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**Using Corporate Tax Regimes to promote Economic Growth
and Development a Legal Analysis of the Nigerian Corporate
Tax Regime.**

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**A thesis submitted in partial fulfilment of the
requirements of the
Robert Gordon University
for the degree of Doctor of Philosophy**

The Law School

Robert Gordon University Aberdeen, United Kingdom

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January 2017

DECLARATION

I, N. CHISA ONYEJEKWE, hereby declare that the work on which this thesis is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work, nor any part of it has been, is being, or is to be submitted for another degree in this or any other university. I authorize the University to reproduce for the purpose of research either the whole or any portion of the contents in any manner whatsoever.

ABSTRACT

The recession that started in the late 2000s has created significant economic and financial challenges globally and within nation states. In particular, oil-producing countries have been further affected by the fall in oil price. It is therefore crucial that alternative, more sustainable methods of sourcing revenue be investigated and utilised. The purpose of this thesis therefore is to examine the use of corporate tax regimes as a sustainable revenue source in promoting economic growth and development in Nigeria. Using a qualitative legal analysis, of the Nigerian corporate tax regime and through an extensive literature review, the thesis identified a number of key findings.

Inter alia, that revenue from corporation tax structures are a sustainable revenue source mostly because of the amount of revenue generated through Multinational Corporations (MNCs). Secondly, the existing Nigerian corporation tax regime is in need of reform as there are developmental challenges, including lack of implementation and ambiguous legislation, which continue to thwart its success. Therefore, this leads to establishing how, and to what extent that Nigeria can use its corporate tax regime as a sustainable revenue source. The answer to this lies in the legal framework of corporate tax regimes. This thesis argues that legal uncertainties in the corporate tax regimes are the principal reason for the challenges faced by both state governments and MNCs. The thesis concludes by recommending reforms to the Nigerian tax regime while also recommending a tax compliance strategy for both domestic and international corporate tax regimes. This will set a foundation for corporation tax regimes as a sustainable revenue generation source for developing countries.

Keywords: Corporation Tax, Law and Economic Development, International Corporate Tax, Compliance and Enforcement, Developing Countries, Nigeria, United Kingdom, Tax Evasion and Avoidance, Multinational Corporations.

DEDICATION

To my parents- Dave and May

ACKNOWLEDGMENTS

In the course of writing this thesis, there is so much for which I am thankful. This thesis will not have been possible without the blessing and grace of God, who turned an illusion into a dream and finally into my reality. I am ever thankful for His constant love and mercy.

I am grateful to my parents; whose overwhelming love saw me through this journey. Without their constant encouragement, I would not have made it. Thank you for believing in me.

To my siblings Mez Ude&Uju, Mu, & Deb, Uche & Amaka who each supported me in their own ways, thank you for your constant love and support love you all. To the sister of my heart Chidinma, thank you for being you, for sharing the pains and joys, for your love and most especially for your dedication and belief in my success. Mo: - thanks for your faith in me and for the prayers; Michelle- my 'twinnie', thank you for your love, kind words and support.

To my mentor, supervisor and friend – William Craig, I say thank you for introducing me to Tax Law, thank you for introducing me to teaching, thank you for being my strong support at all times without failing; without you as my supervisor, this will not have been achieved. I thank you and your lovely Karen for taking me into your home and into your hearts. I wish to thank my second supervisor, Dr Sarah Christie for her gentle support and constructive feedback. Drs Leon Moller, Elimma Ezeani, Joseph Mante, Robert Halsall, Simon Fraser, Martyn Gordon for their input and support in my thesis. I wish to thank in a special way the friends I was blessed and privileged to meet on this journey – Adekunle, Miru, Maureen, Ada & Uddy, Aisha, Paul, Amede, Chimere, Ibukun, Karan, Nkeiru, Agnieszka, Fr Patrick Lambert. Special thanks go to the Dyslexia and Disability centre RGU, The University library especially, Anne Nichol, Lyn Mair, Irene Brockie, Carol Kemp, Lindsey Connon, Heather Bain, Susan Cowling, Karen Smith, Alison Bell, Alison Burnett, Jane Williams, Margret Buchan and Colin Maclean.

Finally, to Arthur- thank you for your steadfast friendship and dedication particularly at the tough times.

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LIST OF ABBREVIATIONS

Association of Certified Chartered Accountants (ACCA)

Base Erosion and Profit Shifting (BEPS)

Capital Gains Tax (CGT)

Chevron Nigeria Limited (CNL)

Companies and Allied Matters Act 2004 (CAMA)

Companies Income Tax Act 1990 (CITA)

Confederation of British Industry (CBI)

Corporate Affairs Commission (CAC)

Corporate Income Tax (CIT)

Corporate Profits Tax (CPT)

European Union (EU)

Exchange of Information (EOI)

Federal Inland Revenue Service (FIRS)

Finance Act (FA)

Foreign Account Tax Compliance Act (FATCA)

Foreign Direct Investment (FDI)

General Anti-Avoidance Rules (GAAR)

Gross Domestic Product (GDP)

Gross National Product (GNP)

Her Majesty's Revenue and Custom (HMRC)

House Committee on Petroleum Resources (HCPR)

Inland Revenue Service (IRS)

Intergovernmental Agreement (IGA)

International Monetary Fund (IMF)

Joint Venture Agreement (JVA)

Least Developing Countries (LDC)

Limitation of Benefits Clauses (LOB)

Mobil Producing Nigeria Unlimited (MPN)

Multinational corporations (MNCs)

National Insurance Contributions (NICs)

National Office for Technology Acquisition and Promotion (NOTAP)
Nigeria Liquefied Natural Gas Company (NLNG)
Organisation for Economic Co-operation and Development (OECD)
Permanent Establishment (PE)
Personal Income Tax (PIT)
Petroleum Profits Tax Act 1990 (PPTA)
Petroleum Profit Tax (PPT)
Reserve Additional Bonus (RAB)
Shell Petroleum Development Company of Nigeria (SPDC)
Shell Petroleum Internationale Mattschappig (SPIM)
Small and Medium Enterprises (SMEs)
State Infrastructure Maintenance and Regulatory Agency Law, 2004 (IMRA)
Tax Appeal Tribunal (TAT)
The Taxes and Levies (Approved List for Collection) Act (TLA)
Trades Union Congress (TUC)
United Nations (UN)
Universal Declaration of Human Rights (UDHR)
Value Added Tax (VAT)

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CHAPTER 1: Thesis Introduction

1.0 Introduction

Nigeria has a vision to be one of the world's great economic powers by 2020.¹ The country's economic recession² at the time of writing this thesis, presumes that this will not be achievable. However, this thesis argues that this present economic conditions create an ideal environment and opportunity to set Nigeria on the course to achieve this vision. It is on this premise that this thesis sets out to investigate and analyse the corporate tax regime of Nigeria to understand how the said regime can facilitate the achievement of this vision within a realistic timeframe.

