the International Fiscal Association in Lausanne,[10] the general Reporter observed that "the procedures for the determination of the income and capital of a permanent establishment have been evolved on a purely pragmatic basis". Apart from the Royal Dutch Decree of 1965 and the United States Regulations, there seem to be no detailed legal provisions in this respect in the majority of countries. In addition, "relevant jurisprudence is rare" and "administrative procedures where they exist are not being publicised to any extent". According to the Reporter, tax authorities in the majority of countries are not basically influenced by whether solely domestic law ought to apply or whether this should be applied subject to the provisions of a double taxation convention.[1]

These observations are no less true for the countries represented at the I.F.A. meeting as they are for Nigeria and other developing countries.[2]

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10. Prior to this date, no major effort had been made on the international level to actually explore and set out detailed and uniform accounting procedures as regards double taxation agreements. The OECD Draft, admirable in several respects, is sadly lacking in anything of substance on the determination of business profits - being content to assume that once adequate accounts can be constructed for each part or section of an enterprise, the profits and expenses adjusted as necessary can be allocated to particular parts of the enterprise with a considerable degree of precision. Subject to some minor refinements, it is interesting to note that most of the Rules concerning the allocation of income still remain essentially the same as they were first formulated by the Fiscal Committee of the League of Nations. As a general background to our present discussion see Mitchell B. Carroll, "Allocation of Business Income: The Draft Convention of the League of Nations" - (1934) 34 Columbia Law Review p. 473 et seq. See also, Tax Treaties between Developed and Developing Countries - Second Report 1970. U.N. Salēs No. E.71 XVI.2 pp. 47 - 51

1. Max Beat Ludwig, "The Taxation of Enterprises with Permanent Establishment Abroad"- (1973) LVIIa. Cahiers, p. 1/55 at pp. 1/60, 1/61.

2. In the next chapter, the problem is examined again from a different angle especially as regards the machinery for administering the tax treaties - exchange of information, mutual agreement procedures etc.

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The Nigerian Agreements for example, have no detailed provisions setting out the appropriate method to be adopted in arriving at taxable profits. They follow standard international practice by stating *inter-alia* that

> "where an enterprise of one of the (Contracting parties) is engaged in trade or business in the other territory through a permanent establishment situated therein there shall be attributed to the permanent establishment industrial or commercial profits which it might be expected to derive from its activities in that other territory if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment".[3]

To say the least, this provision is not very helpful even though the purpose behind it is evident - i.e. to discourage any attempt to divert profits from the permanent establishment to the parent establishment or vice versa.

In the context of our present discussion, it must be remembered that the kind of enterprise being considered is one that carries on some of its business through a dependent permanent establishment outside the state of residence. In this circumstance, and according to the principles of commercial law, accounting records are likely to be kept at the head office of the enterprise, giving all details of transactions conducted both within the state and abroad. i.e. a profit and loss account and a balance sheet

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3. Nigeria - U.K. Agreement Article 3(3)

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that reflects overall profits and capital.

One would have thought that such consideration of commercial law would influence the apportionment of the profits and capital of an enterprise between the state of residence of the enterprise and the state in which the permanent establishment is located. But this is not so. All available evidence show that the general rule in most countries is to prescribe separate book-keeping for permanent establishments even where it is quite clear that a permanent establishment simply could not exist as an independent establishment and that any separate book-keeping done would hardly be informative.

The usual practice today, is for the profits and, hence, the tax liability of the permanent establishment to be determined on the basis of its own records without regard to the general aspects of the enterprise as a whole. Manifest here are the lack of uniformity in the tax laws of the various countries and the reluctance of tax authorities to rely on foreign records which are not freely available for verification. This, indeed, explains why the procedures in this vital area of international tax law have been evolved in a piece-meal manner.

All the Nigerian tax treaties,[3a] like the OECD Draft,[4] place the main emphasis as regards the attribution of income on the accountancy of the permanent establishment. But they would probably admit allocation on the basis of apportionment of "total profits" insofar as this has been customary and if the result is in accordance with the principles underlying the primary method.[5] The OECD Draft as may be pointed out permits taxpayers and tax

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3a. E.g. Nigeria - U.K. Agreement Article 3(1), 3(2) read in conjunction with Article 3(3)

4. Article 7(2)

5. This point is more fully spelt out in the OECD Draft (Article 7(4)), although may be inferred from the Nigerian Agreements.

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authorities to alter the method of attribution of profits only for "good and sufficient reason".[6]

In keeping with the permanent establishment concept, most conventions do not allow the attribution of profits made in respect of purely purchasing activities conducted by a permanent establishment for the parent establishment.[7] In fact, from the wording of Article 7(5) of the OECD Draft it would appear that the same principle apply whether or not the purchasing of goods or merchandise was the sole activity of the permanent establishment.[8]

However, following the protests of the developing countries it is likely that the profits derived from "purchase activities would in future be attributed to the permanent establishment where the permanent establishment is engaged in purchasing and other activities" in the host country.[9]

While it may be simple enough to state that the profits of a permanent establishment are to be determined according to normal accountancy rules as if it were a separate and independent legal entity,[10] in practice, the matter

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6. Article 7(6)

7. E.g. Nigeria - U.K. Agreement Article 3(4). According to the national laws of most countries mere purchasing activities in a particular country does not constitute a trade. Thus, in Lovell v. C.O.T. [1908] A.C. 46 it was held that the purchasing activities in New Zealand conducted on behalf of a U.K. Company by an agent were insufficient per se to render a portion of the taxpayer's profits derived from sales in the U.K. liable to tax in New Zealand.

8. Ibid., The Nigerian provisions are slightly different here. Profits arising from purchasing activities conducted abroad for a p.e. may be wholly aggregated to the profits of the p.e. which is engaged in selling activities.

9. Tax Treaties between Developed and Developing Countries - Second Report 1970 U.N. Sales No. E.71 XVI.2 pp. 5, 16 paras. 90 - 94.

10. The inadequacy of the OECD Draft in this respect is well known. It was in fact acknowledged in the Commentaries on the Draft. See report at p. 79.

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is not nearly so simple. Apart from what may be regarded as ordinary commercial expenses certain classes of payments between the permanent establishment and the parent enterprise give rise to serious difficulties. These include interest, royalties and other similar payments made by a permanent establishment to the head office in return for money loaned, or patent rights conceded by the latter to the former. Also problematical are payments for the performance of auxillary services by the permanent establishment to the head office or vice versa.

Some of the issues involved have been discussed in other contexts.[1] Other relevant aspects are now examined in detail.

(i) Intra-Company Transfer of Goods and Services and Problems of Valuation

The direct method, as may be recalled, involves the fiction that for tax purposes the permanent establishment of a non-resident enterprise is not a dependent part thereof, but a wholly independent enterprise in its own right. It, therefore, presupposes that the nature of the relationship with the parent enterprise is the same as that with third parties.[2] But this fiction does not in any way represent economic reality. The tax authorities will in consequence constantly have to make adjustments in order to arrive at an independently determined profit of the permanent establishment.

A point that has often given rise to endless difficulty is the correct assessment for tax purposes of goods and services exchanged between the perma-

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1. Supra. Chapter III and V.
2. Nigeria - U.K. Agreement Article 3(3). OECD Article 7(2).

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nent establishment and the parent enterprise. Presumably, the value to be applied is the "market price" (or in the case of resale the "wholesale price");[3] but as has been correctly pointed out,[4] this conflicts with the principles of commercial law, in accordance with which such goods should be valued at "purchase or manufacturing cost."

Establishing the "market price" is usually easy if a representative market price is known or can be ascertained. Where this is not possible, a profit on manufacture or sale may be calculated with account being taken of all the relevant circumstances.[5]

Similar problems arise in connection with the alienation of immoveable property from the parent enterprise to the permanent establishment or vice versa. In principle, valuation should be in accordance with the market price, so that if the book value on a sale is lower, a gain is deemed to have been realised by the transferor with the corresponding consequences as regards tax.[6]

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3. We are probably correct, reasoning along the principles of Sharkey v. Wehner [1955] 3 W.L.R. 671. In that case, it was decided that for tax purposes the correct valuation of non-trading dealing in stock was "current realisable value."

4. Max Beat Ludwig op.cit. at page 1/64.

5. Cf. Alan A. Tait, "The Economic and Legal Interpretation of 'Open Market Price'" 1965 B.T.R. p. 216. In this article the author discusses the interpretation by the courts of the concepts of 'Open Market' and compares it to the criteria used in economics. According to him the picture which emerges of the 'legal' open market has close affinities to the economists' theoretical haven. viz.- freedom of entry, perfect knowledge, and a wholly elastic demand schedule.

   N.B. The American Reporter at the Lausanne Conference mentions various methods by which the relevant price can be ascertained in the given situation.

6. Max Beat Ludwig - op. cit. at p. 1/65 summing up the consensus of opinion at the 1973 Lausanne meeting.

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(ii) Intra-Company Loans and the Tax Treatment of Interest and Royalty Payments

Looking at the provisions of Article 7(2) of the OECD Draft,[7] one would expect that the fiction by which a permanent establishment from an international point of view is taxed as an independent entity would be strictly adhered to. But this is not so. For instance, in the particular case of interest payments, whilst it is generally agreed that interest which the permanent establishment pays to third parties represents a tax deductible expenditure, the treatment of interest in dealings between the permanent establishment and the parent establishment remains controversial.[8] Three distinct situations may be considered.

(1) What is the tax position where a permanent establishment has been provided with working or endowment capital? At the Lausanne meeting it was clear that any interest payable on this sum of money is not usually an allowable deduction. This approach is probably correct when an analogy is drawn with the stock capital of a joint stock company.[9]

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7. Article 7(2) of the OECD providesthat "where an enterprise of a Contracting State carries on business in the other contracting state through a permanent establishment situated therein there shall in each contracting state be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment".

8. Max Beat Ludwig op.cit. at p. 1/65.

9. This view as specifically endorsed at the Lausanne meeting by the Netherlands Reporter.

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(2) Secondly, consider a situation where the parent company for legitimate business reasons provides the permanent establishment with some of its own resources - e.g. in order to temporarily bolster its circulating capital. The reverse case in which the permanent establishment is the "creditor" and the parent establishment the "debtor", is also conceivable. In this case, it would seem that interest would not be an allowable deduction since theoretically a loan transaction is not possible within one and the same legal entity.[10]

What emerges here is in gross contrast to the fictitious assumptions on which the "direct method" is based. Were the profits of a permanent establishment to be determined on a truly independent basis, interest payment in the given example must be allowable.

(3) The third situation which may be considered is the tax treatment of interest on debts which the parent enterprise has incurred with third parties completely or partly for the benefit of the permanent establishment.

It would appear that these can be passed on to the permanent establishment in whose books it would be treated as an allowable deduction, provided the parent company can demonstrate the close relationship of the borrowed finances with the requirements of the permanent establishment. It can be assumed that this principle also applied in cases where the permanent establishment takes credit for the parent establishment.

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10. This was the consensus of opinion at the Lausanne meeting. See Max Beat Ludwig op.cit. at page 1/66. The views expressed are considered right using the tax law analogy that a taxpayer cannot trade with himself.

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The special rules which apply to banks in relation to interest accounting between the parent company and the permanent establishment deserve mention. The generally accepted principle when the parent company makes advances to a permanent establishment is to regard the interest payable by the latter as an allowable deduction.[1] This exemption is justified by the Fiscal Committee of the OECD, and rightly too, on the grounds that "money trading" is part of the normal activity of a bank.[2] Thus, in this case, the separate accounting method is implemented to its logical conclusion.

Problems similar to those encountered with the tax treatment of interest also occur in the case of royalties. Where the parent company pays royalties to a third party for "know-how" rights which are demonstrably used in the permanent establishment, the predominant view is that the payments made by the permanent establishment together with overhead costs may be recognised in its accounts as a tax-deductible expenditure. The same rule is often applicable in the converse situation.

On the other hand, contrary to the principle of separate accounting, there is again a reluctance to accept as an allowable expenditure licensing fees paid by the permanent establishment to the parent company for "know-how" which the latter itself developed or purchased. The reasons for this kind of attitude have been alluded to in other contexts.[3]

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1. Max Beat Ludwig -op.cit. at p. 1/66. This conclusion is based on the majority of the reports submitted at the IFA Congress in Lausanne.
2. OECD Report 1963. Commentaries on Draft at pp. 83, 84.
3. Supra. In Chapter III and V.

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(iii) Expenses - Management and other Expenses

Inside a company, there are certain functions which are concentrated in the parent establishment (e.g. management) and which are directly beneficial to its permanent establishments or units. The converse situation is much less frequent. Nevertheless, it may occur if a permanent establishment, for example, undertakes publicity for the whole company.

The question is, how are these costs to be split up for taxation purposes between the individual parts of a company?

Whereas, according to the internal legislation of various countries, Nigeria inclusive, management and administrative costs which occur abroad are as a corrollary of the "source" principle non-allowable deductions; on the international level, the tax treatment of these kinds of expenses are often ill-defined.[4]

However, since 1963 the OECD Draft has given a lead by stipulating that[5]:

> "in the determination of the profits of a permanent establishment there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment[6] including executive and general administrative expenses so incurred, whether in the state in which the permanent establishment is situated or elsewhere".[7]

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4. There is no provision at all in Nigeria's Agreements as regards this.
5. O.E.C.D. Article 7(3)
6. Emphasis supplied.
7. Emphasis supplied.

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The essential point about this provision is that the deductibility of a part of the general overhead costs of the whole company is not dependent on where they arise. But well meaning as it is, the OECD provision is defective for a number of reasons. Firstly, the test for deductibility is not an objective one. To wit, that allowable expenses are those incurred "wholly" and "necessarily" for the purposes of the business or trade. The OECD provision gives the impression that all expenses are to be deductible once the enterprise indicates that it was incurred for the purposes of its trade. There is, therefore, a real possibility of conflict with internal law when a state applies a strict objective test in determining which expenses are allowable and which ones are not.[8]

The British delegate at the Lausanne Congress criticised the OECD proposal in two respects. Namely, that the phrasing "expenses incurred for the purposes of the permanent establishment" is likely to support a restrictive interpretation on the part of national tax authorities. In the opinion of this delegate, it should be possible to transfer the costs that arise overall in the company proportionately even if the permanent establishment is only <u>indirectly</u> a beneficiary (e.g. directors' fees). Moreover, as the British delegate rightly pointed out, there is a contradiction between paragraphs 2 and 3 of Article 7 of the OECD Draft.[9] In the first case, an independent

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8. The Nigerian Law, for example, provides that only expenses "<u>wholly, exclusively and necessarily</u>" incurred in the production of income shall be allowed. s.22 CITA as amended by s.5(2)(b) of the 1966 Income Tax (Amendment) Decree. Relevant in this context is our discussion on the treatment of expenses in the computation of profits and the problems of interpretation and application of the tests for deductibility.

9. For a text of these provisions, <u>supra</u> at page 508 footnote 7; and page 511, footnote 5 respectively.

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entity is assumed, whereas in the other case the permanent establishment is considered a part of the whole company.

To say the least, this inconsistency can lead to serious difficulties.

While it is probably true that the management costs directly attributable to a permanent establishment would present no difficulty, general administrative costs are much more difficult to apportion. A proportional distribution of such costs between the parent company and the permanent establishment may however be based on the ratio inter se of such data like capital, turnover, the number of employees or total wages bill. But what may be noted is that inherent in our suggestion is the problem of establishing the accuracy of any data used, a task which in itself may not be easy.

(iv) Losses - Treatment between parent company and permanent establishment

The question whether it is permissible for the taxation law to be in contradiction of the principles of commercial law becomes more accentuated in the treatment of losses between a parent company and its permanent establishment. On the fiction that the latter is an independent entity, it is clear that a transfer to it of losses where the company as a whole suffers a loss would be unacceptable especially if the permanent establishment has closed its own books with a profit. Indeed, any tax levied on the profits of the permanent establishment in this circumstance is in reality the taxation of a profit which under commercial law is non-existent.

If on the other hand the book-keeping of the permanent establishment shows a loss, this can according to the tax law of most countries be carried over. The impact of such losses on the enterprise as a whole is thus greatly

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diminished especially where taxation in the country in which the parent establishment is situated is on world income.

In countries which avoid international double taxation by the "exemption method", there are no further problems. But the position is different if the company is domiciled or resident in a country which employs the "tax credit method". In such a case, the accumulation of loss carryover in the country in which the permanent establishment is located, combined with a loss equalisation in the country in which the parent establishment is domiciled may lead to an unjustifiable advantage.[10]

B. Allocation of Profits - The Indirect Method

The indirect method of profit allocation starts out from the company's total profit and attributes to the states in which are located the parent establishment and the permanent establishment a part thereof for taxation purposes. This method, although permitted by virtue of Article 7(4) of the OECD Draft Convention,[1] does not seem to have been adopted by many countries. In fact, the Nigerian Agreements do not contain any specific reference as regards its use.

The main advantage of the indirect method is that the determination of profits for tax purposes is made compatible with the principles and practice of commercial law. Consequently, there are no valuation problems and price adjustments of intra-company transfer of goods and services. Even the problems of loss equalisation are eliminated.

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10. Max Beat Ludwig op.cit. at p. 1/68.

1. This provides that "insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment shall, however, be such that the result shall be in accordance with the principles laid down in this Article.

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But be that as it may, there are a number of disadvantages inherent in the system.

In the first place, how easy is it to compel a foreign company which maintains a permanent establishment abroad to hand over to the taxation authorities of the host country all the documents required for determining its "world profits" - especially where these profits are to be computed on the basis of rules applicable under local legislation? Where the necessary documents are missing, incomplete or not available, is it not true that all that remains is a computation of total profits on estimates?[2]

Secondly, assuming that it is possible to determine or verify the total profits of an enterprise on the basis of the domestic legislation of the country where the permanent establishment is resident, it then becomes necessary to decide how these profits are to be apportioned between the parent establishment and the permanent establishment.

