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REVIEW OF MAURITIUS-NIGERIA DOUBLE TAXATION TREATY

Background information

In August 2012, representatives of the governments of Mauritius and Nigeria signed an income tax treaty. Also signed was a Protocol for the treaty which agreements contain measures providing beneficial tax rates for dividends, interest, and royalties. It also provides for resident-based taxation of capital gains arising on sale of shares, and rules with respect to the taxation of permanent establishments. The treaty provisions which have been ratified by Mauritius government still await ratification by Nigeria. Once ratified by both countries, the treaty will enter into force.

Mauritius in all has this treaty existing and in force with 37 countries worldwide, including Asia, the Americas, Middle East and Europe.

In 2002, this treaty came under severe criticism by the tax authorities in India due to abuses. For over a decade, the allegation of abuses by companies with some tacit approval from the Mauritius authorities had been on-going. The treaty has also been known in India to be exploited by companies that do “treaty shopping” which they could take advantage of.

Against this background, it is important to raise questions on the implications of such treaty and similar ones for Nigeria. What are those issues in the treaty that Nigeria authorities may have not paid due attention to and what implications does it have for tax revenue in Nigeria, currently striving to reduce an overdependence on oil and diversify revenue generation sources? Other questions to be asked include the implication of this treaty for the country in the face of the challenges it has tracking and preventing round tripping, transfer mispricing and other tax avoidance techniques.

The following specific questions arise in this context:

1. Extent of conformity of the treaty to the UN model on tax treaties
2. Likely impact of the treaty on sharp practices by multinationals
3. Implication of the treaty for resource generation for the country
4. How does the treaty become a ready document to be exploited by those inclined towards treaty shopping
5. Implications for Foreign Direct Investment – what are the realities as against assumptions?
6. Will an anti-avoidance legislation have any complimentary role in addressing abuses?
7. Proffer alternatives to the treaty and or recommendations on issues arising from the treaty.
8. Are there revenue policies and existing tax laws and or other legislations in the country the treaty would be in conflict with?
9. Does the country’s tax administration/arbitration system have the capacity to respond to some of the challenges and conflict that could arise from the treaty?

Comments

Generally the main objectives of a double tax agreement are to mitigate double taxation, prevent double non taxation, curb tax evasion, clarify the taxing rights of parties involved, enhance exchange of information and mutual cooperation.

In the case of the Mauritius-Nigeria DTT, though the agreement has been ratified in Mauritius, this is not the case in Nigeria and therefore the DTT is not yet in force.

Below are some of the key provisions of the tax treaty.

- Taxes covered under the DTT are capital gains tax, personal and corporate income taxes including Tertiary Education Tax in Nigeria.

- According to Articles 10, 11 and 12 of the DTT, dividends, interests and royalties derived by a Mauritian resident from a Nigerian company or vice versa, would be subject to a maximum tax deduction of 7.5% of the gross amount, provided the recipient is the beneficial owner.

- Where dividend received by a Mauritian company from Nigeria is liable to tax in Mauritius, the relief by way of credit covers any withholding tax paid in Nigeria as well as the underlying taxes paid by the Nigerian company on the profit distributed.

- Royalty is defined to mean payment of any kind received as consideration for the use of, or the right to use any copyright of literary, artistic or scientific work including cinematograph film and films or tapes used for radio and television broadcasting, any patent, trade mark, design, model, computer program, 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.

- Business profit is only taxable in the source country where a Permanent Establishment (PE) has been created. Article 5 limits a PE to (a) a building site or construction, installation or assembly project, or supervisory activities in connection therewith only if the site, project or activity lasts more than 6 months (b) the furnishing of services including consultancy services by an enterprise of a Contracting State through employees or other personnel engaged in the other Contracting State, provided that such activities continue for the same or a connected project for a period or periods aggregating to more than 6 months within any 12-month period.

- Profit attributable to a PE is largely determined based on the arm's length principle but also the force of attraction principle may be applied.

- In determining the profit attributable to a PE there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

- In the case of dependent personal service – the conditions for tax exemption are:

  a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the fiscal year concerned; and
  b) the remuneration is paid by, or on behalf of an employer who is not a resident of the other State; and
  c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

- Under the Mutual Agreement Procedure (MAP), where an agreement between the competent authorities result in agreed adjustments to be made, such will be implemented regardless of any time limit contained in the local legislation.

- There is a provision for the exchange of information but it does not allow the supply of any information which is not obtainable under the laws or in the normal course of the

administration of either country.

- Article 23 contains a tax sparing provision under paragraph 3 which states that "for the purposes of allowance as a credit the tax payable in Mauritius or Nigeria as the context requires, shall be deemed to include the tax which is otherwise payable in either of the two Contracting States but has been reduced or waived by either State in order to promote its economic development."