Tax systems, as a set of laws with clear policies, work towards achieving economic growth. The process of economic development in every nation state involves the interplay of both law and economics in order that the impact on the quality of life and its infrastructural development³ is felt. In essence then, well-structured rules and legislation provide an environment that fosters economic growth and development. Such economic growth is underpinned by several factors including natural resources, human resources, technology and capital through investment. Of these factors, investment and capital are seen to be key aspects.⁴ This is because through tax systems, governments have not only stimulated investment but also fulfilled their objectives with revenue accrued from taxes.⁵ Accordingly, Frecknall-Hughes states that taxes have been used to service government plans and needs, and this invariably forms the main objective of

¹ Federal Ministry of Budget and National Planning, Nigeria: Vision 2020' December 2010 < <http://www.nationalplanning.gov.ng/images/docs/NationalPlans/nigeria-vision-20-20-20.pdf>> accessed 09 January 2017. In 2009, the National Planning Commission came up with Vision 20:2020 in which Nigeria's GDP is projected to reach \$900 billion by 2020 and thus ranking Nigeria as one of the top 20 economies of the world.

² At the time of writing this thesis, Nigeria has gone into economic recession. Martin Patience, 'Nigerian economy slips into recession' BBC News < <http://www.bbc.co.uk/news/business-37228741>> accessed 14 September 2016.

³ Mashood A Baderin, 'Law and Development in Africa: Towards a New Approach' (2011) NIALS Journal of Law and Development 4.

⁴ Adewale Stephen Bakare, 'Multinational Direct Investment and Economic Growth in Nigeria: An Empirical Study' (2010) 4 International Business Management 171.

⁵ Adewale Stephen Bakare, 'The Crowding-Out Effects of Corruption in Nigeria: An Empirical Study' (2011) 2(2) Journal of Business Management and Economics 059.

taxation.⁶ What constitutes a particular governments' plan and needs may differ from that of another government. Therefore, it is necessary that the role of tax revenue be clarified. Essentially, Craig states that taxes are an inevitable factor in the provision of social welfare and therefore, it could be proper to conclude that for public dissension to be avoided, modern tax systems must be acceptable.⁷ Individually, developed and developing countries worldwide have experimented and proven that nations cannot truly develop without developing a tax system.⁸ By establishing effective tax systems, developed countries have used it as a means of revenue creation, which has served their economies to the extent that this has become a sustainable source of revenue.⁹ In the same vein, many developing countries are on the verge of reforming existing tax systems¹⁰ and establishing new systems that will work towards generating much needed revenue. It is expected that these reformed and new systems will simultaneously generate revenue and combat revenue migration through tax evasion, tax avoidance and illicit financial flows.

Through the years, revenue from taxation whether income tax, value added tax or some other type of taxation, has been used to fund government needs and it has been noted that an effective tax system ought to satisfy the twin purposes of raising maximum revenue as well as encouraging production.¹¹ Consequently, many countries have embarked on tax reforms and restructuring with a view to developing a tax system that maximizes government revenue without creating dis-incentives for investment.¹²

⁶Jane Frecknall-Hughes, *The Theory, Principles and Management of Taxation: An Introduction* (Routledge 2015).

⁷ William Craig, *Revenue Law* (3rd ed. Edinburgh University Press 2013).

⁸ M Emmanuel, 'Nigerian Tax System: Entrenching New National Tax Policy' [2010] Nigerian Tribune in Uyi Kizito Ehigiamusoe, 'The Nexus between Tax Structure and Economic Growth in Nigeria: A Prognosis' (2014) 4 (1) Journal of Economic and Social Studies 113.

⁹ The UK Budget shows that revenue from taxation funds almost all of the governments projects.

¹⁰ The structure of a majority of the tax systems in developing countries, are creations of the colonial rulers which in that era, would have favoured the colonial government.

¹¹ Uyi Kizito Ehigiamusoe, 'The Nexus between Tax Structure and Economic Growth in Nigeria: A Prognosis' (2014) 4 (1) Journal of Economic and Social Studies 113.

¹² Ibid.

Business taxation is considered one avenue of sustainable income for governments, especially with globalization and the rise in international trade and investment.¹³ Well-structured business taxation systems have encouraged corporations in certain developed countries to contribute to economic growth through FDI.¹⁴ The majority of revenue from business taxation is generated from corporation tax and the importance accorded to the major players within corporation tax (MNCs) cannot be downplayed. This therefore drives the need to understand their activities as these are particularly important considering that they generate positive (or negative) spillovers to domestic firms and the local economy.¹⁵ Ideally, it is presumed that MNCs are more profitable than domestic corporations are, and should consequently pay a higher amount of tax in developing countries. However, despite the payment of tax, evidence suggests that MNCs shift income to low-tax jurisdictions more easily using a variety of devices such as transfer pricing or excessive levels of debt.¹⁶ Most MNCs make decisions that are driven by the cost of, and the expected return from investment projects. Corporate tax can therefore have a negative effect on corporate investment by reducing its profits after tax return. Empirical literature suggests that there is a relationship between corporation tax and FDI. Furthermore, corporate tax rates and the tax base are essential to investment, which is vital to national economic growth.

Certain factors determine the success of corporation tax and these can range from the rate of changes of the tax base, the stability of the legislation, and the enforcement measures. Changes in business taxation, in particular, can have disruptive effects on firms if they are not phased in

¹³ See for instance, Michael P Devereux, 'Business Taxation in a Globalized World' (2008) 4 Oxford Review of Economic Policy 625.

¹⁴ After the fall of the Celtic Tiger, Ireland sought to improve its economy by attracting FDI through Multinational corporations. One of the major changes it did to achieve this was to restructure its business taxes especially, the corporation tax laws.