An apportionment index can often be determined relatively simply if the parent establishment and the permanent establishment are engaged in similar activities. As far as is ascertainable,[3] the usual practice has been to apportion profits on the basis of "invested capital and total profits" where the company is a manufacturing concern. Alternatively, apportionment has been based on the "ratio of expenses" of the units to the total expenditure of the enterprise.

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2. In this connection, the mutual consultation procedure between tax authorities may be used. But this may prove too tortuous to be practical.

3. Max Beat Ludwig op.cit. at p. 1/69.

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However, difficulties arise if the parent company and the permanent establishment are engaged in different activities albeit within the framework of the company as a whole (e.g. - production - sales). Here, it becomes necessary to break down the total profits into a production and sales profit. The partial profits can then be attributed to the states in question using a suitable and acceptable index.[3a] But as the cases from various jurisdictions show, it is far from settled whether indeed a company's profit can be apportioned between various units of the same enterprise quite apart from the question of finding a suitable criterion for such apportionment.

For example, in the case of Laycock v. Freeman, Hardy, Willis[4] where a company's activity consisted of manufacturing and retail of shoes, the court held that it is extremely artificial to suppose that the company therefore makes two profits, a manufacturer's wholesale profit derived on the basis of a notional sale by the production unit to the retail unit and a retailer's profit - the fact that it may have been convenient and useful that accounts be kept on that basis notwithstanding.[5]

Proceeding from the findings in the above case, the question then is whether the profits of a taxpayer are apportionable for income tax purposes between a manufacturing branch in one taxing jurisdiction and a selling branch in another.

3a. What is contemplated here is a method of "fractional apportionment" described more fully subsequently.

4. [1939] 2 K.B.1

5. Ibid., See especially Sir Wilfrid Greene, M.R. at p. 11.

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In the case of The Provincial Treasurer of Manitoba v. Wn. Wrigley Junior Co. Ltd.,[6] the question at issue was whether for purposes of income tax the income of a non-resident company can be apportioned between the manufacturing branch of the company situated outside the Province of Manitoba and a selling branch situated inside the Province.

The company had its head office and factory in Ontario and an office and warehouse in Winnipeg from which merchandise was distributed to a so-called Western Division including Manitoba, Alberta and Saskatchewan. The total cost of manufacturing the merchandise varied from 19.18 cents to 22.23 cents per unit during the four years in question, but in every year the company charged the selling division at Winnipeg a flat arbitrary rate of 28 cents per unit for all merchandise shipped to that division. The Revenue of the Province claimed that the profits arising from the business in Manitoba were the net profits from the sales in Manitoba after due allowance for cost of manufacture, cost of sale and a proportion of general administrative expenses. It assessed and taxed the company on the entire net profit received from sales through the Winnipeg branch; that is, on the difference between the actual cost price and the actual selling price, ignoring for income tax purposes the arbitrarily fixed figure of 28 cents.

The company did not deny its liability to pay tax in Manitoba but claimed that this should only be on the difference between 28 cents and the amount for which it later sold the goods. It contended that the profit made from merchandise sold in Manitoba did not arise solely from the sale in Manitoba,

6. [1945] 53 Man. R. 213; [1945] 3 W.W.R. 305. For a review of this case see G.P.R. Talin 1945 23 Canadian Bar Review p. 781.

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but partly from the manufacturing process carried on in Ontario and partly from the sale in Manitoba. In its view, such profit must be apportioned in accordance with s.24 of the Manitoba Act[7] so that only the part arising from the sale in Manitoba is subject to taxation in the Province. In addition, the company drew the attention of the Court to sections 23 and 26 of the Tax Act[8] which in its opinion categorically recognised the principle of apportionment.

The majority of the Court held that the business which yielded the profit was the business of "selling the goods". Following Laycock v. Freeman, they emphasized that a manufacturer who sells at retail does not make two profits - a manufacturer's profit and a retailer's profit - but one profit only and that such profit is made when and where the goods are sold.[9] The Court was clearly of the opinion that there is "no such thing

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7. s.24 reads "The income liable to taxation under this Part of every person residing outside Manitoba, who is carrying on business in Manitoba either directly or though or in the name of any other person, shall be the net profit or gains arising from the business of such person in Manitoba."

8. These sections read in part as follows: s.23. "Where any corporation carrying on business in Manitoba purchases any commodity from a parent, subsidiary, or associated corporation at a price in excess of the fair market price, or where it sells any commodity to such a corporation at a price less than the fair market price, the minister may, for purposes of determining the income of such corporation, determine the fair price at which such purchase or sale shall be taken into the accounts of such corporation."

   s.26. "Where a non-resident person produces - Manufactures ..... or constructs, in whole or in part, anything within Manitoba and exports the same without sale prior to the export thereof, he shall be deemed ..... to earn within Manitoba a proportionate part of any profit ultimately derived from the sale thereof outside Manitoba."

9. The following cases were also considered by the court: Ericksen v. Last [1881]Q.B.D. 414; Lovell v. C.O.T. [1908]A.C. 45 and C.O.T. v. British Australian Wool Realisation Association [1931] A.C. 224

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..... as apportionment between different departments of a taxpayer's business or between taxing jurisdictions". Accordingly, sections 23 and 26 of the Tax Act were to be regarded as special provisions for particular conditions which in no way indicated that the principle of apportionment was applicable generally or to the circumstances of the present case. Commenting on s.24, the Court held that it was not a taxing section, but as the Crown had contended, an exempting section which neither provided for, nor, contemplated the apportionment of profits.

The above decision, probably correct in strict law, is most unimaginative. In the opinion of this writer, the dissenting judgement of Dysart. J., is much more realistic. His Lordship took the view that since liability under s. 24 is expressly confined to the "net profits or gains" arising from business carried on inside Manitoba by non-residents, the Act impliedly excludes from taxation any profits arising from the businesses of such persons outside Manitoba. Furthermore, his Lordship reasoned that sections 23 and 26 do recognise that profits may be earned by processes through which goods passed before they came to Manitoba to be sold, and that profits do not arise wholly or solely at the time and place of sale. In that regard therefore, statements in other cases that profits on goods arise wholly or solely at the time and place of sale must be read in the light of the particular facts of those cases.

Perhaps, what ought to be remembered here is that the question of what profits actually arise from a business activity and the precise location of those profits are matters of fact and not law.[10]

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10. Cf. F.C.T. v. Mitchum [1966] A.L.R. 29 (H.C. of Australia F.C.)

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To put our discussion in its proper perspective, and to illustrate how the attitude of the courts have changed over the years, we refer to the Indian case of Lal v. C.I.T.[1] decided by the High Court of Calcutta recently and whose facts were remarkably similar to the Manitoba case.

The taxpayer company manufactured certain products in India which it sold through its branch establishment in Burma. The Burmese authorities assessed the company to income tax on the gross profits in that country without taking into account that the retail profits included in actual fact manufacturing profits properly attributable to the manufacturing activities in India.

Pursuant to the double taxation agreement between India and Burma, the taxpayer sought relief for the tax paid in Burma in respect of his manufacturing profits which were, of course, liable to taxation in India.

The judgement in this case which is considered reasonable may be summarized by the following propositions: viz. (1) In cases where the Court has to consider where a particular income arose or accrued, manufacturing profits must be held to have arisen or accrued at the place where the goods were manufactured and not at the place where they were sold. (2) That although profits may not be realised until a manufactured article is sold, such profits are not wholly made by the act of sale. To the extent that profits are attributable to manufacturing operations, profits accrue at the place where the business operations are carried on.

Clearly, if the indirect method of profit allocation is to be applicable as contemplated in the OECD Draft, the Revenue authorities of the Contracting Parties must be prepared to act along the lines established by the High Court

1. [1971] Vol. 79 I.T.R. (Indian Tax Reports) p. 147

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of Calcutta in the case of Lal v. C.I.T. and by the minority judgement in the Manitoba case.

Returning to the main theme of our discussion, it may be recalled that the main advantage of the indirect method of profit allocation is that it is compatible with the principles of commercial law. Where all the units of an enterprise operate at a profit there are no difficulties. But problems arise when a part of overall profits is attributed to a company unit which has operated at a loss.

In this connection, the solution may be to adopt an apportionment index which had hitherto found little use at the international level. That is, basing the apportionment of the total profits of a company on the book-keeping profits of the parent establishment and permanent establishment. The point to note is that this would constitute only the index for apportionment of total profits and not, as is the case with the direct method, the basis for taxation. This procedure thus eliminates the situation in which either the parent of permanent establishment is attributed a quantum of profits when it had closed its own books with a loss.[2]

Finally, two other observations may be made. Namely, that the indirect method is uniquely unsuitable in the apportionment of certain kinds of receipts. For example, in the apportionment of gains or losses resulting from the alienation of capital and the profits or losses resulting from changes in currency exchange rates. The same is true for a non-business income like dividends which must be previously attributed to that part of the company to which they are commercially related.

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2. Max Beat Ludwig op.cit. at p. 1/70

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As a contrast to that however, it must be acknowledged that the indirect method is very useful in the allocation of insurance profits.[3] This is because it is relatively easy for the total profits of an insurance company with an international activity to be apportioned on the basis of the relationship that exists between "total premiums" and "premium income" in the country in which the permanent establishment is resident.

The mechanics of this procedure within the context of the Nigerian law has been examined elsewhere.[4]

C. Allocation of Profits - The Reasonable Estimate Method - Significance for Developing Countries

From our foregoing discussion, it must be evident already that in practice the determination of profits is to a large extent based on estimations and lump sum calculations. Where a permanent establishment's records are unreliable and the profits declared appear to be inadequate, the Revenue authorities are obliged to make a "best of judgement" assessment which is usually based on a comparison with the trading profits of an independent firm engaged in the same or similar trade as the permanent establishment.

Although not clearly spelt out, most tax treaties allow the use of the reasonable estimate method of profit allocation where the information supplied by a permanent establishment is inadequate or unreliable.[5] The Nigeria -

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3. Max Beat Ludwig op.cit. at p. 1/70. As this author points out the indirect method of allocating insurance profits is used by many countries.

4. Supra. Chapter III.

5. Not even the OECD Draft is explicit here. But this writer is of the opinion that the reasonable estimate method is allowed in appropriate circumstances.

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New Zealand Agreement is an exception in this respect. In order to avoid any doubt, it is provided in that Agreement that:

> "if the information available to the taxation authority concerned is inadequate to determine the profits to be attributed to the permanent establishment, nothing in the Agreement shall affect the application of the law of either territory in relation to the liability of the permanent establishment to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authority of that territory: Provided that such discretion shall be exercised or such estimate shall be made, so far as the information available to the taxation authority permits, in accordance with the principle stated in this Agreement."[6]

The reasonable estimate method, crude as it is, can be of great advantage to developing countries where the majority of people have little or no education. Surely, it is wishful thinking to expect illiterate petty traders or itinerant merchants to keep detailed books of accounts. If these categories of persons (i.e. petty traders, hawkers etc ...) are to be regarded as permanent establishments as advocated by some,[7] then the best method of determining their taxable profits as at present is by reasonable estimation.

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6. Article 3(3)
7. Supra at page 462.

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There are other advantages too in the use of the reasonable estimate method. Considering the insufficient number of accountants in most developing countries it is very unlikely that professional advice can be available to everybody. The Revenue authorities of these countries are also helped. They are spared the effort of engaging in frustrating enquiries in order to establish the measure of profit of a permanent establishment.

In spite of its clear advantages, one major danger inherent in the reasonable estimate method must be recognised. The Revenue's discretion in this circumstance must be exercised "reasonably", but as we know, what is reasonable can sometimes be highly subjective. However, the situation may not be too menacing once it is generally recognised that what is intended here is an objective test and not an arbitrary exercise of authority by the Revenue.

D. Attribution of Profits - Some Special Cases

(i) Carrier Enterprises - Shipping, Air and Road Transport

For the sake of clarity, attention must be drawn to our earlier discussion highlighting the peculiar problems involved in the taxation of some special enterprises. The main issues as regards the taxation of shipping and aircraft profits have been examined from the point of view of internal law and to some extent under the applicable rules of the tax treaties.[8] Our concern in this brief section, therefore, is to look more

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8. Supra. Chapter III. Our discussion above on shipping and Aircraft profits and the concept of permanent establishment is relevant here.

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closely at the rules for the allocation of profits of carrier enterprises under the tax treaties.

As may be recalled, under Nigeria's tax treaties exclusive jurisdiction to tax shipping and aircraft profits is given to the country of residence.[9] Rejecting this approach, we have advocated the principle of revenue sharing between the country of residence and the country of source - in spite of the considerable difficulties involved.

The proposal made recently by a member from a developing country to tax shipping profits on a fifty-fifty basis is considered to be one way out.[10] This was discussed at length at the first meeting of the U.N. Group of Tax Experts. To be effective, it is interesting to note that developing countries are prepared to accept audited financial statements of the foreign shipping enterprise or a certified statement by the tax authorities of the latter's home country as a basis for computing their taxes on the allocable portion of the profits. The fact that shipping enterprises often receive accelerated depreciation, deductions, investment allowances and similar benefits (e.g. government subsidies) in the home countries are matters which the source countries are even prepared to consider in the determination of taxable income.[1]

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9. E.g. Nigeria - U.K. Agreement Article 5. In the OECD Draft jurisdiction to levy taxes is reserved to the place where the "effective management" is situated - Article 8(1).

10. Tax Treaties between Developed and Developing Countries. First Report 1969. U.N. Sales No. E.69. XVI. 2 page 15 para. 67.

1. For example, see s.41. F.A. 1971 U.K. granting free depreciation on ships. See also Nanta, "Free Depreciation - Ships" - (1973) B.T.R. pp. 266 - 267. For a full discussion of the kind of favourable treatment given to shipping and aviation companies see G.C. A. Smeets, "Special Provisions for the Taxation of Netherlands Antilles Shipping and Aviation Companies"- (1972) Vol. 26 BIFD p. 311 et seq.

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An alternative to the fifty-fifty formula of revenue allocation is the method whereby an estimated amount of income based on "gross freight" to and from the country of source is deemed to be taxable. The liability of the taxpayer is then adjusted at the end of the year on the basis of net profit figures supplied by the carrier enterprise.

This approach is preferable in Nigeria's tax treaties because it is closely akin to the procedure currently followed under internal law.[2]

Whatever the method adopted for the allocation of shipping and aircraft profits it must of necessity be based on compromise rather than logic. In this regard, it is significant to note that neither the IFA nor the U.N. Group of Tax Experts have displayed sufficient ingenuity in producing a more sophisticated and yet readily acceptable formula than the two methods outlined above.

Directing our attention specifically to the allocation of aircraft profits, much of what has been said in relation to shipping profits should apply <u>mutatis mutandis</u>. " A distinction" which the Tax Experts draw between these two categories of profits " is not easily defensible".[3] Why indeed they agreed to maintain the rules in the OECD Draft, Article 8, namely, that aircraft profits should be taxable only by the country in which the "place of effective management" of the enterprise is located is difficult to understand.

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2. See discussion in Chapter Three.
3. J.H. Christiaanse <u>op.cit</u>. at page 47.

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(ii) Agencies - Allocation of Income from Sales

Where a foreign enterprise carries on business in Nigeria through an employee or agent with a stock of merchandise, what profits will the enterprise be required to allocate to the Nigerian permanent establishment for the purposes of the country's taxation? The truth, of course, is that there is no simple answer to this question.

As has been pointed out already, allocation problems remain even where separate accounting is practicable. The problems are compounded where there are no separate accounts and there are no reasonable means or basis for constructing them. For instance, experience shows that separate accounting is often impracticable when an enterprise of one country carries on business in another by means of an agent. In this circumstance, how is a measure of the overall profit to be allocated to an agency permanent establishment? What factors are important? The situation may be further complicated by the distinction which is drawn in tax treaties between "dependent" and "independent agents" (i.e. brokers, general commission agents and the like).

Assume for example that a Nigerian sales agent constitutes a permanent establishment of a foreign manufacturer and assume further that the agent and manufacturer are otherwise unrelated. Presumably, in this arm's length relationship the remuneration or commission earned by the agent may be said to be the amount earned by an "independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment".[4] Whereas, the agent's remuneration or commission will

4. Nigeria - U.K. Agreement Article 3(3); OECD Draft Article 7(2).

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be included in his "total income" for purposes of Nigerian taxation, it would seem to follow from Article 3(3) of the Nigeria - U.K. Agreement that no portion of the manufacturer's profit would be allocated to the Nigerian permanent establishment.[5]

This result is rather absurd considering that on general principles tax conventions quite obviously contemplate that some portion of a manufacturer's profit is to be allocated to its sales agency. Were it not so, there would be little or no point in having an agent constitute a permanent establishment.

Regrettably, neither the IFA in their studies nor the OECD Fiscal Committee have given clear guidelines for determining the amount of a manufacturer's earnings to be allocated to an agency permanent establishment. However, examining the matter recently, one author has come up with a number of interesting ideas.[6]

At least three general methods of apportioning income to an agency permanent establishment have been suggested:

(1) Where a manufacturer can establish that he sells the same product or group of products to independent distributors under comparable conditions, the tax authorities of the source country may agree to consider the price charged to such distributors as the cost of the product to the agency. In

5. Under internal law, as we may recall, where a non-resident carries on a trade partly in the country and partly outside through an agent or the like, liability to tax is on total profits to the extent that they are derived from a Nigerian source. Supra, Chapter Three. But as must be emphasised here internal law is superceded by the tax treaty provision.

6. R. Alan Short, "Allocation of Income:Agencies" (1964) Canadian Tax Journal p. 135 especially at p. 141 et seq.

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this situation, the profit to be allocated to the permanent establishment may be determined by deducting from the gross receipts of the agency the costs as determined above and the expenses attributable to the establishment. These expenses will include the agent's commission and other direct expenses of the establishment plus an appropriate share of the selling and administrative overheads of the head office. Alternatively, it may also be possible to determine an appropriate product cost to the agency by reference to the published prices of commodities where a free market exists, or, by reference to the value for customs or commodity tax purposes and so on.