Response to specific questions

1. Extent of conformity of the treaty to the UN model on tax treaties

The DTT conforms to the UN model double tax convention in some respect. For instance Article 5 deems a PE when a construction, installation or assembly project exceeds 6 months. This provision is consistent with the conditions stated in the UN model tax treaties for determining PE. Also, there is Service PE which can be created through the furnishing of services including consultancy services by an enterprise of a Contracting State through employees or other personnel engaged in the other Contracting State, provided that such activities continue for the same or a connected project for a period or periods aggregating to more than 6 months within any 12-month period.

The DTT is also consistent with the principles of the UN model tax treaties on the attribution of business profits to a PE through the application of force of attraction principle. It however conflicts with the UN model in that the DTT allows for the deduction of expenses to the head office based on the arm's length principles.

Below is a summary of the key differences:

Item	**Mauritius Nigeria DTT**	**OECD Position**	**UN Position**
Threshold for a PE	Construction PE from 6 months.	Construction PE from 12 months.	Construction PE from 6 months.
Service PE	The furnishing of services constitutes a PE if it continues for more than 6 months within any 12month period.	Generally not applicable, unless optional services PE included in specific treaty.	Services PE may be created thereby allocating taxing right to source country.
Profit of PE	Force of attraction applies. Deductions for arm's length expenses.	No force of attraction. Arms' length deductions applicable.	No arm's length deductions; limited force of attraction.
Withholding tax	Reduced from 10% to 7.5% on dividend, interest and royalty.	Reduced WHT on dividend and interest. No WHT on royalty.	Source country can tax dividends, interest and royalties, no max rates specified.
Capital gains	Essentially limited to immovable properties. No tax on gains from shares but this is also the case under the	Gains on immovable properties and other limited cases.	Allows source country impose tax on more gains.

	domestic law.		

Item	Mauritius Nigeria DTT	OECD Position	UN Position
Other income	Article 22 allows source country to tax other income not covered. This could enable Nigeria levy WHT on technical and management fees.	Not taxable (Article 21)	Other income may be taxed in source country.
Tax sparing	Article 23 provides for tax sparing for tax waivers or reduced tax rates.	Not specifically included.	No specific provision included.
Anti-treaty shopping and beneficial ownership	Beneficial ownership included for royalty, interest and dividend reduced WHT but no specific anti treaty shopping provision.	Beneficial owner restriction	Beneficial owner restriction

2. Likely impact of the treaty on sharp practices by multinationals

One of the setbacks of DTTs is the allowance they create for tax evasion and (or) treaty shopping. The Nigerian – Mauritius DTT could result in sharp practices by multinationals operating in the countries and especially in Nigeria through double non-taxation. This is particularly the case with the reduced rate of withholding tax on streams of income flows from Nigeria such as dividend which are not taxable in Mauritius and the tax sparing provision applicable to reduced tax rates and waivers on income streams such as interest and royalty.

Moreover, it might be difficult to distinguish between genuine investors and "shell" companies. Shell companies are those companies which only exist on paper, with no real employees or offices. The legal framework for company incorporation in Mauritius makes this possible. Consequently, a multinational organisation may register in Mauritius and technically earn income in Nigeria without creating a PE and at the same time not considered resident in Mauritius for tax purposes. This will again lead to double non taxation.

3. Implication of the treaty for resource generation for the country

Given that Nigeria is a net importer of capital and will remain so for the nearest future, the DTT by limiting the taxing right of Nigeria on dividend, interest and royalty potentially reduces the tax base of the country which will impact negatively on the revenue generation for the country. Also, due to the unfriendly holding company regime in Nigeria (S19 of the Companies Income Tax Act), many Nigerian based group of companies would take advantage of the DTT to shift their headquarters to Mauritius thereby denying Nigeria of tax revenue.

Section 19 of the Companies Income Tax Act states that "*Where a dividend is paid out as profit on which no tax is payable due to:*

a) *no total profits; or*
b) *total profits which are less than the amount of dividend which is paid, whether or not the*
recipient of the dividend is a Nigerian company, the company paying the dividend shall be charged to tax … as if the dividend is the total profits of the company for the year of assessment to which the accounts, out of which the dividend is declared, relates."

4. How does the treaty become a ready document to be exploited by those inclined towards treaty shopping.

It is difficult to prevent treaty shopping in its entirety. However, there are some obvious loopholes in the Mauritius – Nigeria DTT which will make treaty shopping under the agreement more attractive. For instance, where a holding company based in Nigeria earn dividend which has suffered corporate income tax and withholding tax, the net dividend is regarded as non taxable. However, where the holding company further distributes the dividend, another provision of the local legislation triggers a further income tax at 30% on the holding company making such distribution.

Interestingly, if the holdco is resident outside Nigeria, the dividend can be paid out and brought in by way of redistribution to Nigerian shareholders without any further tax. The DTT with Mauritius makes this even more attractive by limiting the withholding tax payable at the first level of distribution by the Nigerian operating company to the holdco and then exempting the round-tripped income.