¹⁵ Michael P Devereux, 'Business Taxation in a Globalized World' (2008) 4 Oxford Review of Economic Policy 625.

¹⁶ OECD, 'Action Plan on Base Erosion and Profit Shifting' (OECD 2013)
<<https://www.oecd.org/ctp/BEPSActionPlan.pdf>> accessed on 08 May 2015.

appropriately; for example, in the UK, politicians have had a tendency of pledging to implement reform during election campaigns. However, these changes are not always implemented when in power. Moreover, changes in one country's tax system can affect other countries, directly and indirectly. In the bid to attract FDI, state governments cut and change the CIT rate and in some situations, have lax enforcement strategies or laws.¹⁷ Consequently, other countries feel the need to do likewise and the subsequent ripple effect distorts the entire international tax system. Invariably, developing countries could end up bearing the proverbial 'bad end' of this and emerge poorer than before. This is evidenced in the literature of the effects of corporation tax on economies that will be reviewed.

This thesis is based in this context; and to further develop and situate this study, this chapter first presents a background to the problem and identifies the general purpose and specific objectives of the research. The significance of the research will be explored while the methodology used will be discussed. Finally, an outline of the thesis is presented.

1.1 Background of the Problem

Whether tagged as a 'developing', 'emerging' or even a 'perpetually developing' country, Nigeria has been experimenting with different methods for achieving economic growth in order to ease the current total dependence on crude oil as a revenue source.¹⁸ The slow growth of Nigeria's economy has hindered its development and subsequently brought into focus the need for a diversification of the revenue sources.¹⁹ Oil revenue has contributed substantially to the Nigerian economy. In 2015, it accounted for 95 percent of the government revenue and 70 percent of the total foreign exchange earnings.²⁰ However, the supply, demand and price

¹⁷ An example of this can be found in the "pick and choose" strategy and sweetheart deals of the UKs HMRC with MNCs where MNCs have been seen to arrive at deals on their tax liabilities.

¹⁸ AA Awe and SO Ajayi, 'Diversification of Nigerian Revenue Base for Economic Development: The Contribution of the Non-Oil Sector' (2009) 6 Pakistan Journal of Social Sciences 138.

¹⁹ Ibid.

²⁰ Emmanuel Ezeji Chigbu and Charles Odinakachi Njoku, 'Taxation and the Nigerian Economy: (1994-2012)' (2015) 2(2) Management Studies and Economic Systems 111.

limitations of the product have made continuation of its dependence unreliable. Ezeani alludes to the reliance on the significant wealth generated from the oil sector, particularly in the 1970s and early 1980s, as being the Achilles heel in the country's economic progress.²¹ Additionally, the decline in oil prices from the mid-1980s, and the stringent loan conditions applied by the International Monetary Fund (IMF) made the Nigerian government adopt tough measures in a bid to salvage its dwindling economy.²² The Nigerian government seemed to have had a somewhat questionable ideology that its economic problem required a more appropriate allocation of the funds to different sectors rather than a generation of more revenue.²³ Despite these measures, the trend of relying on oil continued and with the recent oil price crash, the country now faces a dire situation.

Nigeria has presently slipped into recession and, as a result, is in urgent need of diversification of its revenue generation. Although the government's aim is to raise majority of its needed funds through taxation, it has been argued that the system is besieged with issues and complexities.²⁴ This thesis argues that these include, but are not limited to, overlapping legislations and regulatory bodies, and uncertainties mainly due to laws that do not seem to be coherent and therefore creates legal uncertainties for foreign investors. It has also been identified that ingrained corruption in the government plays a role in creating such uncertainties while the taxpaying public does not contribute to Nigeria's economic development.²⁵ The present Finance minister has stated that although wastage remains a challenge, corruption is

²¹ Elimma C Ezeani, 'Economic and Development Policy-making in Nigeria' (2012) 56 *Journal of African Law* 109.

²² *Ibid.*

²³ *Ibid.*

²⁴ See *inta alia*, the following literature- Uyi Kizito Ehigiamusoe, 'The Nexus between Tax Structure and Economic Growth in Nigeria: A Prognosis' (2014); AA Awe and SO Ajayi, 'Diversification of Nigerian Revenue Base for Economic Development: The Contribution of the Non-Oil Sector' (2009) 6 *Pakistan Journal of Social Sciences* 138.

²⁵ Ifeuko O Okauru, (ed.) *Federal Inland Revenue Service and Taxation Reforms in Democratic Nigeria* (Ibadan 2012).

the most debilitating factor in the Nigerian economy.²⁶ She suggests that whatever revenue was not stolen has been misused.²⁷ This scenario therefore sets the foundation for an unattractive business environment that does not encourage investment. Thus, there is a need to revisit the Nigerian tax system especially the corporate tax structure.

In addition to the above issue also, the international system for taxing MNCs can be said to be uncertain and rife with inconsistencies and loopholes which include, but are not limited, to tax evasion, tax avoidance and base profit shifting.²⁸ This has also added to the negative impact of the downturn in Nigeria's economy, as there have been reported instances where the activities of MNCs have led to tax evasion and avoidance.²⁹ Further, there have been calls for reforms by academics³⁰, campaigners³¹ and governments, from mostly developed and advanced countries and this suggests that the effects of the problems are faced worldwide.³² These calls

²⁶ Kemi Adeosun, 'Corruption has been the most debilitating factor in Nigeria's economic picture' (BBC World News Africa Business Report, April 29 2016) < <http://www.bbc.co.uk/programmes/p03skt14>> accessed 14 September 2016.

²⁷ Ibid.

²⁸ Sol Piccioto, 'Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation' (2015) 24 (2) Social Legal Studies 165.

²⁹ Activities of MNCs such as Chevron, MTN, Shell, Siemens etc. have been said to lead to tax evasion and avoidance.

³⁰ See Michael P. Devereux and John Vella, 'Are We Heading Towards a Corporate Tax System Fit for the 21st Century?' (2014 Centre for Business Taxation) 14/25

<https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/2014/iipf_summer_school/devereux-vella.pdf> accessed 24 April 2016.