(2) Secondly, the income of an agency permanent establishment can be determined by applying a percentage figure to the gross receipts of the establishment. An acceptable figure can usually be negotiated with the Revenue and fixed in accordance with the nature of the business in question or by comparison with results obtained by similar enterprises operating in the country.[7]

(3) Finally, the profits of an agency permanent establishment may be determined by a method known as "fractional apportionment", whereby the earnings of each establishment are computed as a proportion of the total income of the enterprise. The apportionment index may be based on sales, wages, capital

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7. This method is apparently used in the U.K. where the taxpayer has the right to appeal the amount of the percentage to the General or Special Commissioners and to appeal further to a Board of Referees appointed by the Treasury - See R. Alan Short op.cit. at p. 141.

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employed, or, on a combination of these or other factors.[8] To a great extent this approach is in accordance with the indirect method of profit apportionment discussed above.

In its application, fractional apportionment may be unlimited or limited. When it is unlimited, the total income of an enterprise from all sources is apportioned. In the second and more acceptable case, the apportionment is limited to the income derived by the enterprise from those activities in which the establishment has participated thereby excluding unrelated income and losses from the computation.

When applied to any given factual situation, the three methods of proft allocation give rise to very different results. In fact, under the third method, the amount of income allocable to a permanent establishment will vary according to the particular factors used in fixing the allocation formula and according to the amount of income to which these factors are applied.

Scientifically, "fractional apportionment" would appear to be the most accurate method of profit allocation where the separate accounting of an agency permanent establishment or other, cannot be relied on. Yet, because of the uncertainty in the selection of the relevant factors the method is not as widely used as it might have been. Consequently, its

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8. According to R. Alan Short, the Americans have traditionally favoured a method of allocation by which one-half of the income is allocated in the ratio that the property of the permanent establishment bears to the total property of the enterprise, and the other half is apportioned on the basis of sales. On the other hand, the author continues, "Canada and the Provinces use a combination sales and wages basis for allocating business income between the provinces" - op. cit. at p. 141.

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development and refinement have been hindered.

In that regard, Article 7 of the OECD Draft is especially disappointing in view of the fact that in 1946 the Fiscal Committee of the League of Nations made recommendations which had they been implemented would have reduced the uncertainty in this area. In the London and Mexico Model Tax Conventions - Commentary and Text [9] - that Committee proposed that the method of fractional apportionment should be imposed only in those circumstances in which other methods are inappropriate, that the apportionment should be limited to that portion of the income derived by the enterprise from the activities in which the establishment has taken part; and that in any event, the profits allocable to a permanent establishment should reflect the extent to which the activities of that establishment might be construed to have contributed to the earnings by the enterprise.[10]

The following example illustrates how these principles would operate to limit the area of uncertainty. Assume that two manufacturers are carrying on business in Nigeria through dependent agents supplied with stocks of merchandise. Assume that on behalf of one manufacturer the agent has "no authority" to conclude contracts and that his responsibilites are limited to the making of deliveries whenever ordered to do so by the

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9. League of Nations, Geneva, November 1946. C.88. M.88. 1946 11A. See especially Article VI of the protocol to the Model tax Conventions and the commentary thereon.

10. For a summary of these proposals see, Tax treaties between Developed And Developing Countries - Second Report 1970. U.N. Sales No. E.71 XVI. 2 at pp. 41, 42.

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manufacturer. Assume also that on behalf of the other manufacturer the agent actively solicits orders, organises advertising campaigns and sales promotions, supervises installations, negotiates and concludes contracts and so on. Under Article 3(3) of the Nigeria - U.K. Agreement (or OECD, Article 7(2)), neither manufacturer in this example would have very much idea of the amount of income to be allocated to the Nigerian permanent establishment. Certainly, any method of apportionment must take into account the very different extent to which the two manufacturers were in fact "carrying on business" in Nigeria.

As a contrast to that, however, under the allocation rules of the London and Mexico Draft Conventions the problem is considerably reduced. Insofar as the first manufacturer is concerned, the activities of the agent (arranging deliveries) have really contributed very little to its earnings and little if any, of the manufacturer's profits would be allocable to the Nigerian permanent establishment. Insofar as the second manufacturer is concerned, the activities of the agent have contributed very substantially to his earnings and most, if not all, of his selling profits would be allocable to Nigeria. The problem to be solved here would be determine the proportion of the manufacturer's total profit that represents a selling profit.[1]

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1. R. Alan Short op.cit. at p. 142. Our discussion above on the indirect method of profit allocation may be recalled here, especially as regards the source of a manufacturer's profit. Cf. Laycock v. Freeman [1939] 2 K.B.1; The Provincal Treasurer of Manitoba v. Wn Wrigley Junior Co. Ltd. [1945] Man R. 213; (Lal v. C.I.T. [1970] Vol. 79 I.T.R. (Indian Tax Reports) p. 147

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In these circumstances, the first two of the three methods of allocation noted above could be explored to determine if an accurate breakdown can be made between the profits attributable to the selling or distribution operations on the one hand and those attributable to the manufacturing and other functions on the other. And in the absence of any reliable basis for making such a breakdown, the Revenue authorities could fall back on a rough and ready method (e.g. by reasonable estimation).

Under the Mexico and London Conventions, the principal difficulty from the taxpayer's point of view would be to determine the factors making up the formula for "fractional apportionment" which would be acceptable to the various jurisdictions in which he maintained parent and permanent establishments. The truth is that no one factor or combination of factors is intrinsically more accurate than others. The appropriateness of a particular formula will depend on the factors adopted and the particular circumstance in which it is applied. To illustrate the point, while an apportionment of insurance profits based on the ratio of "local premiums" to "world premiums" may be appropriate, it may be entirely unsatisfactory to allocate the income of a manufacturer to an agency on the basis of sales. Assuming in the preceding example that all the sales of the foreign manufacturer were made through the Nigerian agent, and that profits are to be allocated in the proportion that Nigerian sales bear to total sales; then the entire income (including manufacturing income) would be allocated to the Nigerian permanent establishment. From this, it is quite obvious that it is inappropriate to apportion the profits of a manufacturer solely

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on the basis of sales.

It may be that a study of actual cases would indicate which combination of factors is most appropriate in apportioning a manufacturer's earnings. At least such a study should reveal those factors that are clearly not appropriate for the purpose. However, until that is done different countries will continue to use different formulae and the principal victim of the uncertainty will as usual be the taxpayer.

In a sense, it might be argued that the problems of allocation in the preceding discussion have been overstated and that the matter is of much diminished importance under the tax agreements since the taxpayer is usually assured of a reasonable treatment. Article 25 of the OECD Draft for example, sets out a "mutual agreement procedure" to be followed where difficulties arise in the application of the Convention. But the truth is that this procedure is cumbersome and expensive in practice. Very often the taxpayer will have paid tax in two jurisdictions on the same income and then will be put to the inconvenience and considerable legal and accounting expense in making representations first to the fiscal authorities of one country and then the other.[2] With luck, he may be able to obtain redress and eventually a refund.

Once more, it is regretted that the fiscal Committee of the OECD were unable to reduce the uncertainty relating to the allocation of income

2. R. Alan Short op. cit. at page 143. The "mutual agreement" and "exchange of information" procedures are examined in more detail in the next chapter.

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to agency permanent establishments. Certainty in this area is highly desirable because for many manufacturers the establishment of a sales agency is the first step into international trade.

E. Nigerian Law and the Attribution of Profits - An Appraisal

Before bringing our detailed discussion on the allocation of profits to a close, it is necessary to relate our observations more specifically to Nigeria.

Since 1968, the whole concept of permanent establishment and consequently the apportionment of income has become somewhat academic. Foreign companies hitherto allowed to operate in Nigeria through branches or other units must now conduct their activities through subsidiaries incorporated in the country.[3] With all companies (whether or not from a treaty country), obliged to file separate accounts[4] reflecting their profit or loss on a world basis,[5] detailed rules of profit allocation between parent and subsidiary companies are no longer necessary.

That notwithstanding, our observations in the foregoing discussion remain crucial in several respects. Although technically a separate and distinct legal entity, a subsidiary company incorporated in Nigeria may

3. Companies Decree 1968, Part X. See also our discussion in Chapter Three on the legal framework for economic activity in Nigeria.

4. Ibid., ss. 140 et seq.

5. Note that any company "managed and controlled" in Nigeria is liable on its global income. s. 18(1) CITA.

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deal with its parent company on a non-commercial basis.[6] In this circumstance, most of the rules of profit allocation discussed above would be useful because the relationship here would hardly be different from that of a parent company and its permanent establishment.

To cite another example, what is the position when a non-resident is trading in Nigeria through an agent or other similar intermediary? As a contrast to the clear and detailed rules governing subsidiaries, the precise method of profit allocation where an agent is acting on behalf of a foreign principal is obscure.[7]

Not much information about this is available anywhere and one even suspects that the overseas trader is probably not assessed to tax as required by law. Clearly, this is an area of tax law (or more accurately tax administration) that warrants further investigation.

The principles of profit allocation are useful for Nigeria in another respect. Namely, in the assessment of itinerant merchants, hawkers, pedlars and the like who may be deemed to constitute permanent establishments. The use of the reasonable estimate method of tax assessment is

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6. Our discussion on the "transfer price mechanism" in Chapter Five is relevant here. Also to be noted is the fact that management and other service fees are no longer deductible.

7. The basic Nigerian rule is that where an individual, agent etc. outside Nigeria carries on a trade or business of which only part of the operations are carried out in Nigeria, the gains or profits of the trade or business shall be deemed to be derived from Nigeria to the extent to which such gains or profits are not attributable to that part of the operation carried on outside Nigeria - s.5 ITMA; s.30 CITA as amended.

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advocated[8] since these category of persons are not likely to keep detailed books of accounts.

Whatever the impression created thus far, one thing must be borne in mind. viz. that the so-called rules of profit allocation have evolved through state practice without great reference to principle. In spite of the commonly used terminology, the techniques employed can scarcely be called "methods". It is quite obvious that the "direct method" contains elements of the "indirect method" and vice versa. Moreover, both "methods" work with the use of some estimation.

This scarcely satisfactory situation cannot be blamed entirely on tax authorities. The taxpayer is also at fault. Frequently, he fails to present the documents necessary for a correct apportionment of tax factors thereby leaving the Revenue with no choice but to base its assessment on assumptions.

Luckily, up till now, undue hardship has been avoided. All available evidence show that countries have behaved reasonably and have somehow managed to resolve problems arising from tax treaties.[9]

Finally, in relation to the arrangement for relief against double

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8. This should be simple enough to achieve because of the specific provisions under internal law. Where adequate records are lacking, the Revenue may assess and charge any taxpayer on "such fair and reasonable percentage of that part of the turnover of the business attributable to operations carried on in Nigeria" - ITMA s.5A(1)(b) as amended by the Income Tax (Amendment) Decree 1968, s.1. As regards companies s.30a CITMA as amended by s.2 of the Income Tax (Amendment) Decree 1968.

9. This is a conclusion which emerges from the General Report of Max Beat Ludwig op.cit. at p. 1/72. The dispute settlement procedures and other administrative matters are dealt with in the next chapter.

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taxation, one other consequence of compulsory incorporation in Nigeria may be noticed. viz. that foreign subsidiary companies are placed on the same footing as indigenous companies and so are assured of equal treatment.[10] Nigeria's tax treaties, therefore, need no extra provisons to guarantee a "most-favoured-nation treatment" or for "non-discrimination" as contained in the OECD Draft.[1]

F. Apportionment of Capital

Not much difficulty has arisen in this area because virtually all tax onventions give the right to tax income from immoveable property to the country of source, that is, the State in which the property producing the income is situated.[2] This "uniform practice in the Conventions is due to the fact that there is always a very close economic connection between the source of the income and the State of source".[3]

A most important feature of the OECD Draft is the wide definition of immoveable property to include "the right to work minerals .... and other natural resources",[4] so that consideration paid in respect of the

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10. This is, however, subject to the provisions of the Nigerian Enterprises Promotion Decree 1972 and the Pioneer Industries Decree 1971. These decrees positively discriminate against foreigners in an attempt to put a larger share of the Nigerian economy under the control of nationals.

1. OECD Article 24(4) - "The taxation on a permanent establishment which an enterprise of a contracting state has in the other Contracting State shall not be less favourably levied in that other state than the taxation levied on the enterprises of that other state carrying on the same activities......."

3 OECD Report 1963, Commentaries at page 78.

4. Article 6(2) OECD Draft.

2. E.g. OECD Article 6(1). Note that taxation may be on the gains from the alienation of capital or simply on capital accretion.

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same is taxable only the territory in which the property is situated. This approach is of particular significance to Nigeria, a country richly endowed with natural resources.

The revenue aspects of the exploitation of natural resources are fully considered in Chapter IX.[7a]

V. INVESTMENT INCOME

In Chapter Five, supra, the Nigerian Law in relation to "investment income" was analysed.[5] Under this head, we examine the applicable rules as modified by the provisions of the Tax Agreements.

A. Interest

The following matters relating to interest[6] are considered important: (1) the scope of interest under the Tax Conventions,[7] and the question whether interest on deferred payment of purchase price of machinery or goods should be treated differently from loan interest; (2) whether taxation in the source country should be on a net or gross basis; (3) which country or countries should have the primary right to tax interest; (4) which method should be used and to what extent should the country of residence relieve double taxation.

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5. Some aspects of double taxation were also examined.

6. The term"interest" is defined in the Nigeria - Norway Agreement to include interest on bonds, securities, notes, debentures or any other form of indebtedness. Article 7(2)(a)

7. Cf. As a matter of interest, in English Scottish and Australian Bank Ltd. v. C.O.T. 43 A.L.J.R. 234 it was held that "interest" in the U.K.-Australia Double Taxation Agreement is not limited to interest on "fixed capital", but in the case of a wholly owned subsidiary which is a bank included interest of moneys which are "circulating capital".

7a. Please see ABSTRACT and note at page 610.

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Whereas items (1) and (2) have been sufficiently dealt with in Chapter Five, items (3) and (4) warrant further comments.

In the Nigeria - Norway agreement where there is a specific provision as regards the taxation of interest payments,[8] jurisdiction to tax is reserved exclusively to the country in which the lender is resident.[9] The country of source is only permitted to levy taxes on any excess where an interest payment exceeds a "fair and reasonable consideration in respect of the indebtedness for which it is paid".[10] Precisely what amount of interest is "fair and reasonable" the Convention does not say, but this would probably be determined by reference to the prevailing interest rates in the open market or between parties who are acting at arm's length.

Considering the one way flow of interest payments from developing to developed countries, it is clear that the Nigerian treaty provisions are unsatisfactory. The truth as must be emphasized again is that the concept of reciprocity which underlies tax treaties between developed countries _inter se_ is not equally valid where contracting states are at different stages of economic development. When one remembers that Nigeria's treaties are in fact extensions of U.K. tax treaties with other developed countries the reasons for the present anomaly become evident.

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8. Some of the Nigerian Agreements contain no provision on the taxation of interest or royalty payments.

9. Article 7(1)

10. E.g. Nigeria - Norway Agreement Article 7(3)

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In the opinion of this writer a decision on which country or countries should have the right to levy taxes on interest must be based on compromise. Members from developing countries have often expressed the view that, in principle, the country of source (i.e. the place where the capital was put to work) should have the exclusive or at least the primary right to taxation. Developed countries on the other hand have argued that as a matter of principle the lender's country of residence (i.e. the place where the capital originated) should have the exclusive or primary right to taxation.[1]

As stated elsewhere in this study, both contentions are logically correct and legally arguable.

To some extent, the OECD Draft tries to deal with the problem. It gives the country of source the jurisdiction to levy a withholding tax of up to ten per cent on the gross amount of the interest paid, and by implication leaves the country of residence the jurisdiction to levy whatever amount of tax it thinks fit on the balance.[2] This general rule is however modified where the non-resident taxpayer has a permanent establishment in the source country "with which the debt claim from which the interest arises is effectively connected".[3] In this case, the interest is to be regarded as a "business income" and taxed in accordance with the provisions of article 7.[4]

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1. Tax Treaties between Developed and Developing Countries - First Report 1969. U.N. Sales No. E.69. XVI. 2. page 19, para. 89; Second Report 1970, U.N. Sales No. E.71 XVI. 2 page 17 paras. 98 - 105.

2. OECD Draft, Article 11(1),(2) read together.

3. Ibid., Article 11(4)

4. This is the article dealing with the taxation of "business income".

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It is our submission that the Nigerian Agreements must be modified so that there is a withholding tax by the country of source. To allow the treaties to stand as they are at present is nothing more than a unilateral revenue sacrifice by Nigeria. In fact, the surprising thing is that the status quo has persisted for so long.

One other matter of importance must be mentioned here. Where a company outside Nigeria grants a loan af at least £75,000 to a company incorporated in the country, the interest payable on such loan is totally exempt in the hands of the foreign company if the loan is not repayable by the borrower until after the expiration of a period of between five to ten years.[5] Any lender, whether or not from a treaty-country may benefit from this exemption.

But to what extent is this tax exemption passed on to the overseas lender? Or, is advantage simply taken of it by the Revenue authorities of the country of residence? The role of the "tax sparing credit" - a mechanism to ensure that tax benefits granted by the country of source are actually enjoyed by the overseas investor is examined in the next chapter.

On the question of relief methods generally, the developing countries prefer a tax exemption on interest payments in the country of residence. Alternatively, they prescribe a full credit in the country of residence regardless of the rate of tax actually levied in the source country. Most developed countries agree to give credit for the source country's tax

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5. See the provisions of Companies Income Tax (Amendment) (No.3) Decree 1971 - discussed above in Chapter V.

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provided that it does not exceed a reasonable level taking into account the net-gross principle discussed previously.

The mechanics of the principal methods of relief and their relative advantages are dealt with in the next chapter.

B. Royalties

Broadly speaking, the basic principles for the taxation of royalty[6] payments under the Nigerian Tax Agreements are similar to those applicable to interest. Consequently, most of our observations and comments on the latter category of receipts are valid in relation to the former.