Another area is employment income (or dependent personal service). The conditions for exemption from tax in Nigeria where the employment duties are wholly or partly performed in Nigeria includes liability to tax in another country with which Nigeria has in-force DTT. This means that executive and management level personnel may be employed through "shell" companies in Mauritius and the affairs arranged in such a way that allows them to pay minimal tax in Mauritius with full exemption from taxation in Nigeria. This will not only deny the FIRS tax revenue but also many of the state tax authorities who are legally empowered to collect tax on most individuals will suffer loss of tax revenue.

5. Implications for Foreign Direct Investment – what are the realities as against assumptions?

Generally, DTTs are expected to stimulate economic growth and foreign direct investments. However, there is no evidence to show that this has been a major factor in making investment decisions into Nigeria by multinationals. US companies are some of the biggest investors in Nigeria notwithstanding that there is no DTT between Nigeria and the US while very limited investments have been made by Pakistani companies into Nigeria despite an in-force DTT between both countries.

Investors tend to be more concerned about the general regulatory environment, protection for their investment, growth potential and certainty of treatment regarding taxation rather than strictly the existence of a DTT.

Overall, Mauritius is a small country and therefore real Mauritian companies will not make any significant investment into Nigeria. Given the interest by global investor in Africa, and the unfriendly tax regime under the Nigerian local legislation, many multinationals will simply use Mauritius as a conduit for their investment into Nigeria by taking advantage of the DTT. Various sources have shown that Nigeria is one of the leading beneficiaries of FDI in Africa and will remain so for some time to come.

6. **Will an anti-avoidance legislation have any complimentary role in addressing abuses?**

   Yes, an anti avoidance legislation will limit (but not fully eliminate) abuses.

   The transfer pricing regulation in Nigeria, modelled in line with the OECD and UN conventions, would go a long way in mitigating tax evasion and other sharp practices by multinationals. The regulation specifies that transactions between connected entities are carried out at arm's length.

   In addition, Section 22 of Companies Income Tax Act (CITA) grants the Federal Inland Revenue Service in Nigeria (FIRS) the power to disregard a business transaction and subject same to tax, if it perceives a business structure as fictitious or considers that it would artificially reduce the amount of tax payable. In practice, the FIRS considers the substance of a business transaction over the legal form.

7. **Proffer alternatives to the treaty and or recommendations on issues arising from the treaty.**

   In view of the "tax haven" status of Mauritius, Nigeria will be giving away far too much by entering into a DTT with Mauritius. Nigeria should either not enter into the treaty at all and if at all necessary the taxing rights should be retained. For instance, there should be no reduction of withholding tax on dividend, interest and royalty. The treaty benefits should be limited to exchange of information, certainty of treatment regarding creation of PE, MAP and so on.

8. **Are there revenue policies and existing tax laws and or other legislations in the country the treaty would be in conflict with?**

   The treaty will conflict with the certain provisions of the Companies Income Tax Act which requires that expenses incurred abroad in respect of management fees and other overhead be approved by the FIRS before a tax deduction can be granted.

   Also the Companies and Allied Matters Act does not permit the operation of business in Nigeria through a branch or PE without the incorporation of a subsidiary except in very limited circumstances. This conflict is however not limited to the Mauritius Nigeria DTT given that similar provisions exist in all the other in-force treaties Nigeria has entered into.

9. **Does the country's tax administration/arbitration system has the capacity to respond to some of the challenges and conflict that could arise from the treaty?**

   Tax administration and arbitration system in Nigeria is largely rudimentary and capacity constrained. This is reflected in the slow resolution of tax disputes and the low quality of decisions by tax tribunals and the court. Also, the competent authority for MAP under the DTT has traditionally not paid sufficient attention to tax matters. For instance, it has been about 2 years now (April 2012) since the head of the FIRS tenure expired without a substantive replacement.

   As a result of the above, the country's tax administration and arbitration system may not be able to respond adequately to the challenges and conflicts that could arise from the treaty.

Conclusion

Overall, the cost (financial and otherwise) of the treaty to Nigeria will outweigh the perceived benefits notwithstanding the unavailability of empirical data to confirm this. It is advisable for

Nigeria not to ratify the treaty unless certain changes are made to retain Nigeria's taxing rights as contained in the domestic tax legislation including the imposition of withholding tax on technical and management fees.

Going forward, treaty negotiations should be based on well-considered parameters from a cost-benefit point of view. This can be achieved by developing a national strategy for treaty negotiation and coming up with a model treaty which best protects the country's interest to reduce reliance on oil revenue. This should be done in full consultation with all key stakeholders including the organised private sector.

The greatest tax incentive which Nigeria should offer at this time is to simplify the tax system in order to improve the ease of paying taxes and provide certainty of tax treatment under similar circumstances applied consistently from one taxpayer to another.

This review was done by Taiwo Oyedele-a tax specialist as a pro-bono service and contribution to ActionAid's work on Tax Justice.