³¹ See the works by Tax Justice Network, Christian Aid etc. – Christian Aid, 'False Profits: Robbing the Poor to Keep the Rich Tax Free, (Christian Aid 2009)< <http://www.christianaid.ie/ActNow/take-action/trace-the-tax/resources/false-profits.aspx>> accessed 23 April 2016; Christian Aid, 'Paying Our Dues: How Tax Dodging Punishes The Poor: A Christian Aid Report' (Christian Aid 2010) <

<https://www.christianaid.org.uk/images/ChristianAidTaxReport.pdf>> accessed 19 April 2016 ; Tax Justice Network, 'The Scale of BEPS: Estimating the Scale of Global Corporate Tax Cheating' (Tax Justice Network 2015) < <http://www.taxjustice.net/scaleBEPS/>> accessed 26 April 2016; Tax Justice Network, 'Still Broken: Major New Report on Global Corporate Tax Cheating' (Tax Justice Network 2015) < <http://www.taxjustice.net/2015/11/10/still-broken-major-new-report-on-global-corporate-tax-cheating/>> accessed 26 April 2016.

³² The thesis, recognises the interest of international campaign bodies such as ActionAid, Oxfam etc. who fight for rights of developing and less developing countries. It also recognises that the African Union (AU) as a body has called for the reforms to be made in the international tax system which allows for illicit financial flows from Africa to tax havens or offshore accounts. See: AU/ECA Conference of Ministers of Finance, Planning and Economic Development, 'Illicit Financial Flows; Report of the High Level Illicit Financial Flows from Africa', (AU/ECA Conference of Ministers of Finance, Planning and Economic Development 2011) <http://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf> accessed 9 May 2016.

from the international community³³ together with state governments are also continuously trialling reforms. As recently as 2013- 2015, a number of developing countries joined in the consultations of the joint G20 and the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project.³⁴ This project has produced an action plan for the reform of the international tax system in order to curb the transfer of profits by nationals from one jurisdiction to another. This shift of profits from jurisdictions affect developing countries much more than developed and advanced countries because of their need for revenue generated by taxing the profits of MNCs. While developed countries are pondering the continuous use of the corporation tax, developing and lower, income countries see corporation tax as a saving need.

The overall aim of these reforms is to promote an influx of Foreign Direct Investment (FDI) through MNCs with the result of achieving economic growth and development. However, despite these reforms, challenges are still faced by both domestic and international communities, which have led to a loss of revenue for state governments.

1.2 Aims and Objectives

1.2.1. Research Aim

With the assumption that corporation tax is integral to national economic stability, this thesis aims to critically examine the corporation tax regime in Nigeria. This will be approached from the perspective of identifying its key challenges and further identifying ways in which these challenges could be remedied to enhance its contribution to sustainable economic development.

³³ International community in this context refers to international organisations such as the OECD and the United Nations (UN), and institutions such as the G20, the European Union (EU) and State governments which are considered key actors in this subject.

³⁴See OECD, 'Developing countries and BEPS' (OECD 2016) < <http://www.oecd.org/tax/developing-countries-and-beeps.htm>> accessed 27 April 2016.

The aim above raises the following questions that the thesis seeks to answer:

1. How does the legal structure of corporate tax regimes influence economic development?
2. What is the impact of MNC practices on the relationship between the tax system and economic growth?
3. To what extent does the international system for taxing MNCs, interact and recognise domestic tax law on the taxation of MNCs in Nigeria?

1.2.2 Research Objectives

To answer these questions, the following objectives are set:

- To analyse the literature and theories on the relationship between taxation and economic development
- To explore the current challenges in the use of taxes in particular the corporation tax as a sustainable source of revenue for economic growth and development for developing countries specifically Nigeria.
- To analyse the effectiveness of the existing corporation tax systems in Nigeria, UK and the international system for taxing MNCs with the aim of identifying best and worst practices and lessons for improvement
- To investigate the influence of the current inadequacies of the legal premise for the location of FDI by MNCs in Nigeria
- To analyse the effects of tax compliance, together with existing deterrence and enforcement measures on national economies.

The findings of the objectives will contribute towards setting the foundation for the justification for the use of tax revenue for sustainable economic growth and development in Nigeria. Additionally, the findings will contribute towards providing recommendations for a reform of the existing corporate tax legislation, which will serve amongst sustainable revenue sources other than oil revenue for the Nigerian government to be able to fulfil its obligations to its citizens. Findings of the penultimate objectives, will lead towards an assessment of the continuous consequences of a weak or poorly structured domestic and international corporate tax system with the aim of providing recommendations for a more profitable, sustainable and equitable system. Further, findings from the last objective, will achieve an evaluation of existing deterrence and enforcement measures. This will contribute towards an understanding of the reasoning behind poor compliance attitudes and in particular, the drive towards tax avoidance and evasion by MNCs.

1.3 Purpose of the Study

The concerns identified above clearly positions the thesis' purpose in terms of understanding these issues. In order to achieve this purpose, the argument for the notion that corporate tax (CT) revenue from MNCs and domestic corporations are important sources of much needed government revenue for economic development is developed. The necessity of this can be seen in the current situation in Nigeria. The top economic goal of Nigeria is sustainable economic growth.³⁵ Nigeria is Africa's most populous nation and the largest economy in the continent. It had until recently, had the highest growing Gross Domestic Product (GDP) rate in Africa and

³⁵ Margaret N Okoli, Charles Odinakachi Njoku and Gift Nkiru Kaka, 'Taxation and Economic Growth in Nigeria; A Granger Causality Approach' (2014) 2 International Journal of Research in Management, Science & Technology 64 < <http://ijrmst.org/download/vol2no3/margaret-nokoli.pdf> > accessed 25 October 2015.

is the world's eighth largest oil exporter.³⁶ Yet, more than sixty percent of the population lives in extreme poverty, and youth unemployment is close to eighty percent.³⁷

Recently, Nigeria has been lauded as having the highest growing GDP in Africa but still no fiscal measure has been put in place to ensure the sustainability of the GDP growth rate.³⁸ Economic sustainability is paramount to the development of any nation, and this sustainability occurs when a nation has the preferred percent, for example 5 percent, of this population below its preferred minimum standard of living level.³⁹ Certain concerns have been noted to stand out as challenges in the Nigerian business environment for foreign and MNCs across Nigeria. These include corruption, inadequate infrastructure and low skill levels, legal and macroeconomic uncertainty.⁴⁰ Similarly, the UK corporate tax regime faces its own challenges. For example, MNCs have been making use of loopholes in the tax regime not just to avoid paying tax but also to avoid paying the right amount of tax. Hence, the question of the extent to which corporation tax is still fit for purpose is raised.