Under the treaty provisions, exclusive jurisdiction on royality payments is reserved to the country of the licensor.[7] Furthermore, capital sums on the alienation of patent rights are only taxable in the country of residence, provided the taxpayer has no permanent establishment in the country of source.[8] The country of source is, however, allowed to levy tax on any excess royalty payments over and above what is considered "fair and reasonable".[9]

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6. This is defined to mean "any royalty or other amount paid as consideration for the use of, or the priviledge of using, any copyright, patent, design, secret process or formula, trade mark or other like property, but does not include any royalty or other amount paid in respect of the operation of a mine or quarry or of any other extraction of natural resources". e.g. Nigeria - Norway, Article 7(2)(b).
7. Nigeria - Norway Agreement Article 7(1)
8. Ibid., Article 7(4)
9. Ibid., Article 7(3)

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The OECD Draft follows this approach[10] and hence has been the subject of much criticism by developing countries.[1]

Again, like the position on interest payments, where the non-resident taxpayer has a permanent establishment in the country source with which the right or property giving rise to the royalties is effectively connected, the amount in question may be taxed as a "business income" in that country.[2]

Whilst acknowledging that a lot of development costs goes into the making of inventions etc., this writer is of the opinion that developing countries must be allowed to levy a modest withholding tax on gross royalty payments[3] which for example may be less than the forty per cent currently deductible under Nigeria's internal law. To allow a complete exemption at source on royalty payments is clearly unacceptable.

C. Dividends

Under the Nigeria - U.K. Agreement, dividends[4] paid out of taxed profits are exempted from any tax in the country of source provided that the non-

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10. Article 12

1. To cite just one example, Enrique P. Richard stated recently that "both from a theoretical and a practical point of view ..... royalties must be taxed in the country of their source". The taxation of this specie of payments in the licensor's home is considered by the author to be a secondary issue, "Treatment of Royalties in Tax Conventions Between Developed and Developing Countries" - (1973) Vol. 27 BIFD p. 407 et seq.

2. Nigeria - Norway Article 7(1), 7(4). This principle is spelt out more clearly in OECD Article 12(3).

3. The difficulty of determining the net-gross relationship of royalty payments has been highlighted already. Supra Chapter Five.

   The consensus of opinion at the third meeting of the Tax Experts is in agreement with our suggestions here. Tax Treaties Between Developed and Developing Countries - Third Report, 1972. U.N. Sales No. E.72 XVI. 4 page 23 para. 146.

4. The term "dividend" is not defined, but presumably will include all manner of company distribution whether of capital or income - Supra. Chapter Five.

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resident taxpayer is taxable in his own country, and provided further that he is not engaged in trade or business in the country of source.[5] And where a company receives business profits or income from abroad, dividends paid out of it are not taxable in the territory from which the business profits are derived.[6]

Compared with the Nigerian Treaties, the OECD Draft is preferable. Subject to a number of laid down conditions, the Model provides that dividends[7] may be taxed in the country of source.[8] Accordingly, a 5% tax on gross dividends may be levied in the country of source on international inter-company dividends. That is, where the recipient of the dividends is a company (excluding partnership) which holds at least 25 per cent of the capital of the company paying the dividend.[9] In all other cases a 15 per cent withholding tax may be levied.[10] The permitted tax in the source country is in addition to the tax on the company profits out which dividends are paid.

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5. Nigeria - U.K. Agreement Article 6(1)
6. Ibid., Article 6(2)
7. The term "dividend" is defined as income from shares, jouissance shares or jouissance rights, mining shares, founders' shares or other rights, not being debt claims, participating in profits as well as income from other corporate rights assimilated to income from shares by the taxation law of the state of which the company making the distribution is a resident. - OECD Article 10(3)
8. Ibid., Article 10(1)
9. Ibid., Article 10(2)(a)
10. Ibid., Article 10(2)(b)

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As is the case with interest and royalties, dividends are to be taxed qua "business income" where the taxpayer has a permanent establishment in the country of source "with which the holding by virtue of which the dividends are paid is effectively connected".[1]

Again, in view of the non-reciprocal flow of dividend payments, developing countries have often felt that as a matter of principle dividends should be taxed only by the country of source. If, however, both countries are given the right to tax, the investor's home country should, in their opinion, grant a full tax credit regardless of the amount of foreign tax to be absorbed, and in appropriate cases a "tax sparing credit."[2] This argument must be set against a counter one, viz subsidiaries in developing countries should be taxed only on their corporate profits without any further tax being levied on dividends paid to the principal companies. In other words, that no further tax should be levied on inter-company dividends.

Reviewing the subject of inter-company dividends paid by a subsidiary company in one country (source country) to a parent company in another country (residence country), the Tax Experts agreed[3] that considered as a jurisdictional matter, the country of source is in a position to assert a

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1. Ibid., Article 10(5)
2. Tax Treaties Between Developed and Developing Countries - First Report 1969. U.N. Sales No. E.69 XVI.2 p. 21 para. 98.
3. The Tax Experts reviewed the question of dividends generally at the meeting in 1972. Tax Treaties Between Developed and Developing Countries - Fourth Report 1972. U.N. Sales No. E.73 VI.1 page 12 et seq. especially at page 16 para 78 et seq.

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tax on the profits of the subsidiary and also on the dividends paid by it (usually a withholding tax), while the residence country is in a position to assert a tax on the dividends received by the parent, subject to any unilateral double taxation relief available.

It was recognised that source countries often claim an exclusive right to tax dividends, even when they realise that residence countries would nevertheless assert their claim to taxation. On the other hand, as was pointed out, residence countries sometimes forgo a tax on dividends on the theory that inter-company dividends should not be taxable whether they occur internally within a single country or externally between two countries.

The main problem as was rightly noted by the Tax Experts is the fact that withholding rates applied at source tended to be at significant levels, so that when coupled with the basic corporate tax rates the total effective tax rate in the source country on dividends turns out to be quite high. Clearly, such high effective rates coupled with full taxation in the residence country is a potential barrier to the international flow of investment capital.

What was contemplated by the Experts is a compromise solution considering that "private capital needed for economic development cannot be driven into the less developed countries" but must be attracted.[4] In the opinion of this writer, any withholding tax (i.e. in addition to tax on corporate profits) in the source country must be reasonable.[5]

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4. I.C.C. Statement on Double Taxation.

5. This submission is especially valid in the case "portfolio dividends".

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The taxation of dividends according to Nigeria's internal law has already been examined.[6] So far as is relevant to our present discussion the following points may be repeated. There is currently no withholding tax or dividends[7] and no tax on inter-company dividends where the payee or payor companies are resident in the country.[8] But while there is no withholding tax on exported inter- company dividends (i.e. from Nigerian subsidiaries to overseas parent companies), the tax treatment of imported intercompany dividends is obscure. (i.e. from overseas subsidiaries to Nigerian parent companies).

For our immediate purposes the crucial point to note is that the exemption granted to dividend payments pursuant to the Finance (Miscellaneous Taxation Provisions) Decree 1972 is applicable to all companies operating in Nigeria, foreign or local. Equally important is the fact that companies from treaty-countries are no more favourably treated than those from non-treaty countries. Whether or not the authorities intended this result is not entirely clear.

In any case, whatever was the intention, this writer is of the opinion that the present Nigerian law as regards dividends is extremely generous, even perhaps, too generous. But apart from that, it shows quite clearly that no extra advantages accrue to residents of treaty-countries

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6. Supra. Chapter Five.

7. s.34(2) CITA as amended by s.1(c) of the Finance (Miscellaneous Taxation Provisions) Decree 1972.

8. Ibid., s.34(3) CITA as amended by the 1972 law.

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and that little attention is paid to the role of tax treaties generally.

VI. THE TAXATION OF PERSONAL SERVICES AND CULTURAL EXCHANGE

A. Independent and Dependent Personal Services

Broadly speaking, a person resident in a treaty-country is exempt from Nigerian tax on profits or remuneration in respect of personal (including professional) services performed within Nigeria in any year of assessment provided the following conditions are fulfilled. Firstly, that he is present in Nigeria for a period or periods not exceeding a total of 183 days in that year.[9] Secondly, if the services are performed on behalf of a non-resident employer[10] and lastly, provided the profits or remuneration are liable to tax in the treaty-country.[1]

From the way the relevant sections of the Tax Agreements are drafted, the following observations may be made. viz for the exemption from Nigeria tax to operate must the three conditions above be fulfilled concurrently? In addition, since there is no clear distinction between dependent and independent personal services is it not true that some unintended consequences may arise? Assume, for instance, that an architect from a treaty-country is engaged in a project in Nigeria for a period of

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9. E.g. Nigeria - U.K. Agreement Article 9(1)(a).

10. Ibid., Article 9(1)(b)

1. Ibid., Article 9(1)(c)

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less than 183 days and that prima facie his income is liable to taxation in his own country, would he be liable to Nigeria tax simply because his services had not been performed "for, or on behalf" of an employer "in a treaty country"? We think not.

In order to avoid any absurdity, the Revenue in Nigeria is not interested in whether or not work is performed "for or on behalf of an overseas employer." The usual tendency has been to rely on one simple test - the duration of stay in the country.[2]

Subject to a number of conditions, the OECD Draft like the Nigerian Agreements adopts the principle that tax may be levied on income from personal services in the source country. For the sake of clarity, however, the Model Agreement goes a little further by drawing a distinction between independent personal services and dependent personal services. Thus, Article 14 of the OECD Draft is concerned with what are commonly known as "professional services"[3] including other independent services of a similar character. This excludes industrial and commercial activities and also professional services performed in an employment (e.g. an accountant working in a company).

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2. This is applied in conjunction with the source principle.

3. In the OECD Draft Article 14(2), the term "professional services" is said to include "independent scientific, literary, artistic educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants. Two points are worth noting here (a) That the article does not cover the performances of public entertainers and athletes working on their own account - Commentaries on OECD Draft at page 130; and (b) that in treaties with developing countries account must be taken of professions unknown to the Western World.

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The provisions of OECD Draft Article 14 are similar to those customarily adopted for the taxation of income from industrial or commercial activities. Liability on professional income depends on the existence of a "fixed base" in the country of source just as liability on "industrial or commercial" profit depends on the existence of a "permanent establishment".[4] However, unlike a "permanent establishment", it has not been thought appropriate to define a "fixed base", which on the analogy of the former would include, for instance, a doctor's consulting room, or the office of an architect or lawyer.

As a rule, a person performing professional services would probably not have premises of this kind in any other state than that of his residence. But if there is in another state a centre of activity of a "fixed or permanent character" then that state would be entitled to tax the persons activities.

Attractive as the OECD proposals are, they are not trouble free. The criterion prescribed for making professionals liable to tax on the availability of a "fixed base" is clearly unacceptable especially when one considers that tax may be levied only on so much of the income of the professional "as is attributable to that fixed base". Consider for instance a situation where a foreign professional is engaged in Nigeria on a project which does not require him to operate from a fixed base as may be the case with a land surveyor. Would he be able to escape tax simply because he does not operate from a "fixed base"?

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4. Article 14(1) compared with Article 5.

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In order to avoid any controversy, and more important still, to safeguard their own revenue interests, some developing countries have suggested a test for determining the tax liability of visiting professionals. Namely, that they should be liable on all income from the country of source without any reference to the duration of stay or the availability or otherwise of a "fixed base" in the source country. This, they stressed should be so, especially where the remuneration in question exceeds a certain amount.[5]

The submission[6] of the developing countries is supported by this writer bearing in mind past experiences in Nigeria whereby large sums of money have been earned tax free by visiting professionals from treaty countries. The usual excuse for non-taxation is on the basis that the duration of stay is less than 183 days - a condition precedent to liability under the tax agreements.

The first paragraph of Article 15 of the OECD Draft establishes the general rule as to the taxation of income from employment (other than pensions), namely that such income is taxable in the state where the employment is actually exercised. This general proposition is, however, subject to the three conditions laid down in the second paragraph. These conditions relate to employments of short duration abroad and are aimed mainly to facilitate the international movement of qualified personnel as in the case

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5. It is interesting to note that after much discussion the Ad Hoc Group of Tax Experts considered it desirable to maintain a distinction between dependent and independent services and in fact categorically accepted Article 15 concerning dependent personal service. <u>Tax Treaties between Developed and Developing Countries</u> - First Report 1969. U.N. Sales No. E.69 XVI.2 page 16, paras 76; page 17 para. 77

   Also, the consensus of opinion at the meeting was that professionals should be taxed on the basis of a "fixed base" in the host country or presence there for at least six months - page 16, para. 76.

6. <u>Ibid</u>., page 16 para. 70.

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of firms which sell capital goods and are responsible for installing or assembling them abroad.

To qualify for any exemption, it would appear that the three conditions prescribed in OECD Article 15(2) must be satisfied concurrently. Firstly, the duration of stay abroad must not be more than the 183 day period which is stipulated in the Mexico and London Model Conventions of the League of Nations.[7] Secondly, the employer paying the remuneration must not be a resident of the state in which the employment is exercised.[8] Thirdly, the exemption is granted on condition that the employer does not maintain a "fixed base" or "permanent establishment" in the source country to which the remuneration is attributable.[9] Apparently, where the employer has a "fixed base" or "permanent establishment" the profit from personal services would be taxable in the source country as "business income".[10]

The third paragraph of Article 15 relates to the remuneration of crews of ships or aircraft in international traffic or of boats engaged in inland waterways transport. The principle adopted here is in line with that applied to the income from shipping, inland waterways transport and air transport, i.e. to reserve the power to tax to the contracting state in which the "place of effective management" of the enterprise concerned is situated.

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7. OECD Article 15(2)(a)
8. Ibid., Article 15(2)(b)
9. Ibid., Article 15(2)(c)
10. For example, see the New Zealand Case No. 5 decided by the Board of Review 3 N.Z.T.B.R. p. 49. This case has been discussed above in other contexts.

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Whereas, this writer has urged that jurisdiction over shipping and air transport be shared between the country of source and the country of residence of the operator, a corresponding sharing of taxing powers in respect of the income of crewmen etc. is not considered necessary. It is our view that the administrative costs involved in assessing foreign crews to local taxation would greatly outweigh the advantages.[1]

B. Pensions

The Nigeria - U.K. Agreement as an example, draws a distinction between government pensions relating to civil service duties on one hand, and "commercial pensions" government or private, on the other.[2] Whereas, the former is taxable in the source country, the latter is categorically exempt.[3] The rationale or logic behind this dichotomy is difficult to discover especially when one remembers that "commercial pensions" are likely to be higher than "civil service" pensions.

Considering that pensions are consideration for past employment, this writer is of the opinion that they should be taxable in the country in which the services of the employment are performed. This submission is probably sensible in view of the fact that few Nigerians are deriving pensions from abroad in contrast to the hundreds of ex-colonial officers

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1. The Nigerian Agreements are silent in this respect.

2. Article 8 deals with governmental pensions in respect of civil service and other duties and Article 10 deals with private pensions.

3. Article 8(1) read in conjunction with Article 10(1). The OECD Model follows this approach. Cf. Articles 18 and 19 - where a distinction is drawn between governmental and other pensions.

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deriving pensions from the country. To allow the present anomaly to persist is to leave the current unilateral revenue sacrifice unchecked.

Regrettably, the U.N. Group of Tax Experts have not yet examined the question of pensions and surprisingly very little has been written on the subject in recent years. This may be attributable to two factors. (1) The breakdown of the old colonial set up, and (2) the fact that the present day transfer of skilled personnel are arranged through the auspices of the various international agencies.

C. Cultural Visitors - Artistes, Athletes etc.

In accordance with the long established international practice, the Nigerian treaties provide that the profits of cultural visitors are taxable in the country of source without reference to the duration of stay.[4] As a consequence of this, one problem already alluded to must be mentioned again. That is, the classification of profits of companies providing personal services. For example, where artistes and public entertainers perform their services as employees of corporations owned by themselves or others what is the legal position?

The technical question arising here is as follows: Can the corporation rendering the personal services escape tax in the country of source on the grounds that it has no "permanent establishment" in that country to

4. E.g. Nigeria - U.K. Agreement Article 9(3). The OECD Article 17 is more explicit here. It provides inter-alia that "income derived by public entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting state in which these activities are exercised".

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which its profits are attributable? This, we may recall, was one of the arguments which arose in a New Zealand case to which we have already referred.[5]

To avoid any problems in future, it has been suggested,[6] and we think rightly too, that the OECD Draft provisions be amended so that:

> "income derived by public entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by others, from their personal activities as such, or income derived from the furnishing by an enterprise of the services of such public entertainers or athletes may be taxed in the contracting state in which these activities or services are exercised".[7]

It is submitted that the Nigerian Agreements be amended along the above lines.

D. Visiting Scholars, Students and Apprentices

The remuneration derived by a visiting professor or teacher from a treaty country during a period of temporary residence (not excedding two years) in Nigeria is exempted from the country's taxation.[8]

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5. Case No. 5, 3 N.Z.T.B.R. p. 49. Supra.

6. Tax treaties between Developed and Developing Countries -Second Report 1970, U.N. Sales No. E.71. XVI. 2 pages 11, 12, paras. 57 - 61.

7. This paragraph would represent an amendment to the present Article 17 of the OECD Draft. Emphasis supplied in the last four lines. Second Report U.N. Experts page 12 para. 61.

8. E.g. Nigeria - U.K. Agreement Article 11.

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As a developing country, this provision is of great benefit bearing in mind the need to attract and retain the services of international scholars who are in short supply all over the world.[9] Even though it would appear that the non-taxation of these persons is another unilateral revenue sacrifice by Nigeria, yet, it is believed that the disadvantage is offset by the benefit which the country derives from the services of these persons.

As a matter of fact, it is suggested that all visiting scholars be exempted from Nigerian taxation whether or not from a treaty country. This is to avoid the kind of incident which came to light recently whereby certain professors from the Irish Republic (no treaty with Nigeria) were held liable to local taxation while their English colleagues were exempted.

Similar to the provisions governing scholars, students and business apprentices from treaty countries are exempted from taxation on their stipends especially where such funds are remitted from abroad.[10] This is quite reasonable tn view of the fact that maintenance allowances would invariably be paid out of funds which have already been taxed.

E. Directors' fees

The OECD Draft Article 16 relates to the remuneration received by a resident of a contracting state whether an individual or a legal person, in the capacity of a member of a board of directors of a company which is a

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9. It is interesting to note that the OECD Draft has no specific provision on teachers and professors. This may be so because of the less acute need of developed countries to attract professors and teachers from abroad.