The thesis evaluates the means through which revenue generated by corporation tax systems, may serve in promoting sustainable economic development particularly for developing countries. It delves into the debate over the efficacy of corporation tax by highlighting apparent complications that attends its use. The aforementioned will be analysed and discussed using Nigeria as the specific country example while using the United Kingdom as an illustration of a model structure. This thesis recognises that there are countries⁴¹ other than the UK, which share similarities with Nigeria and could have been chosen for illustration. The choice of the

³⁶ Central Intelligence Agency, 'The World Fact Book-Nigeria' (CIA 2015) <<https://www.cia.gov/library/publications/the-world-factbook/geos/ni.html>> accessed 25 October 2015.

³⁷ Ibid.

³⁸ Ibid note 28.

³⁹ Ibid.

⁴⁰ PWC, 'Nigeria: Looking beyond Oil' (PWC March 2016) <<https://www.proshareng.com/admin/upload/reports/nigeriaooking.pdf>> accessed on 20 August 2016.

⁴¹ African countries such as Ghana, South Africa etc., share similar demography with Nigeria while a developed country like the United States and Nigeria have a similarity in their federalism.

UK is because Nigeria was colonised by the UK and Nigeria has set its laws based on the UK laws. It is interesting to note that the UK does not have a federal system of government nor does it have a written constitution. Nevertheless, the foundation of Nigerian law especially, the company and corporate tax laws is modelled on the UK's law.

1.4 Significance and Contribution of the Study

This thesis therefore considers the role of corporation tax system in Nigeria and in particular its legislations in promoting sustainable economic growth and development for countries. It relies on the idea that economic development is fundamental for all countries but especially for developing countries. This study aims to firstly and primarily proffer recommendations that will aid in addressing the planned reform of the Nigerian corporate tax regime. Further, it will recommend a tax compliance strategy for the future, and a reform of the system for taxing MNCs operating in Nigeria.

This thesis has contributions for the academic literature in Nigeria and Policy contributions for the government through the Ministry of Finance and Federal Inland Revenue Service. These are summarised in this section but discussed in detail in Chapter 6.

1. A number of articles and opinions exist on this topic, albeit in the field of economics and accountancy, and all of which adopted an empirical and quantitative method. In addition, some of the limitations faced included finding literature in this area and hence a reliance on newspapers and government websites and websites of non-governmental organizations. Additionally, by conducting a qualitative legal analysis, this thesis introduces a new method and strategy of understanding the challenges of the corporate tax in Nigeria and its relationship to economic growth and development.
2. The thesis, contributes to tax policy development by making recommendations for improved corporate tax legislation, a tax compliance strategy and creating an

enforcement regime in Nigeria, which will enable the government in sustainably using the revenue from corporation tax as one of its means of revenue generation. It is expected that this will help in the much needed and ongoing process of diversifying the Nigerian revenue base as the existing National Tax Policy has failed to address the mentioned problems in the structure. The success of this should have a positive economic influence on the Nigerian citizens and government.

1.5 Research Methodology

Given the anticipated contribution of this study to the extant body of knowledge, it is important that the methods used for data collection and analysis be explicit and rigorous⁴². This section therefore outlines the methodology and explains the justification for the particular method in order to achieve the aims and objectives.

1.5.1 Research method and Justification

This thesis primarily, is conducted using a qualitative non-doctrinal legal research method.⁴³

This does not discount the fact that elements of doctrinal legal research are incorporated.

⁴² Jan Jonker and Bartjan Pennink, *The Essence of Research Methodology: A Concise Guide for Master and PhD Students in Management Science* (Springer-Verlag 2010).

⁴³ Non-doctrinal research more generally refers to external factors while seeking answers that are consistent with the existing body of rules. This type of research is also described as interdisciplinary, empirical or socio-legal research. Non-doctrinal legal research commences when the epistemological nature of legal research changes from an internal enquiry into the meaning of law, to that of an external enquiry into either the nature of law or law as a social entity. This form of legal research is considered empirical in nature and helps in the understanding of how law works in practice. It is used to understand, evaluate and examine the effects and impacts that legal rules and legislation have not only on people and communities, but also on the wider international community.

Furthermore, it helps in understanding how other disciplines influence law and legal institutions. In other words, non-doctrinal research does not investigate the law as the doctrinal research does, rather it researches about law and in particular, how it affects or relates with the society and other institutions. For example, it can evaluate the effectiveness of a particular piece of legislation in achieving a particular social goal. Similarly, it could examine the extent with which a particular legislation is being complied. Research questions structured in the manner mentioned above cannot be fully answered doctrinally. This notwithstanding, to fully answer such questions, there must be an element of doctrinal research. While trying to answer questions about the law or legislation being researched empirically or non-doctrinally, a researcher has first to determine the existing law, which can only be done doctrinally.

There are three main reasons for choosing this method against other styles in order to achieve the research aim. Firstly, the research question that this thesis sets out to answer is open in nature; it seeks to understand the relationship and effects of corporate tax legislation on national economies as well its contributions to economic growth. Relating this to the chosen method, non-doctrinal legal research is best used to answer open qualitative questions, which borders not only on the nature of law but as well as its relationship likewise, how it affects society. To this end, a doctrinal method will not be adopted.

Secondly, it is acknowledged that the focus of thesis is on two countries with corporation tax regimes that are individually unique, however it is also noted that some level of uniformity cuts across nations and these stem from international institutions such as the OECD. Hence, a comparative legal method is not preferred, more so, because the theory of legal transplant is not envisaged as a possible solution to the issues faced in developing countries. Amongst the reasons for not choosing legal transplants lies in one of the arguments raised in this thesis about whether corporation tax, together with its legislation is now redundant for developed countries. This can be understood from the perspective that if the dependability of the corporation tax and its legislation in developed countries is being questioned, then to what extent would transplanting existing laws be feasible for developing countries? Finally, the adopted research method will aid the legal discussion and analysis of the theoretical underpinning of this thesis. The theoretical foundation of this thesis is the classical economic growth theory, which finds its basis on the Adam Smith's canons of taxation.⁴⁴ Although the theory will be expounded in chapter 2, it necessary to note the justification for using this economic theory rests on the basis

⁴⁴ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Book V, Chapter II, Part II an electronic classics series publication (University of Pennsylvania).

that law as discipline has its limitations in the evaluation of both the political and economic motives on which the thesis is set.

1.5.2 Research Approach

Conducting and writing this thesis will rely on previous empirical academic evaluation and research, institutional information derived from legal documents, reports, decisions and data published on official websites of the illustrative countries. This data was compiled by using particular search terms such as taxation, corporate tax structures, compliance and multinational corporations. The literature acquired was subjected to thematic analysis, which was then categorised into law, economics, development and growth. Legislation was analysed to evaluate its challenges in either positively or negatively achieving its set social goal.

Furthermore, this analysis would be interdisciplinary, utilising the fields of law and economics as this is required to explain the ambiguities witnessed within the corporate tax regime. Given that This analysis will be employed in every chapter this thesis eschews the need for a separate chapter for analysis.

1.6 Scope and Limitations of the Thesis

Although this thesis revolves around the subject of economics, accounting, investments and law, it is necessary to set the scope of the thesis in order to delineate the focus. The thesis does not delve into the economics and accounting discussion and analysis of tax rates and numbers nor does it delve into developmental economics or deeply into the economic theories of growth. Rather, it considers the issues of corporation tax as being part of a regime of legislation, policies and regulation and therefore focuses only on this aspect.

Similarly, there are different FDI location indicators that include but are not limited to ease of doing business, local expertise, market and tax and trade policies. This thesis, limits itself to

the tax policies and in this instance, corporation tax. In addition, it is recognised that various other legislation can promote FDI location to developing countries an example of which is Bilateral Investment Treaties (BITs). The scope of this thesis does not relate to BITs rather is limited to taxation, and in this instance solely corporation tax on foreign companies.

Finally, in the context of the tax regime in Nigeria, this thesis does not analyse the entire tax system, as this again will be outside the scope of the thesis. Nonetheless, various aspects of the tax regime in Nigeria insofar as they relate to corporations are mentioned. It is recognised that corporation tax is not the only form of taxation that can bring about economic growth. When VAT and PIT are well structured and administered, they are a sustainable revenue source. In the context of the corporate tax regime in Nigeria, this thesis does not delve into all the complexities of the regime. Rather, it analyses and discusses the pertinent issues of the regime.

On the other hand, this thesis deals with the international and domestic system of taxing MNCs, specifically the regime that administers this. It looks at country specific illustration and analyses the effects of the system and revenue generated on Nigeria's economic growth and development.

Certain limitations were faced especially in the terms of literature in Nigeria. This led to a reliance of newspaper articles and official government papers. Rather than this being a weakness of the thesis, it will rather be taken as a strength as this thesis will form a part of the foundational literature in this area.

1.7 The Thesis in Outline

This chapter introduced this study by highlighting its scope, subject matter, objectives and research methodology. Chapter 2 sets the foundation of the study by exploring the meaning of tax within the scope of this thesis. It highlights the inter-relationship between domestic tax law and international tax law and draws on the societal need for tax in order to achieve economic

development. From this, the theory of economic development is considered as it relates to the jurisdiction researched.

Chapter 3 then legally examines the economic effects of corporation tax by descriptively analysing quantitative data from the Federal Inland Revenue Service (FIRS) in Nigeria and Her Majesty's Revenue and Custom (HMRC) in the UK. It seeks to create a link between legal uncertainties and the location of MNCs in the illustrative developing country. This analysis sets the scene for subsequent articulation and analysis in forthcoming chapters where legal uncertainties in the corporation tax legislation in Nigeria are highlighted. It commences with an exploration of Multinational corporations (MNCs) and corporation tax.

Following this, chapter 4 shows a legal analysis of the corporation tax regime of Nigeria and then using the UK corporation tax regime as an illustration of a developed country. Chapter 5 continues to explore the effects of corporation tax on national economies; analyses the effects of lack of compliance, deterrence and enforcement measures on national economies. These effects are analysed using specific business case studies to elucidate the weakness of legislation. Furthermore, the existing enforcement measures are explored and recommendations are suggested. Finally, chapter 6 concludes the thesis firstly by reflecting on the analysis and examination conducted in the thesis. It then provides recommendations for the findings while providing thoughts on future research. The study concludes with final thoughts on the thesis.

CHAPTER 2: The Need for Taxes for Economic Development

2.0 Introduction

Tax systems are central to society as they are the channel through which governments generate the revenue they need to maintain public expenditure. Additionally, they are regularly the direct instrument for policy implementation.¹ The effectiveness and efficiency of tax systems has an impact on every citizen² that is far and above the collection of tax. This is necessary as it determines the level of benefits obtained by the government. More recently, especially with globalization and increased international trade, tax systems have distinctly become more complicated by mirroring the situation and location where they are produced.³ Although globalization has transformed societies through an ever-evolving movement of commodity, the importance of tax in maintaining these societies is undiminished.⁴

Therefore, as the world evolves, so must tax systems evolve in order to meet the expectation and demands placed on them. Developed economies, which seem to have managed to change their tax systems alongside world changes, continue to strive to attain the most suitable tax system that operates at maximum while achieving the best for its society. There is therefore a necessity for developing economies to follow suit and create efficient, fair and sustainable tax systems with well-developed tax structures to raise revenue for government finance. Although this is necessary, it is not an easy task for developing countries, which may lack the work force in the form of well-trained staff with the necessary expertise or resources to achieve this aim. Given the overall aim of this study to analyse the position of corporation tax in achieving

¹ Association of Chartered Certified Accountants, 'Foundations for a Sound Tax System: Simplicity, Certainty and Stability' (ACCA 2015) <<http://www.accaglobal.com/us/en/technical-activities/technical-resources-search/2015/july/foundations-for-a-sound-tax-system.html>> accessed 10 December 2015, 3.

² Ibid.

³ James Abiola and Moses Asiweh, 'Impact of Tax Administration on Government Revenue in a Developing Economy – A Case Study of Nigeria' (2012) 3(8) International Journal of Business and Social Science 99.