10. E.g. Nigeria - U.K. Article 12.

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resident of the other Contracting State. Since it might sometimes be difficult to ascertain where the services are performed[1] the provision treats the services as performed in the country of residence of the company.

The Nigerian treaties contain no specific provision relating to directors, but on the theory that all companies incorporated in the country are resident therein the OECD approach is recommended.

I. CONCLUSION

Whereas, a general appraisal of Nigeria's double taxation agreements has been deferred till the next chapter, it has been thought necessary to reiterate some of our more salient observations thus far.

The Nigerian treaties as a legacy of its colonial past, retain the traditional concept of a permanent establishment. This was criticised as "narrow", failing as it does to reflect sufficiently the de facto economic situation prevailing in a developing country. Our submission was that the criteria of "presence" should be as wide as possible especially if it was to find acceptance among countries that have adopted the principle of liability on all "source" income.

As a consequence of the above, a stricter test was prescribed before allowing exclusions from the concept of a permanent establishment. Thus, purchasing offices and other "fixed places" for "preparatory or auxillary" activities were to be deemed to be permanent establishments depending on the precise use to which they are put. But as was acknowledged, in practice, drawing a distinction between a trading centre and a mere distribution point

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1. The difficult question of the source of a director's income has been considered already. Supra. Chapter IV.

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would not always be easy as this often would be a matter of degree.

The usual exemption of construction sites of limited duration from the concept of a permanent establishment was considered unacceptable. Instead, it was suggested that a building site be deemed to constitute a permanent establishment of a foreign enterprise irrespective of the duration of its existence. In addition we took the view that Nigeria's new tax treaties have to provide for taxation solely on the grounds that machines are used in the country by a foreign enterprise; or, in situations where a foreign enterprise carries out supervisory functions at a construction site. Similarly, installation charges are to be taxable once above a certain amount (e.g. above 10% of the value of the equipment purchased).

The distinction in Nigeria's treaties, like others, between dependent and independent agents was found to be tenuous and rather legalistic. Our suggestion was that persons who may be deemed to constitute permanent establishments should not be limited to those who are dependent simply from a legal point of view but must be extended to cover those who are dependent from an economic point of view.

The special case of the insurance agent was gone into and our conclusion was that taxation in the country in which premiums are collected is desirable.

Considering the application of the concept of a permanent establishment to carrier enterprises, the principle of taxation in the country of residence was rejected. In its place, the principle of revenue-sharing was advocated bearing in mind that the majority of ships and aircraft coming and going to

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treaty-countries are foreign owned. The resultant revenue flow from the developing to the developed countries was clearly unacceptable. As a contrast to this however, the principle of taxation in the country of residence was thought desirable in the ~~country of residence in the~~ case of road haulage transport. In this situation, there is a reciprocal flow of payments between Nigeria and her West African treaty partners.

The scope of "business profits" was probed in considerable detail. The "effectively connected with" principle in Nigeria's tax treaties was considered suspect even though it is now generally favoured after its endorsement by the OECD Draft. On balance, the "force of attraction doctrine" is preferred for Nigeria and, indeed, for developing countries generally.

In examining the ambit of the expression "industrial or commercial profits", our view as supported by several authorities is that the expression must be interpreted in the widest possible sense just as must the "permanent establishment" concept to which it relates. As a consequence, therefore, the expression would include income from businesses like "mining", "farming", "pastoral enterprises", "the leasing of machines", "banking", "insurance", and the rendition of "personal services".[2] The overriding test has to be whether or not they are attributable to a permanent establishment.

Problems of computation and profit allocation (i.e. between a parent establishment and its permanent establishment) were discussed extensively. Three methods of profit allocation were highlighted. Firstly, the Direct Accountancy method whereby profits are allocated on the basis of the records

2. i.e. when rendered by a corporation.

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of the permanent establishment which for this purpose is regarded as a distinct and separate entity from the parent enterprise of which it is a part. But as was illustrated in this chapter, not only is this approach contrary to the principles of commercial law, it also fails to solve the problems which arise when related entities deal with each other on a preferential basis. The following special cases were looked into. The intra-company transfer of goods and services and the question of valuation; intra-company loans and the tax treatment of interest and royalty payments; management and other expenses; and the tax treatment of group losses.

The second method of profit allocation considered was the "indirect method", the great merit of which is that it is compatible with the principles and practice of commercial law. This method starts out from the company's total profits and attributes to the states in which are located the parent and permanent establishments a part thereof for tax purposes. Inherent in the system are a number of disadvantages which were pointed out. For example, the difficulty of ascertaining "total profits", and of fixing an apportionment index especially where the various units of an enterprise are engaged in different activities.

The third method of allocation allowed under the tax treaties is the use of "reasonable estimation". Crude as this method is, it is thought to be of great significance for developing countries often lacking in skilled personnel and where the majority of traders are unlikely to be able to keep proper books of accounts. The danger of arbitrary assessment and abuse was, however, acknowledged.

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Attention was focussed on two special cases of considerable difficulty as regards profit allocation. (a) The allocation of profits of carrier enterprises and (b) the allocation of income from sales agencies. In the case of the former, it was suggested that attribution may be on a fifty-fifty basis or on a percentage of gross freight; whereas in the case of the latter, what was proposed was a method of "fractional apportionment" to reflect the extent to which the activities of a sales agency permanent establishment might be construed to have contributed to the overall earnings of the enterprise. In other words, apportionment is to be in accordance with the intensity of an agent's activity in the host country.

Relating the concept of a permanent establishment and the problems of profit allocation more specifically to Nigeria, we made the following observations: (1) That, since 1968 the whole concept of a permanent establishment and consequently the apportionment of income has become somewhat academic. This is because companies are no longer allowed to operate in the country as branches but must now be incorporated as subsidiaries which must file separate accounts. (2) That notwithstanding, most of our discussion on profit allocation was nevertheless considered important because Nigerian subsidiaries tend to deal with their parent companies on a non-commercial basis with all that that implies. (3) But particularly relevant to Nigeria, was our discussion of the legal problems in instances where a non-resident is trading in the country through an agent or other similar intermediary; or, as regards the assessment of itinerant merchants, hawkers, petty traders etc., who may sometimes constitute permanent establishments.

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Having regard to the one-way flow of "investment income", (i.e. interest, dividends and royalty payments), from the developing to the developed countries, our conclusion was that these should be taxable in the country of source. However, as was pointed out, withholding taxes should be modest in order to take into account development costs and other expenses incurred by the taxpayer. This is so especially in the case of royalty payments.

The OECD approach which favours the taxation of "investment income" in the country of residence was thought to be clearly unacceptable in treaties between developed and developing countries.

The treatment of other categories of income under the tax treaties were also considered. (1) As regards personal services, whether dependent or independent, the test favoured was liability on all "source" income without much regard to the duration of stay or to the maintenance of a "fixed base" in the host country. (2) The same stand (i.e. liability on all source income) was taken on pensions, and the remuneration of artistes and other cultural visitors. (3) As for director's fees these were to be taxable at the place of residence of the company irrespective of where the functions of management are exercised.

While this chapter has been devoted to a thorough examination of a number of technical problems concerning the treatment of various species of income, the next chapter is devoted to procedural matters which are no less daunting.

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CHAPTER EIGHT

DOUBLE TAXATION (III)

METHODS OF RELIEF, EXCHANGE OF INFORMATION AND OTHER ISSUES

I. INTRODUCTION

In this chapter, we examine the various methods of relief against double taxation and seek to discover which is more suitable in tax treaties between developed and developing countries. In this regard, the function and significance of the "tax-sparing credit" - a comparatively recent innovation - is explored.

Attention is focussed on the machinery for administering the tax treaties; notably, the provisions for the exchange of information, the mutual agreement procedure, the arrangements for the settlement of disputes and other procedural matters.

Finally, a general appraisal of Nigeria's tax treaties is attempted basing our conclusion on findings in this and the two other preceding chapters.

II. METHODS OF RELIEF

A. General Principles - No Relief without Double Taxation

One matter of fundamental importance may be noticed here. Namely, the fact that there can be no relief from double taxation unless double taxation is imminent or has actually taken place. In other words, for purposes of

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relief, the mere possibility of double taxation per se is not sufficient.[1]

The kind of problem envisaged, arose recently in the Australian case of Emanuel v. Federal Commissioner of Taxation.[2] In that case, a U.K. taxpayer was in receipt of dividends from an Australian company. He was not engaged in business in Australia and although resident in the U.K., was not domiciled in the country. The consequence of the latter fact was that any income tax liability which he might have in respect of the "income arising from possessions out of the United Kingdom" [3] only arose in respect of income as was remitted to the United Kingdom.

The dividends in question were paid in Australia to an agent of the taxpayer but were not remitted to the United Kingdom.

In these circumstances, the Court (Windeyer, J.), had to consider whether the taxpayer came within the terms of the provision whereunder the Australian tax liability of the taxpayer, as a United Kingdom resident in receipt of dividends from an Australian source was limited to one half of the tax rate of 30 per cent.[4] This provision appears in Article VI(3) of the Double Taxation Agreement between the United Kingdom and Australia.[5]

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1. Thus, a given specie of income must also be technically subject to double taxation in two countries before any relief can be given. Cf. C.I.T. v. Carew & Co. Ltd. [1973]Vol. 87. I.T.R. (i.e. Indian Tax Reports) p. 459 S.C. It may also be noted here that the manner of payment or assessment of tax is irrelevant. In C.I.T. v. Clive Insurance Co. Ltd. [1972] 85 I.T.R. p. 531 the Supreme Court of India held that for the purposes of relief against double taxation, tax deducted at source is the same as tax paid.
2. [1968]10 A.I.T.R.. (H.C.) (Australia)
3. I.T.A. (1952), s.132 (Schedule D, Cases IV and V).
4. Income Tax and Social Services Contribution (Non-Resident Dividends) Act 1959, s.6.
5. S.R. and O. 1947, No. 806 replaced in 1968 by a new agreement (S.I. 1968, No. 305) which does not contain the article discussed, post, but see article 8 therein which has the same consequence in simple terms.

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The sole point for decision[6] was the meaning of the phrase:

> "..... any dividend the whole or part of which is paid out of profits derived from sources in Australia to a United Kingdom resident who is subject to a United Kingdom tax in respect thereof ...."

Windeyer, J's conclusion was that the taxpayer could only benefit from the limitation of 15 per cent on the Australian tax if, as a United Kingdom resident not domiciled there, he remitted his Australian dividends to the United Kingdom. Since the dividends in question remained with his agent in Australia, the full 30 per cent rate was payable. In other words, since there was no liability to United Kingdom tax, there could be no question of relief for double taxation on the dividends. The taxpayer was subject to Australian tax only and had to bear that tax in full.

Although the terms of the 1968 treaty provisions are different, there can be no doubt that the above decision is significant in that it underlines a fundamental principle which must always be applicable <u>viz</u>. That there can be no relief without double taxation.

In connection with our present discussion, we may also refer to the *Indian case of <u>C.I.T.</u> v. <u>Carew and Co. Ltd</u>.*[7] *In that case, it was held* that in determining the question of relief under the tax agreement (i.e. between India and Pakistan) that the assesser's agricultural income in Pakistan had to be kept out of his business profits because agricultural income was not liable to tax in Pakistan even though it was taxable in India.

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6. Since the taxpayer was not engaged in trade or business in Australia through a permanent establishment.

7. [1973] Vol. 87, I.T.R. (S.C.)

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Stated differently, this simply means that double taxation relief is available only when a specie of income is taxable in two countries.

Another important principle governing the granting of relief may be mentioned. i.e. that in determing the quantum of relief all the provisions of the charging statute must be taken into consideration. That is to say that relief can only be granted on the taxpayer's "net liability" and not on "gross liability." The point we are making, although fairly obvious, did actually arise in a case decided by the High Court of Madras recently. Thus, in O.A.P. Andiappan v. C.I.T. (Madras),[8] where a taxpayer resident in India was also taxed in Ceylon as if he were resident on account of his business activities in that country; the problem that faced the Court was to determine the quantum of tax abatement in India pursuant to the double taxation agreement between the two countries.

The Court held that in computing the taxpayer's liability in Ceylon, the charging sections had to be read in conjunction with the provisions granting him exemptions and personal allowances.

Finally, dwelling on the general principles governing the availability of relief, it is worthwhile to note that where a double taxation agreement is in existence relief may be granted for the tax payable in two countries on the same income without regard to the period to which it relates. In other words, in determining whether or not relief should be granted, the measure (i.e. basis of assessment) by which the income in question is computed is not the crucial factor but, rather, the simple fact that tax is payable twice on the same income.

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8. (1971) 82 I.T.R. page 876

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In Duckering v. Gollan[9] for instance, the question facing the court was the identification of the "chargeable income" against which relief from U.K. tax was to be granted. Until the year 1957-58 New Zealand income tax was charged on the income of the year preceding the year of assessment. By section four of the New Zealand Income Tax Assessment Act 1957 income tax became chargeable on the income arising in the year of assessment (i.e. on a current year basis). The U.K. tax under Cases IV and V of Schedule D was at all material times chargeable on income arising during the year preceding the year of assessment.

The respondent who was resident in the United Kingdom, derived income from sources in New Zealand and in 1958-1959 he paid £1,033. 9s. 6d as New Zealand income tax. He claimed relief against United Kingdom tax for that year under Article XIV of the Double Taxation Relief (Taxes on Income)(New Zealand) Order 1947. That relief was refused on the ground that the United Kingdom assessment was based on income arising in 1957-58 which had not, in fact, been taxed in New Zealand. The respondent's appeal was allowed by the Special Commissioners who held that the New Zealand tax which he had paid for 1958-59 was paid "in respect of" the same income as that on which the United Kingdom was claimed.

On appeal by the Crown to the House of Lords, it was held dismissing the appeal that Article XIV on its true construction referred to the chargeable income, that is, the income assessable in respect of any year, rather than to the measure by which such income was computed. Furthermore, the Court held that although the basis of assessment to New Zealand income tax

9. [1965] 1 W.L.R. 680

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was changed, the respondent was not thereby relieved of liability to pay New Zealand tax in any year; and that having, in fact, paid tax in 1957 - 58 and also in 1958-59, he was entitled by virtue of Article XIV(1) to a credit against United Kingdom tax in respect of the amount of tax paid in New Zealand.

B. The Exemption Method and the Credit Method

A study of international agreements, including the OECD Draft, show that two leading principles are followed for the avoidance of double taxation. That is, the "exemption method" and the "tax credit method".

For the purposes of simplicity only income tax is referred to in what follows but the principles apply similarly to capital tax.

(i) The Exemption System - This system implies that the state to which a convention has not given the right to tax a certain income shall leave out that income when determining the amount which is chargeable to income tax in that state.[10]

The Exemption Method is usually found in two different forms: (a) the income in question may be left out altogether, so that the state concerned

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10. As may be recalled, one of the functions of a tax treaty is to settle the question of jurisdiction over certain categories of income between two states.

In this context it is relevant to refer to the I.C.C. resolution of 1955 which concluded inter-alia that the country of origin, that is, the country from which the income is derived has the sole right to tax the income. That the problem of double taxation arises from the claim of the country of residence to tax income of foreign origin. Thirdly, that the only sure method of avoiding double taxation is for the country of residence to exempt foreign income from any proportional or progressive tax. See Pamphlet No. 180: Avoidance of Double Taxation: Exemption Versus Credit Method - Resolution of the I.C.C. Council and Report of Commission on Taxation. February, 1955.

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is not entitled to take that income into consideration when determining the rate of tax to be imposed on the rest of the income. For short, this method is referred to as "full exemption". (b) The income in question is left out, but the state concerned retains the right to take that income into consideration when determining the rate of tax to be imposed on the rest of the income. This method is often referred to as "exemption with progression".

Where the exemption system is adopted in a convention and the state of residence is not given the right to tax, it normally follows the form described under (b).

(ii) The Tax Credit System - The adoption of this system implies that the state applying it imposes tax on the basis of the taxpayer's total income including income from another state, and then allows a deduction from its own tax for the tax paid in that other state.[1]

The credit system may also take different forms. (a) The deduction given by the state of residence may be restricted so that the deduction does not exceed that part of its own tax appropriate to the income from the other state. Hereinafter this method is referred to as the "ordinary credit" method. (b) In some forms of the credit system, the state of residence allows a deduction of the total amount of tax paid in the state of source. This is a method which may for short be referred to as the "full credit" method. (c) Further variations of the credit system are possible e.g. where the state of residence limits the deduction to an amount not

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1. For a detailed review of the application of the tax credit system in two developed countries. See R.M. Hammer, "The Foreign Tax Credit in the United States and the United Kingdom" - 1973 B.T.R. p. 107. This article reveals the degree of refinement of the tax credit system over the years.

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exceeding the tax which it would itself have imposed on that income if the taxpayer had no other income. (d) A more recent innovation is the credit for underlying tax, otherwise referred to as the "indirect tax credit".[2] In the newer treaties of the U.K. and the U.S.A. for example, a domestic corporation which owns a given percentage of the voting stock of a corporation from which it receives dividends may claim a foreign tax credit for taxes paid abroad on the income out of which such dividends are paid.

Whilst avoiding arithmetical calculations,[3] we may sum up the differences between the two systems of relief against double taxation as follows: "the exemption system looks at income whereas the credit system looks at the tax on income".[4]

C. Relief Under Nigeria's Tax Treaties

Except in the specific cases where the exemption of income is provided for,[5] the usual method in Nigeria's tax treaties for the elimination of double taxation is the credit method. In other words, credit is given for taxes paid in the source country.[6] Apparently, what is required is that credit should be given only for the tax actually paid and not for the tax

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2. Ibid., especially at pp. 109, 122.

3. Commentaries on OECD Draft at pp. 142-145. An arithmetical illustration of the functions and effects of the two systems is given in the pages mentioned. For further arithmetical illustrations see Double Taxation Relief - I.R.6 (1969) at pp. 10 et seq. Pamphlet issued by U.K. Revenue.