⁴ Ibid.

economic growth and development in countries particularly developing countries, it is essential to understand the theory of tax in its entirety. In order to do this, this chapter will first operationally define the notion of tax by reviewing key definitions and then identify tax legislation and its role in taxation. Subsequently, the theories of tax are summarized in order to provide a theoretical understanding of the rationale and justification of tax. Consequently, the foundations of an effective tax system will be discussed. Essentially, therefore this critical analysis discusses the need for tax and tax systems in developed and developing economies with the aim of setting out the foundation of an ideal corporation tax regime for economic growth and development.

2.1 The meaning of tax and tax law

To better appreciate the aim of this thesis, it is necessary to explore some definitions of tax, its need in society and the laws that govern it. Tax as it is known today, has evolved from a series of factors. These factors could be because of either personal needs⁵ or governmental needs.⁶ Although there is often a sense that few people like to pay tax, which may be the reason behind its evasion and avoidance;⁷ from the time of the first payment of tax until date, tax has been seen as a required payment to the government.⁸ Understanding the meaning and the need for tax is expected to give an understanding of the compulsory nature of tax payments. Through the centuries, different definitions of tax have been proffered, accepted and rejected. Therefore, in this section, a brief analysis of different definitions that may best describe the current

⁵ Jane Frecknall-Hughes, *The Theory, Principles and Management of Taxation: An Introduction* (Routledge 2015)

⁶ For instance, in the United Kingdom, corporation tax came into being because of the governments' need to pay for the then World War. Similarly, governments use taxes as a means of obtaining funds for the state and citizen use. In modern times for developed economies, taxation has the surest source of revenue for the government.

⁷ See generally, the works of William Craig, *Revenue Law* (3rd edn, Edinburgh University Press 2013); Jane Frecknall-Hughes, *The Theory, Principles and Management of Taxation: An Introduction* (Routledge 2015)

⁸ Victor Thuronyi, *Comparative Tax Law* (Kluwer Law International 2003)

meaning of tax especially concerning the prevailing international tax issues will be analysed.

Two definitions that are analysed indicate:

A tax is a payment, exacted by authority, from part of the community, for the benefit of the whole. From whom, in what proportion such a tax a payment shall be required and to what uses it shall be applied, those only are to judge to whom the government is entrusted⁹

From this definition, it can be deduced that tax is rightly paid by only part of the society but not equally paid, as not all taxpayers earn the same amount of money. This definition by Johnson can be interpreted as indicating that the government can independently decide the total tax to be paid by the taxpayers, and dictate the purposes for which it is used. Although Johnson's definition of tax was made in the 18th century, centuries later, it still rings true. This could be identified as a foundational cause of tax avoidance and evasion by taxpayers and in particular, multinational corporations (MNCs) as most taxpayers consider that the amount of tax imposed on them by the government creates a burden on their profits. Furthermore, some individual taxpayers as well as businesses may advocate for the hypothecated tax and in such a vein would like to have a say in what public funding their tax payments are spent.¹⁰ As much as the government has the ultimate right to decide on the amount of tax and its use, there is a necessity to include the taxpayers in making these decisions. This however does not preclude the government from considering taxpayer opinions or trying to reduce the tax burden, as there are incentives that are formulated with the aim of helping with the tax burden on taxpayers.

⁹ Samuel Johnson, 'Taxation No Tyranny an Answer to the Resolutions and Address of the American Congress' From *The Works of Samuel Johnson*, published by Pafraets & Company, Troy, New York, 1913; volume 14, pages 93 <<http://www.samueljohnson.com/tnt.html>> accessed 10 December 2015.

¹⁰ In the UK, there are taxpayers who propose for the hypothecated tax in which the UK government is expected to publish a breakdown of what the taxes paid goes to and in that way, they can decide on what percentage and to what public cause they will pay their tax for.

Likewise, James and Nobes, define tax as, “*a compulsory levy made by public authorities for which nothing is (directly) received in return*”.¹¹ Analysing this definition, in line with the present international economic challenges and revenue loss stemming from tax evasion and avoidance, the following can be deduced:

I. Tax payments are compulsory and as such must be paid. This does not allow room for tax avoidance or evasion and consequentially, deterrence and enforcement measures will apply at the failure to comply.

II. Governments as public authorities, have the right to impose and collect tax.

III. The presumption that nothing is expected in return negates the benefits theory of taxation, which is built on the philosophy that taxes should be imposed in proportion to the benefit received. Despite this, considering that tax revenue is used to fund public needs (roads, schools, hospitals.) something in essence is received in return for the payment. To this end, taxes can be seen as a means of national economic development.

IV. Perceiving tax as being a levy carries the presumption that every required payment to the government could be a tax. Thuronyi stresses that there are certain required payments like fines to the government that should not be confused with taxes.¹² This is because, despite their similarity as being compulsory payments, both do not usually and always serve the same purpose nor have the same effect; moreover, taxes serve a more lasting purpose than fines do. Frecknall-Hughes and Oats own that taxes have been used to service government plans and needs, which invariably form the main objective of taxation.¹³ These notwithstanding,

¹¹ Simon James and Christopher Nobes, *The Economics of Taxation*, (13th ed. Fiscal Publications 2013) 10. Despite their definition of tax likened to a levy, it is necessary that tax and compulsory levies be not confused. Compulsory levies such as TV licenses are not taxes in as much as the government levies them. They also observe that certain taxes are paid for the benefits that will be received from them and an example is the National Insurance contribution in the UK.

¹² Ibid.

¹³ Ibid note 5.

government, have alternative avenues from which they can derive income.¹⁴ James and Nobes argue that taxation is not the only means of economic development as governments can and so often use other means to generate the revenue they need.¹⁵ They contend that governments can borrow from international organisations and other countries at the same time, they recognise that there is a limit to which a country can and will be loaned money.¹⁶

In addition, Tanzi and Zee, maintain that until a better idea is proffered, taxation is the only credible system of raising the revenue to finance governments spending on the goods and services that *most of their citizens who are dependent on them need*.¹⁷ The emphasis here is made by the author as it considers that most of the world's elite or rich may not rely on government services and can well afford to provide these services for themselves. Examples can be seen from both developed and developing countries where in the UK for instance, some people will not use the NHS, preferring treatment in private practice. Likewise, in Nigeria, there are undocumented instances, where some rich individuals will build and maintain roads that lead to their homes for their benefit and do not depend on the government to do this. The rise of privately owned universities in Nigeria is also a testament to the lack of reliance on government owned universities that are maintained by public revenue. This in no way diminishes tax responsibilities on this group of individuals. Most people are not keen to comply with their tax responsibilities largely due to the structure of the existing tax system in their

¹⁴ Considering that the government has sole control of the country's printing press, more funds could be printed to service needs as they arise. The result of this will be inflation when there is an excess of funds in society, which could also lead to the money being devalued. This has been frowned upon and thus printing of money is firmly regulated. Similarly, the government could generate revenue through borrowing whether externally or internally. The down side to this is that the country will be in debt and the loan body or country could reduce its borrowing capacity.