4. Commentaries on OECD Draft at p. 142.

5. For example, in the U.K. - Nigeria Agreement, interest, royalties and dividends are specifically exempted from tax in the source country. Cf. Articles VI and VII.

6. E.g. Nigeria - U.K., Article 13; Nigeria - Norway Article 16.

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"spared" or waived.[7]

The OECD Draft provide for the elimination of double taxation by one of two methods, the Exemption Method as contained in Article 23A and the Credit Method as contained in Article 23B. On a close reading of the texts, it is the opinion of this writer that the provisions though suitable in treaties between developed countries, are unsuitable where a tax treaty is between a developed and a developing country.

It can be argued that in the present form Articles 23A and 23B place the onus of avoiding double taxation on the contracting state in which the owner of the income or capital is resident. Where both contracting states are developed, it may be fairly assumed that in the long run the OECD approach gives neither of them any decided advantage nor does it result in any real disadvantage as far as their revenues are concerned. Where, however, one of the contracting states is a developing country, that approach is inappropriate. This is because persons owning income or capital which is taxed in that state are often residents of that contracting state which is a developed country.

The position then may be looked at in this way: How can an investor in a developed country be relieved from double taxation when he has paid taxes abroad and how can he enjoy the benefits of the taxes spared in the source country? Stated differently, this means that not only must the methods for eliminating double taxation leave the tax benefits granted by developing countries in the hands of the investor, but these methods must in themselves constitute an incentive - for herein lies one of the principal objectives of the tax treaty.

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7. The significance of the "tax-sparing credit" is considered presently.

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In view of the above, it is proposed that relief against double taxation should be granted along the following lines: (1) In general, full exemption should be available in the country of residence.[8] (2) Where the convention specifically allocates the power to tax between contracting parties as in the case of dividends, interest and royalties then the developed countries should apply the full credit method. (3) The principle of "tax-sparing" should now be formally incorporated into conventions where the contracting parties are a developed and developing country. This would ensure that the tax benefits granted in the latter, are actually enjoyed by the persons to whom they are granted and not taken over by the tax authority of the place where he is resident.

As might be expected, the practical application of provisions in tax treaties granting an exemption or a tax credit has not always been easy.

A case which clearly highlights these difficulties is Bowater Corporation Ltd. v. Murgatroyd[9] which went all the way to the House of Lords. In that case, the appellant company, a United Kingdom resident, with a subsidiary resident in Canada was entitled under the relevant double taxation agreement to a credit against U.K. tax in respect of the United States and Canadian taxes paid on the profits of the subsidiaries in North America (U.S. and Canada), the equity shares in which were all held by the Canadian subsidiary (Bowater North America).

In terms of the U.K. law,[10] the U.S. and Canadian taxes to be taken into

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9. (1969) 3 W.L.R. p. 412. This case is reviewed by L. Lazar in the 1969 A.S.C.L. at p. 605 et seq.

10. Income Tax Act 1952, Schedule 16, para. 9.

8. As indicated already, the I.C.C. is wholly in favour of the exemption method.

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account in computing this credit were the taxes borne on "the relevant profits" of the company concerned. In computing their profits liable to Canadian or U.S. taxes, the various subsidiaries deducted the depreciation allowances made to them under the relevant tax laws. These allowances differed from the provision for depreciation made in the respective company accounts.[1] In the result the account profits were not so low as the adjusted profits for tax purposes (which would not have been commercially true).

The appellant company contended that "relevant profits" meant profits as computed for the purposes of foreign taxes; alternatively, that the dividends paid by Bowater North America should be deemed to be paid out of taxed profits (and not rateably out of taxed and untaxed profits). For the Revenue it was contended, successfully, that the phrase meant the gross divisible profits, namely, those shown in the accounts after deducting the depreciation which it was proper to make. In other words, the sole dispute between the parties was as to the calculation of the "relevant profits".[2]

Briefly, the basis of the decision of the Special Commissioners, and of Cross, J. in the Chancery Division, was that on a proper reading of the provisions, whether dividends are paid for a specified period or out of

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1. For example, one subsidiary depreciated certain fixed assets on a straight-line basis and the rate to which it was entitled was twice that used in its accounts. Further, the Canadian subsidiaries computed on a straight-line basis for accounts purposes and on a reducing - balance basis for tax.

2. There was agreement that it was necessary to construct a fraction and to apply it to the foreign tax paid, that the numerator of the fraction was the dividend in question, and that the denominator was the "relevant profits" as reduced by the foreign tax. See Lord Wilberforce [1969] 3 W.L.R. at 423.

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specified profits, the "relevant profits" were those available for distribution as shown by the accounts; furthermore, that in the case of a dividend paid neither for a specified period nor out of specified profits, the "relevant profits" were those of the last period for which the accounts of the body corporate were made up before the dividend became payable.

These views were later confirmed by the Court of Appeal and by the House of Lords.

One other case which also brings home quite clearly the complexities of applying the provisions of double taxation agreements in relation to internal law is the Canadian case of Interprovincial Pipeline Co. v. M.N.R.[3] In that case, the sole question was how the calculation of the foreign tax deduction was to be made. This result depended on the effect of an amendment of the law in 1960[4] subsequent to an earlier decision regarding such calculation.[5]

Interprovincial owned and operated a pipeline in Canada, with a connecting link in the United States which was owned and operated by the Lakehead Company, a wholly owned subsidiary of Interprovincial. The latter company raised all the money to construct those lines and lent the money to Lakehead taking bonds in return. In 1960, Interprovincial received interest on

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3. (1968) 67 D.L.R. (2nd) 753 (S.C.) Canada. This case is reviewed by L. Lazar in (1968) A.S.C.L. p. 603.

4. Income Tax Act R.S.C. 1952, c. 148, s. 41. The amendment in 1960, c.43 s.33(3) repeals s. 139(1)(az) and substitutes a new s.139(1)(a) and (b).

5. Interprovincial Pipe Line Co. v. M.N.R. 1959 20 D.L.R. (2nd) 97; (1959) Vol. 37 Canadian Bar Review p. 625

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those bonds of approximately $ 2.42 million from Lakehead, but the cost of borrowed money used to acquire the Lakehead bonds was approximately $ 2.36 million. The net surplus was about 57,000 dollars (say $ 0,057 million). The amount of $ 2.42 million was not an actual receipt by Interprovincial in 1960 in that about $ 0.36 million was remitted by Lakehead to the U.S. government, the fifteen per cent withholding tax of the latter country. However, Interprovincial in computing its Canadian income tax included the full $ 2.36 million interest it paid; Lakehead, in computing its income for U.S. tax, deducted the $2.42 million interest paid to Interprovincial.

Interprovincial was allowed a deduction for interest on borrowed money, including the interest on the $ 2.36 million borrowed to acquire the Lakehead bonds. What remained was what was to be done about the withholding tax of about $ 0.36 million paid to the U.S. The earlier decision (1959) had held that this sum was available as a tax credit in respect of foreign tax paid on a gross basis on receipts of an income nature, whether or not those receipts after deduction of expenses incurred to earn them, resulted in a net profit when brought into the computation of the taxpayer's overall taxable income. That decision also held (1) that there was no authority for splitting up the income of the business of the taxpayer, and (2) that the income of the business to be determined in order to ascertain what was the taxable income was the entire income of the appellant taxpayer and not that income split up into parts according to the situs of the source of that income.

Interprovincial still submitted that the full $ 0.36 million U.S. with-

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holding tax was deductible[6] on the basis that its gross income of $ 2.42 million from U.S. source, unreduced by the Canadian interest paid, was to be taken into account. The Minister submitted that the amended section[7] contained a mandatory direction that the total interest ($. 4.55 million approximately) was to be broken up and related to the various sources of Interprovincial's income in computing income from various sources for the purpose of the deduction[8] of interest on borrowed money claimed.[9] The court accepted the Minister's submission. Thus, the U.S. income of Interprovincial had, first, to be segregated. That income was not a gross amount of $ 2.42 million but a net amount of $ 0.057 million (after deducting the interest expense paid of $ 2.36 million in Canada). This amount of $ 0.057 million was the foreign tax credit allowable in terms of the amended section.

Interprovincial raised a second point as an alternative argument; namely, that the terms of Article XV[1] of the U.S. - Canada Double Taxation Convention prevented the application of the provision of the Canadian Act as just outlined, so that the Minister could not deny the taxpayer the full deduction of foreign taxes paid. The Court upheld the view expressed in the Exchequer

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7. s.139 (1)(b) - infra.

8. s.41. This section enabled the taxpayer to deduct from the tax payable an amount equal to the lesser of the two sums: (a) any income or profits taxes paid to a foreign government, or (b) that proportion of the tax that (i) the taxpayer's income from sources in that foreign country are of (ii) the taxpayer's income for the year.

9. Section 11(1)(c).

10. Section 139(1)(b) in the amended provision provided: "In applying sub. s.(1)(a) for the purposes of .... s.41, all deductions allowed in computing the income of a taxpayer .... shall be deemed to be applicable either wholly or in part to a particular source or to source in a particular place".

1. Article XV: "1. As far as may be in accordance with the provisions of the Income Tax Act, Canada agrees to allow as a deduction from the Dominion income .... which was derived from sources within the U.S. and was there taxed, the appropriate amount of such taxes paid to the U.S." A similar para. 2 embodied the U.S. undertaking to like effect.

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Court that the effect of the Article was to establish a mutual covenant to apply as between each country whatever foreign tax credit provision the respective domestic laws of each country might from time to time adopt. This covenant did not require any alteration in the appellant's rights as determined by the interaction of subsections 41 and 139(1)(a) and (1)(b) discussed above.

What conclusions may be drawn from our discussion thus far?

In the opinion of this writer, it would seem that no particular method of relief is suitable for a developing country per se. Much would always depend on the allocation of taxing powers under the conventions. Where there is a reciprocal flow of investments and the rates of taxes in the territories of the contracting parties are comparable, the exemption method is preferred. Alternatively, the full credit method may be acceptable where the investor's country of residence is willing to give credit to the full extent to the taxes paid at source.

In practice, however, the developed countries have tended to favour the credit method usually fixing the level of credit allowable for taxes paid in the source country to the level of taxes in its own territory. What must be emphasized in this context is the argument of several of these countries that to grant a full exemption or a full credit for the taxes paid at source would not only encourage the source countries to levy very high rates of taxes, but would amount to an erosion of their own taxing jurisdiction.

Relating the above discussion specifically to Nigeria, it is our view that a re-allocation of taxing jurisdiction under the treaties is imperative.

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To be more precise, dividends, interest, royalties, shipping and aircraft profits should be taxable in the country of source, with a full tax credit granted in the country of residence. The present situation whereby they are exempted from taxation in the country of source is clearly unsatisfactory - especially when one recalls the non-reciprocal flow of these specie of payments between Nigeria and her treaty partners.

D. Unilateral Relief

A convenient point to start is to re-echo J.H. Christiaanse's recent comment that "too little attention is given to unilateral measures for relief against double taxation".[2]

But what precisely is meant by a "unilateral relief" against double taxation?

Put simply, it means that a country's tax system should be designed to relieve residents from home tax, or part of it, on income which has been taxed abroad; and to relieve non-residents of local taxation on certain heads of income arising within the country.[3]

Whilst emphasizing the vital importance of the rapid conclusion of bilateral agreements, the International Chamber of Commerce proposed as far back as 1950 that countries should take unilateral action for the relief of double taxation. In its opinion, such action would remove by far the greater

2. J.H. Christiaanse op.cit. (19) Cahiers. Vol. LIVc p. at

3. See I.C.C. Statement on: "Unilateral Relief from Double Taxation". (1951) Vol. 5. BIFD p. 113

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part of the impediment double taxation places in the way of international private investment, thus leaving the negotiation of treaties to the narrower field of computing the relief in particular instances arising out of the interaction of two tax systems.

What emerges here is that the more widely and effectively unilateral measures are used the less the need for tax treaties.

Since 1950, several nations have taken unilateral measures to relieve double taxation, with or without a demand for a reciprocal treatment for its own residents by the home country of the beneficiary.[4] What is far from clear, however, is the degree of success of these measures since an objective evaluation of their effect is lacking.

To take up the point that J.H. Christiaanse was making, it is fair to say that both the Fiscal Committee of the OECD and the U.N. Ad Hoc Group of Tax Experts have so far failed to pay sufficient attention to the whole question of unilateral relief against double taxation.

In the opinion of this writer, where the economic tie between two countries is quite strong and there is a two-way flow of income and other payments, the unilateral method for relief against double taxation is extremely useful. But countries are probably justified in their reluctance to apply it where the economic position is imbalanced and one party is obliged to grant more unilateral relief than the other.

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4. The Commonwealth Income Tax Relief Scheme may be referred to in this context. S.13 ITMA; s.36 CITA. But for this to be available to a foreign taxpayer under the Nigerian law, a Nigerian resident deriving similar income from that particular taxpayer's home country must be entitled to a similar relief.

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As far as developing countries are concerned, of far more importance to them is the "tax-sparing credit" as opposed to the "unilateral relief against double taxation". The distinction between the two is extremely important. Whereas the latter is a unilateral relief (i.e. by exemption or credit) in the country of residence for a tax which has actually been paid in the country of source, the former is a credit for the tax which would have been paid at source but for the fact that that country has refrained from imposing any tax on it.

We examine the position more closely in the following subsection.

E. Tax Incentives and the Role of the "Tax-Sparing Credit".

In order to attract capital most developing countries have promulgated development laws whose provision include total or partial tax exemption for a certain number of years for income from investment made in industries that contribute to their economic and social development.[5]

Without attempting to determine the merits or demerits of this policy, what may be stated is that usually at the time of granting tax incentives no consideration is given to the financial sacrifices made by the developing country. But after several years of applying this policy, it is now being recognised that tax incentive is far from becoming the determining factor of investment in most instances and that the fiscal sacrifices of developing countries only benefit the treasuries of the developed countries from where

5. Tax Treaties Between Developed and Developing Countries - First Report 1969 - U.N. Sales No. E.69: XVI. 2 para. 28 - 30, pages 9, 10.

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the investment originates. In other words, where the sacrifice made by the treasury of the developing country is not recognised by that of the foreign investor, the result is a transfer of revenue from the former to the latter.[6]

In short, what the capital exporting countries are required to do is to regard any tax waived at source as a tax paid - at least, for the purposes of claiming a foreign tax credit.[7]

Until recently, there has been strong condemnation of the "tax-sparing credit" by the United States of America[8] and other developed countries. Some of the specific criticisms made are as follows: (a) That tax-sparing ignored the principle of "tax neutrality". (b) That instead of engaging in fundamental and efficient tax reforms which would be attractive to investors, developing countries have adopted the simple expedient of granting so-called tax incentives. (c) That an unhealthy scramble for capital may result thereby compelling poor countries to give more and more tax exemptions. (d) Fourthly, it is argued that the tax exemption granted by developing countries may induce a more rapid repatriation of earnings to foreign shareholders than might otherwise occur.[9] Clearly, what is being pointed out

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6. Adolpho Atchabahian, "Some Aspects of International Double Taxation Between Developed and Developing Countries" - (1971) BIFD p. 451. at 463 et. seq.

7. R. Alan Short, "Tax Treaties with Developing Countries" - (1966) Vol. 14 Canadian Tax Journal p. 171 at p. 173.

8. Ibid., at p. 173, where the author referred to the statement of Stanley S. Surrey to the Committee on Ways and Means of the House of Representatives, 86th congress, 1st session, 1959.

9. Tax Treaties Between Developed and Developing Countries - Fourth Report 1973. U.N. Sales No. E. 73: XVI page 37 para. 179.

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here is that tax concessions might attract speculative capital. Finally, (e) the developed countries have objected to the principle of "tax sparing" because of so-called administrative difficulties often encountered in making the tax-sparing provisions effective.[10]

Apart from the above, a more fundamental objection has been expressed by some developed countries who take the view that a demand for a tax-sparing credit is an interference with its tax policy (i.e. of seeking neutrality for its investors). The developing countries see it the other way round, viz. that a refusal by a developed country to grant a tax-sparing credit is an interference with, and a frustration of its own tax policies.[1]

However, over the years, countries have generally come to accept the principle of the tax-sparing credit which the country of residence may grant unilaterally or as provided for in a double taxation agreement.[2]

The U.N. Group of Tax Experts considered the question of tax-sparing and other alternative measures at its fourth meeting in December 1972. The majority of members[3] from both developed and developing countries regarded

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10. R. Alan Short op.cit. at p. 174

1. Tax Treaties etc. Fourth Report page 46 para. 221.

2. The U.K. was among the first industrialised countries to adopt this principle by virtue of s.17 of the Finance Act 1961. A provision for tax-sparing appears in the Pakistan - U.K. Double Taxation Agreement of 1961. Cf. Article XIV. (See s.1 1961 No. 2467)

3. As must be pointed out there is still more opposition left to the principle of tax-sparing. See, Tax Treaties Between Developed and Developing Countries - Fourth Report - 1973 U.N. Sales. XVI. 1 page 46 para. 222.

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tax-sparing as an approach presently available that was "workable and desirable" and that has been utilised over a period of time. In the words of the Special Adviser to the Rapporteur:

> "The tax-sparing scheme has the merit that the developed country did not take for itself any of the benefits given to the investor, and its merits were recognised by all developing and many developed countries."[4]

That notwithstanding, what must be pointed out is the lingering doubt in this area of international fiscal law. As the Experts acknowledged at their meeting, the advantages of tax-sparing credits need to be further explored in order to see if enough statistical data can be obtained,

> "indicating whether and to what extent tax-sparing credits, and indeed the tax incentives themselves on which tax-sparing credits necessarily rested, brought about a significant inflow of desired investment considering the financial costs of those incentives to the developing countries and of tax-sparing credits",[5] (i.e. to the developed countries).

Also commended for further study by the Experts were possible alternatives to the tax-sparing credit where treaty partners do not desire to incorporate it in their tax treaties. Since the basic objective of tax-sparing credits and the tax incentives involved is to provide financial assistance to investors, any future study would likely extend to seeking alternative forms

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4. Ibid., page 46 para. 220

5. Ibid., page 46 para. 223

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of assistance to be used by a developing country which is willing in the first instance to grant such assistance solely for the benefit of the investor. Clearly, grants, favourable loans, subsidies, a guarantee of a minimum profit level for an initial period, the provision of special facilities for the enterprise etc. are methods of assistance which could be considered.

Such consideration would involve both whether the techniques were feasible for the developing country to offer and whether they would be workable in the sense that any taxes paid by the enterprise in the developing country would be regarded by the developed country as qualifying for full tax credit even though the enterprise was receiving such assistance in the developing country. This latter aspect could, of course, be an appropriate subject for inclusion in a tax treaty. In this regard, the much talked about "leaseback arrangement", which offered assistance through lease terms of government-owned facilities at below market price levels, can also be studied from such standpoint. But above all, methods of non-tax assistance offered by a developing country would have to be analysed from the viewpoint of their financial feasibility and realistic utility to the investor.[6]

Where a developed country fails to grant a tax-sparing credit either unilaterally, or, in its treaty provisions must this necessarily deter a developing country from proceding with its programme of granting tax incentives to foreign investors? For example, is it not true that where an overseas subsidiary is using the profits of its initial period of operation to pay off borrowed capital that tax incentives by a developing country would be of immediate benefit thus obviating the need for a tax-sparing credit in

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6. Ibid., page 47 para. 224.

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the country of residence? Is it not true that this would also be the case if the profits are reinvested by the subsidiary?

It is important to note here is that the absence of a tax-sparing credit need not be a disincentive since there are alternative ways in which a subsidiary's profit can be utilised without a repatriation to the parent company or to the country of residence.[7]

Furthermore, it is to be hoped that any future study as envisaged by the U.N. Tax Experts would explore ways open to a developed country desirous of providing inducements to its nationals to invest in developing countries. This is particularly important where a developed country does not wish to use a tax-sparing credit or any other aspect of its tax system.

Looking at the Nigerian law against the foregoing exposition what do we observe?

In this connection, two fairly recent legislation deserve mention. Namely, the Industrial Development (Income Tax Relief) Decree 1971, and the Companies Income Tax (Amendment)(No. 3) Decree 1971. The former provides for relief from income tax for a period of three years or more for companies engaged in pioneer industries.[8] The latter decree, on the other hand, provides that no tax shall be payable on any interest derived or deemed to be derived in Nigeria by a foreign company from any foreign loan of not less than £75,000 granted in any year by the foreign company to a person carrying on a trade, business, profession or vocation in Nigeria; if, the loan is granted for the purposes of that trade, business, profession or vocation and is not repayable

7. Ibid., page 47 para. 225

8. i.e. s.10 Industrial Development (Income Tax Relief) Decree 1971

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by the borrower until after the expiration of a period of not less than ten years. The decree also provides that in respect of any such loan granted as aforesaid and which is repayable after the expiration of a period of less than ten years but not less than five years, tax under the Act shall be chargeable on the foreign company at half the normal rate prescribed under the general law.[9]

Undoubtedly, these far reaching measures have been taken by Nigeria in order to attract foreign capital. However, what is not so clear is the extent to which these benefits are passed on to foreign investors. It is particularly disturbing to note that there is nothing in the Nigerian Law demanding a "tax-sparing credit" in the country of residence of the foreign investor. The impression seems to be that it is the Treasures of the industrialized countries that benefit from the revenue sacrificed by Nigeria.

In relation to the above, it is the opinion of this writer that the aforementioned tax concessions should only be available to investors in countries applying the tax-sparing credit. Furthermore, future Nigerian treaties must provide for the application of the tax-sparing credit.

III. ADMINISTERING THE TAX TREATIES

A. Exchange of Information

The application of a convention for the avoidance of double taxation implies a co-operation between the tax administration of two contracting states. An obvious instance is the administrative assistance required in

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9. s.2 Income Tax (Amendment)(No. 3) Decree 1971 providing for a new s. 17A CITA.

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particular cases for the purposes of ascertaining the facts in relation to which the national tax legislation and the rules of the convention are to be applied.

Article 14 of the Nigeria - U.K. Agreement embodies the rules according to which information may be exchanged with a view to having a proper basis for taxation under the convention. It is stipulated in this article that the competent authorities of the contracting states shall exchange such information as is necessary in order to secure the correct application of the articles of the convention as regards the taxes covered.[10] In order to keep the exchange of information within the framework of the convention, a limitation to the compulsory exchange of information is set. Thus, information can be given only in so far as a local tax is covered by the convention and the taxation under the national law in question is in accordance with the convention.[1]

The following illustrations clarify the principle set out in the above paragraph:

When applying the provisions of Article 7 (Nigeria - U.K. Agreement) on the taxation of royalties, the "taxation authority"[2] of the state where the

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10. Obligation to furnish information does not extend to the case where the national tax law concerned is not covered by or is contrary to the convention. E.g. information for the purposes of the imposition of an extra-ordinary tax on capital appreciation with respect to which a given convention is not applicable.

1. Although couched in slightly different terms the OECD Article 26 and the Nigeria - U.K. provisions are essentially the same.

2. This expression is defined in the Nigeria - U.K. Agreement Article 14(2) to mean the Commissioners of Inland Revenue or their authorised representative in the case of the United Kingdom and the Commissioner of Income Tax (now Chairman of the Federal Board of Inland Revenue) or his authorised representative in the case of Nigeria.

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recipient is resident may find it necessary to request information from the competent authority of the state where the payer is resident, concerning the amount of royalty transmitted by the payer to the recipient. And vice versa, in determining the taxation of the payer, the taxation authority of the state of the payer's residence may have occasion to inquire about the identity of the recipient in order to see if there exists a special relationship which may be relevant for tax purposes.[3]

Some kinds of information are often of importance - such as information on quoted prices between two enterprises situated in two different contracting states or between a permanent establishment in one country and its head office in another. Generally, an exchange of information in this field will be needed for a proper allocation of taxable profits between two associated enterprises or for adjusting the amounts of profit shown in the accounts of a permanent establishment and that of its head office.

A further typical example of the necessity to exchange fiscal information is in the application of the relief measures themselves. Experience show that tax authorities may have to consult with one another in order to discover the precise nature of a taxpayer's overseas liability.

However, it should be noticed that while the main rule on exchange of information is applicable in many cases where information is required for the prevention of fiscal fraud or fiscal evasion, it does not apply to matters of administrative assistance for the purposes of tax collection.[4]

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3. i.e. to see whether the parties concerned have been dealing at "arm's length".

4. The general rule of international law is that State A, may not help in the collection of taxes imposed by State B, unless there are treaty obligations to the contrary. See D.P. O'Connell: International Law. Vol. 2 (1970) at page 715 et seq.

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On the procedural level, the rule on exchange of information presupposes that information shall be exchanged only on application. Obviously, it is to be assumed that the internal sources of information available to a tax authority would be relied upon in the first instance. Assistance under the exchange of information provisions should, therefore, normally be requested when in a particular case the information obtained from regular sources is insufficient or is in need of corroboration. Clearly, wide ranging requests for information concerning, for example, all payments of royalty made from one contracting state to the residents of another, might if the information is at all available, entail too much administrative difficulty.[5]

The obligation to treat as secret the information which is received under Article 14 of the Nigeria - U.K. applies to all authorities of the contracting parties including those which are empowered with the jurisdiction over tax disputes. Thus, special measures may have to be taken to safeguard the secrecy of information in court proceedings.

Apart from the above, there are other qualifications to the principle of exchange of information. Firstly, tax authorities are positively stated to be under no obligation to disclose any trade secret or trade process.[6] Secondly, taking the restriction further, the OECD Draft provides that a contracting state need not go beyond its own internal laws and administrative practice in putting information at the disposal of another contracting state.[7]

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5. A number of conventions already provide for a scheme of regular and automatic exchange of certain categories of information.

6. Nigeria - U.K. Agreement, Article 14(1); OECD Draft, Article 26(2)(c).

7. Article 26(2)(a).

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Furthermore, since the main rule on exchange of information is based on the principle of reciprocity, under the OECD Draft, a contracting state is not obliged to carry out administrative measures that are not permitted under the law or practice of the enquiring state or to supply items of information that are not obtainable under the laws or in the normal course of administration of that state.[8] The idea is that a contracting state should not be able to take advantage of the information system of a treaty partner where it is wider and more sophisticated than its own.

In spite of the unambiguous provisions in most tax treaties that information shall be exchanged between competent tax authorities in order to secure a correct application of treaty provisions, experience show that the actual mechanics of exchange is obscure. Taking cognizance of this fact, the Ad Hoc Group recommended[9] at their fourth meeting that OECD Draft (Article 26) be modified so that competent tax authorities shall through consultation develop appropriate conditions, methods and techniques in respect of exchanges of information.

In the opinion of this writer, until such time when these procedures are crystallized, the provisions for the exchange of information in tax treaties cannot be put to optimum use. This would be particularly true in the case of tax treaties between developing countries - often lacking skilled personnel.

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8. Article 26 (2)(b). Information is deemed to be obtainable in the normal course of administration if it is in the possession of the tax authority or can be obtained *without special investigations or special examination* of the business accounts kept by the taxpayer or other persons - See commentaries on OECD Draft at p. 159.

9. Tax Treaties between Developed and Developing Countries -Fourth Report. U.N. Sales No. E. 73. XVI. 1 page 33 paras. 162 - 164.

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B. Problems of Treaty Interpretation - Mutual Agreement Procedure - remedy of last resort?

A study of bilateral agreements currently in operation shows that the remedies provided by national laws and by the agreements themselves for resolving disputes frequently fail to provide satisfactory redress for the taxpayer aggrieved by the action of one or other of the contracting states. In the opinion of the International Chamber of Commerce the avoidance of double taxation through the medium of bilateral agreements demands not only a high level of effectiveness in the provisions themselves, but also a high degree of efficiency in the machinery for resolving difficulties arising out of the agreements.[10] This writer certainly agrees.

Apart from the provisions for the exchange of information, the Nigeria - U.K. agreement as an example, does not contain guidelines on the settlement of disputes arising from the Agreement.[1] Indeed, whether or not problems have arisen in the past as regards that interpretation or application of any Nigeria's Agreements is difficult to say. This may be attributable to the fact that few people in the country are deriving income from treaty countries.[2]

That notwithstanding, it is quite relevant to our study to explore the

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10. Pamphlet No.196: Settlement of Difficulties and Disputes Arising Out of Double Taxation Agreements - Statement adopted by the Executive Committee of the I.C.C. Feb. 1959 and Report of its Commission on Taxation pages 3, 4.

1. Most of the early Commonwealth agreements contained no provision on the use of a "mutual agreement procedure". See Raoul Lenz, "The Interpretation of Double Taxation Conventions" General Report, (1960) Vol. 42 Cahiers de droit Fiscal Inter-national p. 294 especially at pp. 303 - 306.

2. All available evidence suggest that, in general, disputes on interpretation hardly arise under tax agreements.

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methods of treaty interpretations and the mechanics of conflict resolution currently available elsewhere.

The first thing to note is that international agreements for the avoidance of double taxation are bilateral treaties and thus belong to the law of nations in the same way as any other political or economic treaty.[3] The established practice here is that if the meaning of a treaty provision is not clear then the problem can be resolved in the first place by applying the usual rules governing the interpretation of statutes. However, double taxation agreements have a purpose substantially different from that of normal political or economic treaties because they are intended to reconcile two national fiscal legislations and to avoid the simultaneous taxation of an individual's income in two countries. Since the normal terminolgy used in international law are not adequate to obtain this result, negotiators are often obliged to employ technical terms found in the tax law. It is the use of such terms that create problems of interpretation peculiar to double taxation agreements.

Further difficulties may be created because technical terms used in a bilateral agreement are unknown in the fiscal legislation of one of the states; it may also happen that a technical term found in the tax laws of both states have a substantially different meaning in each of them. Clearly, in these instances, the usual rules governing the interpretation of bilateral treaties will not ensure a uniform application of the agreement in the two countries concerned due to the close connection existing between the agreement and the domestic law of the contracting parties. In this respect, double taxa-

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3. Raoul Lenz, "The Interpretation of Double Taxation Conventions" - op. cit. p. 294.

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tion agreements are comparable with two other types of bilateral conventions closely related to domestic law; namely, with treaties of reciprocal establishment and with treaties on the competence of tribunals or administrative authorities in judicial matters.[4]

The types of difficulty or dispute which arise out of double taxation agreements may be listed as follows:[5]

(a) failure of the two states to adopt a common interpretation and application of the terms used but not defined in the agreement and failure to adopt a common measurement of the income which is the subject of the agreement;

(b) the rigid application of general provisions to particular cases with an inequitable result;

(c) the conflict of law which arises from the use of terms and phraseology which are appropriate to the national law of one state but not to that of the other state;

(d) discrepancies between the two texts when the agreement is concluded in two languages;

(e) ambiguity in the text;

(f) failure to include provisions for avoidance of double taxation in certain cases; this may be due to failure to negotiate an agreed solution or by oversight;

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4. Ibid., at page 294

5. Pamphlet No. 196 op.cit. I.C.C. 1959 at page 10.

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(g) failure of the agreement to cover certain cases of double taxation which subsequently arise as a result of changes in national tax laws;

(h) the omission of a general direction to improvise an equitable solution for cases for which provision is not made or where the provision made is ineffective.

All the above faults are faults in either the quality or the scope of an agreement. Items (a) to (e) are mainly difficulties of interpretation. Items (f) to (h) are faults of omission. In addition to the above, there is the insoluble difficulty which arises when one state levies tax in breach of a clearly understood provision of its agreement with the other state. For this, once all the opportunities for discussion and negotiation have been exhausted, there is no sanction but to denounce the agreement ~~in which~~ - as double taxation becomes the result of the normal operation of the national law.[6]

There are two different ways to achieve a uniform interpretation of a treaty when some terms have different meanings under the domestic tax laws of the treaty partners. According to the first method, a definition of the controversial terms is included in the agreement itself or in an attached protocol. According to the second method, a particular provision in the agreement stipulates that reference shall be made to the legislation of one or the other of the states for the definition of controversial terms as may be appropriate. Both methods are used today to ensure a uniform interpretation of the technical terms employed in tax agreements.[7]

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6. Ibid., at pp. 10, 11.

7. Raoul Lenz, "The Interpretation of Double Taxation Conventions" - op. cit. at p. 294.

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Continuing our discussion on the administration of the tax treaties mention must be made of the so-called "mutual agreement procedure".

Practically all recent agreements, including the OECD Draft,[8] provide for consultations between the administrative authorities of contracting states for the purpose of eliminating difficulties or doubts as to the application of such agreements. Apart from this general authorisation, agreements often provide that the "mutual agreement procedure" may be used to determine the types of taxes to which an agreement ought to apply when new taxes are introduced in one of the contracting states, to determine the fiscal domicile of the taxpayer in cases of doubt, to establish rules for the allocation of profits to permanent establishments of a particular enterprise or for certain categories thereof, and sometimes to specify the procedure under which relief may be claimed for taxes withheld at source.

The judicial value of a decision reached during a mutual agreement procedure varies according to its nature. Although the terms of an agreement do not distinguish clearly between two situations, administrative authorities in fact have different powers according to whether the procedure relates to the application of the agreement in instances in which the authorities wish to co-ordinate their discretionary power, or whether the administrative authorities consult each other with a view to supplement the agreement.[9]

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8. Article 25

9. Raoul Lenz, "<u>The Interpretation of Double Taxation Conventions</u>" - <u>op. cit</u>. at p. 304.

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In the first case, any decision that is reached will not be binding on the courts. Thus, they will still be free to decide that an equitable application of the agreement in their state does not allow the taxation of the person in question despite the fact that the administrative authorities may have agreed between themselves that the right to tax this person belongs to that state. On the other hand, where a court decides that tax is due to a particular state, while the administrative authorities have agreed that the right to tax belongs fully or partially to the state, the latter's decision will prevail.

In the second case, i.e. when the administrative authorities consult with each other with a view to supplement the agreement, they make use of powers which have been delegated to them by the legislative bodies. These powers may be delegated to the administrative authorities by virtue of the provisions relating to the mutual agreement procedure which often allow consultations in cases where double taxation is not avoided by the agreement. The delegation of these powers may also be based on the provisions in a tax agreement authorising the administrative authorities to supplement the agreement or to give an authentic interpretation thereof with respect to specified points. Providing the aministrative authorities do not exceed the powers which have been delegated to them, the decision reached during a mutual agreement of this kind are binding on the courts.

Although theoretically acknowledged as sound, the mutual agreement procedure seems to be of limited value in practice.[10] This is probably

10. See Max Beat Ludwig - op. cit. at p. 1/78

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so because the result of such procedures whether relating to specific cases or to decisions (embodied in protocols or negotiations) as to the application of an agreement in general are rarely published.[1] The consensus of opinion seems to be that the results of mutual agreement procedures should generally be made known to the public as this would help to make the results of such consultations less fortuitous and more consistent with each other.[2]

Is the mutual agreement procedure a remedy of last resort where double taxation is imminent? This would appear to be so. But where this procedure fails to resolve any case before it, what next?

The view often expressed is that unresolved disputes should in the end be examined by an international body[3] whose decision would be binding on the contracting parties. Reasonable as this proposal is, it has not gained universal acceptance; and if the reluctance of states to submit to the jurisdiction of the International Court of Justice is anything to go by it is never likely to be adopted.

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1. Raoul Lenz op. cit., at p. 304

2. In other words, a body of precedents could be established.

3. Raoul Lenz agrees with the recommendation of the League of Nations for the setting up a "Consulting Commission" op. cit. at p. 305. The I.C.C. in 1959 proposed the submission of disputes first to an International "Conciliation Commission" and finally to the International Court of Justice.

   Sten F.W. Bille explored the possibilities more fully in his Article in 1951. See, "Some views on the Methods of Settling Disputes on Questions of Double Taxation" - (1951) Vol. 5 BIFD p. 201 et seq.

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C. What are the Rights of the Taxpayer?

Although the taxpayer may from time to time be dissatisfied with the operation of a double taxation agreement, the area within which he can be regarded as having "acquired rights" seems to be strictly limited. He cannot for example sue either taxing authority directly or through any international court in respect of ommissions from a treaty;[4] nor can he expect the State of which he is a national or any international authority to interfere with the interpretation given to a national law by the courts of the state concerned.

This unsatisfactory position has been very much criticised in the past.[5] A proposal put forward which is worthy of consideration is the possibility of contracting parties without loss of sovereignty permitting a taxpayer to submit a difficulty of interpretation or application to an international court or tribunal when the administrative authorities alone are competent to reach a decision and they cannot or will not do so.[6]

IV. CONCLUSION

In this chapter, the principal methods of relief against double taxation were explored. In general, the exemption method was preferred

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4. The general rule is that only the parties to an agreement can derive benefits under it.

5. For example, see Sten F.W. Bille op. cit.

6. See I.C.C. Pamphlet No. 196 op. cit. at pages 13, 14

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provided there a reciprocal flow of payments between treaty partners. Where this condition is lacking, the full credit method was considered an acceptable alternative.

From the point of view of developing countries, it was shown that what is often needed is not only a credit for the tax actually paid at source, but a credit for any "taxes spared." To do otherwise, we argued, is likely to create a disincentive to the foreign investor whose country benefits from the unilateral revenue sacrifice by the host country.

Several questions concerning the administration of treaties were raised. While acknowledging that the exchange of information provision is an admirable one, it was seen that its usefulness is very much diminished because of the obscure procedures of exchange.

As regards treaty interpretation, the following important conclusions were arrived at. (1) That the normal rules of treaty interpretation should be applicable in the first instance. (2) Where these fail the mutual agreement procedures should be followed. (3) As a last resort we considered the possibility of adjudication by an international body.

Clearly emphasized in this chapter is the vagueness of an individual's rights under a tax agreement. Access to an international forum as a last resort was considered a possible solution without any loss of sovereignty by the contracting parties.

Finally, as the I.C.C. rightly pointed out, the avoidance of double taxation cannot be accomplished without a smooth administrative machinery

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however effective substantive treaty provisions are in theory. Whereas, much has been accomplished internationally as regards the latter, the former has somehow failed to get the attention it deserves.

On a broader level and considering our discussion in Chapters VI and VII a number of further observations may be made:

(1) That tax treaties have not been a crucial factor influencing the inflow of foreign investments. Since 1960, the country's trade has been extended to countries with whom she has no tax agreement and which are not members of the Commonwealth and so do not benefit from the Commonwealth Income Tax Relief Scheme. The important point to note is that private capital from non-treaty, non-Commonwealth countries have been on the increase.[7] The clear indication is that the profit margin of these enterprises are probably so large that they are prepared to suffer tax twice.

(2) As suggested by A.O. Philips the concession on the importation of plant and machinery are more powerful incentives to the foreign investor than relief from double taxation or tax holidays.[8] Furthermore, the general business climate and the sheer size of the market are powerful incentives.

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7. Capital inflow from Western Europe (excluding the U.K.) was from £6.8 m. in 1961, to £23.7 m. in 1966. Figures from: The Financial and Economic Review - (1968) Vol. 6, No. 2 at page 11 - published by the Central Bank of Nigeria. See also (1971) Vol. 9, No. 1 of the same journal, pages 77 - 92, indicating the almost universal extent of the country's foreign trade.

8. "Nigeria's Tax Incentives" - [1971] Vol. 5, No. 4 - Quarterly Journal of Administration, Institute of Admin., University of Ife.

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(3) Because of their origins and the fundamental assumption of reciprocity, which is lacking, Nigeria's treaties amount to an unwarranted revenue sacrifice in most instances.

However, in spite of the above, the establishment of the proposed West African Economic Community and the achievement of further economic integration in Africa may cause Nigerians to invest more in other African states. In these circumstances, double taxation is likely to be a very relevant factor. Also, whilst the need to attract foreign investment may decline as Nigeria earns more from oil,[9] tax treaties with industrialised countries would still be required if the country is to attract the necessary foreign technology. In view of these possible developments it is our hope that the very detailed treatment of the subject of double taxation here will be helpful in concluding new treaties and in modifying the existing ones.

9. E.g. The Federal government revenue from the oil exploration industry for the second quarter of 1973 was 206.037 (i.e. more than £100 million pounds). See Central Bank of Nigeria Monthly Report - October 1973 at p. 8.

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CHAPTER NINE

CONCLUSION

I. OPENING REMARKS

Considering that the main issues have been summarised at the end of each chapter, the discussion here must be selective in order to avoid unnecessary repetition. Apart from a restatement of a number of salient points, only relevant observations of a general nature are made.

II. HIGHLIGHTS - CHAPTERS ONE TO EIGHT

Starting with a description of the general scheme of taxation within the Nigerian federation in the first chapter, we moved on to examine the essential philosophy behind the law in Chapter Two.

From our analysis of the charging provisions, it was concluded that the Nigerian law is based on a twin principle - liability on all "source" income and liability on a "remittance basis". While these rules may be easily stated, it was shown with the help of a number of decided cases that their application is far from easy.

Using our findings in Chapter Two as a basis, certain aspects of the taxation of trading or business income were considered in the third chapter. Thus, it was established that any trading or business income having its source or deemed source in Nigeria or which has been remitted to the country is liable to the country's taxation. In this connection, a multiplicity of tests was advocated for the purpose of determining whether or not a trade or business has been "carried on" in Nigeria. These included the place of the contract test, the situs of control and the "activities test". What was clearly emphasized was the fact that the more comprehensive the criteria for "carrying

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on business" in Nigeria, the wider the country's tax jurisdiction.

The accounting provisions in the tax code and in Companies Decree were examined in some detail. Not only did we demonstrate that well prepared accounts rarely present an accurate view of a company's affairs, also highlighted was the difficulty of determining the profits of a business or trade where proper records are lacking.

Among other things, it was recommended that all traders (illiterate or not) should be assisted to keep books of accounts, while foreign subsidiaries must be made to submit accounts prepared by Nigeria based accountants. The use of oversea based accountants as at present was thought to be undesirable.

Bearing in mind that the Nigerian economy is dominated by companies which are in truth subsidiaries of major international companies, the country's rules for the allocation of income, expenses and losses between related entities were found to be "sketchy and relatively undeveloped". What was, therefore, advocated was the setting up of a number of well defined criteria for determining an "arm's length price." This is certainly important because of the frequent intra-company transfer of goods and services.

Due attention was paid to the tax treatment of a number of special trades because of their transnational character. These are shipping, insurance and the import and export trade. The potential problem of double taxation, reviewed subsequently, was mentioned only in passing.

The taxation of employment and professional income were dealt with in Chapter Four. Some of our more important observations were as follows:

(1) As regards the definition of a "profession", "vocation" or an "employment", it was urged that the authorities should maintain a flexible

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approach bearing in mind for example, that the standard of skill and training of a professional must be relative to the community in which he operates and never in the abstract. Also, that in the particular case of Nigeria, that the majority of the adult population are neither true professionals nor employees but are simply people pursuing vocations.

(2) The Nigerian tax philosophy was interpreted in the case of employment and professional income to the effect that there is liability to tax once the "place of performance" of the duties of a profession or employment is in Nigeria. This approach was approved not only because it is a criterion difficult to manipulate for tax purposes but as being very desirable in the interest of developing countries always at the receiving end of skilled labour.

(3) Considerable attention was focussed in this chapter on the problems involved in determining the precise scope of a taxpayer's emoluments, profits, or gains as the case may be. In this connection, it was noted that his earnings and expenditure were influenced by the customs and traditions of the local community. It was urged that the tax authorities while endeavouring to preserve the social order must take cognisance of payments and purported gifts to professionals and employee where appropriate in the computation of "total income" for tax purposes.

(4) As a corollary to the above, the question of "benefits in kind" was probed in great detail. So also was the unique Nigerian concept of an "allowance" or "fringe benefit". Valuation of these benefits we argued should be based on their "market value" wherever possible.

(5) It was submitted with regard to the rules governing the deductibility of expenses that these are too strict and unrealistic. The "necessarily obliged" part of the expenditure test, it was contended, ought to be dropped in favour of the "actually incurred" test.

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(6) The recent modification of the law (including the procedure for its enforcement) with regard to the armed forces and foreign service personnel was accepted by us. But in addition to that, it was thought that a proper machinery for the collection of taxes from cultural visitors and non-resident directors must be introduced.

In Chapter Five, we were concerned with the taxation of "investment income" - a term employed to include interest, royalties and dividends. Apart from emphasizing the fact that the rules for the taxation of this specie of income must take cognisance of the true economic position of Nigeria as an importer of capital and technology, and hence as an exporter of interest, royalties and dividends; several other important observations were made. For example:

(a) Of all the several logical criteria for the determination of the source of interest and royalty payments, the "place of use" test was favoured. The "source of obligation" test and the "place of supply" test were rejected as being unduly legalistic and out of touch with economic reality.

(b) The expense component of interest and royalty payments was fully discussed. While it was agreed in principle that the taxation of interest and royalties should be on a net basis, immense difficulties of administration did not encourage us to recommend this approach.

(c) The definition and scope of the term "dividend" under the Nigerian Law were considered to be sufficiently comprehensive. The need to bring all kinds of "company distributions" (i.e. whether of capital or income) within the country's tax jurisdiction was clearly recognised, especially as the bulk of such distributions accrue to foreign investors. However, as was suggested, the law needs to be amended in one or two respects; namely, in order to

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ensure that shareholders do not get more than the nominal paid-up value of their shares on a reduction of capital and as regards discriminatory tax rates in favour of undistributed profits.

A major proportion of this thesis was devoted to a thorough analysis of Nigeria's tax treaties. This was considered necessary because no similar exercise had been carried out by any other author. Also, an extended discussion was considered desirable because of the often exaggerated importance attached to double taxation as an obstacle to the flow of foreign investments to developing countries. But above all, an understanding of Nigeria's tax treaties was thought to be of great importance as the country achieves closer economic integration with other countries of Africa.

The Nigerian treaties as a legacy of its colonial past, retain the traditional concept of a "permanent establishment". This was criticised as "narrow", failing as it does to reflect sufficiently the de facto economic situation prevailing in a developing country. Our submission was that the criteria of "presence" should be as wide as possible especially if it was to find acceptance among countries that have adopted the principle of liability on all "source" income.

The scope of "business profits" was examined in considerable detail. The "effectively connected with" principle in Nigerian tax treaties (except the Nigeria - U.S.A. treaty) was considered suspect even though it is now generally favoured after its endorsement by the OECD Draft. On balance, the "force of attraction doctrine" was preferred for Nigeria and, indeed, for developing countries generally.

In examining the ambit of the expression "industrial or commercial profits", our view as supported by several authorities was that the expression must be

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interpreted in the widest possible sense, just as must the "permanent establishment" concept to which it relates. As a consequence, therefore, the expression would include income from businesses like "mining", "farming", "pastoral enterprises", "the leasing of machines", "banking", "insurance" and the rendition of "personal services". The overriding test has to be whether or not they are attributable to a permanent establishment.

Problems of computation and profit allocation (i.e. between a parent establishment and its permanent establishment) were discussed extensively. Three methods of profit allocation were highlighted. Firstly, the "direct accountancy" method whereby profits are allocated on the basis of the records of the permanent establishment which for this purpose is regarded as a distinct and separate entity from the parent enterprise of which it is a part. But as was illustrated in Chapter Seven not only in this approach contrary to the principles of commercial law, it also fails to take account of the problems which arise when related entities deal with each other on a preferential basis.

The second method of profit allocation considered by us was the "indirect method", the great merit of which is that it is compatible with the principles and practice of commercial law. This method starts out from the company's total profits and attributes to the States in which are located the parent and permanent establishments a part thereof for tax purposes. Inherent in the system are a number of disadvantages which were pointed out. For example, the difficulty of ascertaining "total profits", and of fixing an apportionment index especially where the various units of an enterprise are engaged in different activities.

The third method of allocation allowed under the tax treaties is the use of "reasonable estimation". Crude as this method is, it was thought to be

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of great significance for developing countries often lacking in skilled personnel and with a large number of traders unable to keep proper books of accounts. The danger of arbitrary assessment and abuse was, however, acknowledged.

Relating the concept of a permanent establishment and the problems of profit allocation more specifically to Nigeria, we made the following observations. (1) That, since 1968 the whole concept of a permanent establishment and consequently the apportionment of income has become somewhat academic. This is because companies are no longer allowed to operate in the country as branches but must now be incorporated as subsidiaries which must file separate accounts. (2) That notwithstanding, most of our discussion on profit allocation was nevertheless considered important because Nigerian subsidiaries tend to deal with their parent companies on a non-commercial basis with all that that implies. (3) But particularly relevant to Nigeria, was our discussion of the legal problems in instances where a non-resident is trading in the country through an agent or other similar intermediary; or, as regards the assessment of itinerant merchants, hawkers, petty traders etc., who may sometimes constitute permanent establishments.

Of the principal methods of relief against double taxation, the "exemption method" was preferred - provided there is a reciprocal flow of payments between treaty partners. Where this condition is lacking, the full credit method was considered an acceptable alternative.

From the point of view of developing countries, it was shown that what was often needed was not only a credit for the tax actually paid at source, but a credit for any "taxes spared." To do otherwise, we argued, is to create

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a disincentive to the foreign investor whose country benefits from the unilateral revenue sacrifice by the host country.

On a much broader level and considering our discussion in Chapters VI, VII and VIII the following general observations were made:

(1) That tax treaties have not been a crucial factor influencing the inflow of foreign investments into Nigeria. The important point to note is that private capital from non-treaty, non-Commonwealth countries has been on the increase since 1960.

(2) As suggested by a Nigerian economist, the concession on the importation of plant and machinery are more powerful incentives to the foreign investor than relief from double taxation or tax holidays.

(3) Because of their colonial origins and the fundamental assumption of reciprocity which is lacking, it was contended that the provisions of Nigeria's tax treaties amount to an unwarranted revenue sacrifice in most instances. A thorough review of all the treaties is, therefore, urgently needed.

III. OIL COMPANY TAXATION - A NOTE

As was indicated in the ABSTRACT, much thought was given to the taxation of oil companies. Among the problem areas identified by this writer were the following: (1) gross profits and the mechanics of the "posted" price, (2) the "expensing" of royalty payments, (3) chargeable profits and capital allowances, (4) the inter-company transfer of losses and the question of double taxation.

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However, considering the unsettled state of the international oil industry and its direct influence on Nigeria's internal position an analysis of the existing law is thought to be of limited value as conclusions must necessarily be tentative. Radically new ways of taxing the profits of petroleum companies are at present being evolved and in future a tax probably based on the volume of oil produced as distinct from its value or purported value may become the norm. Until that process of evolution is complete intelligent comment is difficult.

IV. CLOSING REMARKS

Many aspects of the Nigerian income tax law have not been interpreted by the Courts, and the Revenue practice as regards the same is still obscure. In spite of the detailed treatment of selected problems, it is quite obvious that much more research still has to be done. How exactly the newly established Revenue Court is going to influence the development of the law is yet to be seen.

Finally, whereas the Nigerian income tax law is primarily a means of providing governmental revenue, it is to be hoped that taxation would in future be used as an instrument to stimulate the economy, to keep down inflation, to generate employment and to establish a more egalitarian and just society.

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APPENDIX I

SCHEDULES

Sections 4 and 16

SCHEDULE 1

ENTERPRISES EXCLUSIVELY RESERVED

Item

1. Advertising agencies and public relations business.
2. All aspects of pool betting business and lotteries.
3. Assembly of radios, radiograms, record changers, television sets, tape recorders and other electric domestic appliances not combined with manufacture of components.
4. Blending and bottling of alcoholic drinks.
5. Blocks, bricks and ordinary tiles manufacture for building and construction works.
6. Bread and cake making.
7. Candle manufacture.
8. Casinos and gaming centres.
9. Cinemas and other places of entertainment.
10. Clearing and forwarding agencies.
11. Hairdressing.
12. Haulage of goods by road.
13. Laundry and dry-cleaning.
14. Manufacture of jewellery and related articles.
15. Newspaper publishing and printing.
16. Ordinary garment manufacture not combined with production of textile materials.
17. Municipal bus services and taxis.
18. Radio and television broadcasting.
19. Retail Trade (except by or within the departmental stores and supermarkets).
20. Rice milling.
21. Singlet manufacture.
22. Tyre retreading.

SCHEDULE 2

Sections 5 and 16

APPENDIX II

ENTERPRISES BARRED TO ALIENS UNDER CERTAIN CONDITIONS

Item *List of Enterprises*

1. Beer brewing.
2. Boat building.
3. Bicycle and motorcycle tyre manufacture.
4. Bottling soft drinks.
5. Coastal and inland waterways shipping.
6. Construction industries.

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7. Cosmetics and perfumery manufacture.
8. Departmental stores and supermarkets.
9. Distribution agencies for machines and technical equipment.
10. Distribution and servicing of motor vehicles, tractors and spare parts thereof or other similar objects.
11. Estate agency.
12. Fish and shrimp trawling and processing.
13. Furniture making.
14. Insecticides, pesticides and fungicides.
15. Internal air transport (scheduled and charter services).
16. Manufacture of bicycles.
17. Manufacture of cement.
18. Manufacture of matches.
19. Manufacture of metal containers.
20. Manufacture of paints, varnishes or other similar articles.
21. Manufacture of soaps and detergents.
22. Manufacture of suitcases, briefcases, handbags, purses, wallets, portfolios and shopping bags.
23. Manufacture of wire, nails, washers, bolts, nuts, rivets and other similar articles.
24. Paper conversion industries.
25. Passenger bus services (inter state).
26. Poultry farming.
27. Printing of books.
28. Production of sawn timber, plywood, veneers and other wood conversion industries.
29. Screen printing on cloth, dyeing.
30. Slaughtering, storage, distribution and processing of meat.
31. Shipping.
32. Travel agencies.
33. Wholesale distribution.

MADE this 23rd day of February 1972.

GENERAL Y. GOWON,
Head of the Federal Military Government,
Commander-in-Chief of the Armed Forces,
Federal Republic of Nigeria

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