¹⁵ Ibid at page 10.

¹⁶ With the economic recession going on in Nigeria, the government has borrowed money from other governments such as China, the UK, and the US etc. to meet its budget objectives.

¹⁷ Vito Tanzi and Howell Zee, 'Tax Policy for Developing Countries' (2001) 27 International Monetary Fund Economic Issue 5.

country. It is therefore imperative that governments adopt systems that must be acceptable to those affected by it¹⁸ in order to circumvent the occurrence of tax avoidance and evasion. Furthermore, as Craig expresses, taxes are inevitable for facilitating societal wellbeing and as such agrees that for public dissension to be avoided, modern tax systems must be acceptable.¹⁹ It can be surmised from the above that taxes fundamentally, play a number of roles in the society.

Firstly, taxes have been used historically to raise funds needed by the monarchy and to pay for state defence in times of strife. More recently, the same principle still applies in the sense that generating revenue is still a primary objective of a modern tax system to help finance public sector expenditure. Additionally, the tax system is a means of ensuring the redistribution of income and wealth in order to reduce poverty and promote social welfare.²⁰ This could be likened to the ability-to pay principle on the basis that people and businesses with higher income should pay more in tax than people and businesses with lower income. Finally, as a means of regulating the national economy, tax systems can be used for promoting economic welfare by attracting foreign direct investment, which will invariably create a sustainable environment for business. To successfully achieve this, there must be a legislation and structure especially as tax assessment, rates and collection can only be achieved supported by legislation.

2.1.1 Tax Law

Tax law is generally seen as the body of legislation and policies through which a government has a claim on taxpayers for their tax liabilities. The authority to levy and enforce taxes is accepted as a right of governments. Commonly, tax concerns only the legal structures of

¹⁸ Ibid note 9.

¹⁹ William Craig, *Revenue Law* (3rd ed. Edinburgh University Press 2013) 11.

²⁰ Ibid.

taxation and not the financial and economic structures.²¹ The making of decisions regarding the different types of taxes, including the rates, is deemed political and does not fall under tax law or legislation. Consequently, tax law could be seen as an instrument, which politicians use to control the economy. The study of the legal provisions that give rise to the charging of tax is relegated to substantive law while formal tax law that concerns the rules is not laid down in the legislation in terms of assessment, administration and enforcement measures. Although tax law of a nation is usually unique to it, there are similarities and common elements in the laws of various countries. This is seen in the interrelationship between domestic tax law and international tax law.

2.1.2 The interrelationship between domestic tax law and international tax law

Tax law is entrenched in the domestic laws of every country, and is developed over time.²² Additionally, it is accepted that taxation is at the core of countries' sovereignty. Harris contends that the jurisdiction to tax or the charge to tax rests in domestic law.²³ Nevertheless, in certain circumstances, the interaction of different domestic tax rules can lead to gaps and frictions.²⁴ For every country the laws provide either specifically in their constitution or otherwise, the right of a state to tax.²⁵ Thus, the relationship that exists between domestic tax law and international tax law is reflected in the design of some states' tax structure, which does not take into consideration, the tax structure of other states'. Cross-border transactions often ignite the

²¹ Charles E McLure, 'Taxes, Saving, and Welfare: Theory and Evidence' (1980) NBER Working Papers 0504, < <http://www.nber.org/papers/w0504> > accessed 21 November 2015.

²² Ibid note 5.

²³ Ibid note 1.

²⁴ OECD, 'Action Plan on Base Erosion and Profit Shifting' (OECD 2013) <<https://www.oecd.org/ctp/BEPSActionPlan.pdf>> accessed 8 May 2015.

²⁵ Section 4(2), Part 1 Second Schedule of 1999 Constitution of the Federal Republic of Nigeria, specifically vests on each tier of government, the power to impose and collect tax.

frictions between these two structures and this has resulted in instances where corporate income was either double taxed or not taxed at all or taxed at nominal rates.²⁶

It is the author's contention that both systems are synonymous and could be seen to be primary and secondary sources of law for each other. In other words, one form starts where the other ends. International organisations such as the Organisation for Economic Co-operation and Development (OECD) and the United Nations (UN) impose laws, which then exert an influence on international and similarly domestic laws. This in turn could control or dictate how these laws are interpreted and implemented in each state. Qureshi defined international tax law as consisting of customary international law, agreements and domestic tax legislation.²⁷ These range from the right of the state to tax, tax treaties and disputes settlement where it is unclear what the respective taxing rights and exchange of information (EOI) is on taxpayers.²⁸ This aptly covers the interrelationship of domestic tax law and international tax law. The foundation of the interrelationship of these two laws lies in the allocation of taxing rights in cross-border transactions.²⁹ Reflecting that the collection of tax is an act of sovereignty and a country will not assist in the collection of tax imposed by another country;³⁰ it then becomes necessary to have international standards or set of rules that will provide for this.

Although there are similarities between domestic taxation and international taxation, there are clearly two different systems and subject to different legislation. Although in some instances, the same legislation that apply in a domestic tax system and do apply in the international system. Kobetsky, states that international taxation, is the taxation of cross border transactions

²⁶ Ibid.

²⁷ AF Qureshi, *The public international law of taxation* (Graham and Trotman 1994) and Angharad Miller and Lynne Oats, *Principles of International Taxation* (3rd ed. Bloomsbury Professional 2012)

²⁸ Ibid.

²⁹ Peter Harris and David Oliver, *International Commercial Tax* (Cambridge University Press 2010).

³⁰ See for instance, *Government of India v Taylor* [1955] AC 491 where this principle was considered and it was held the claim by the Indian government was not maintainable as English law generally does not permit either the direct or indirect enforcement of foreign revenue laws.

with two key dimensions.³¹ Firstly, the taxation by a government of its residents and corporations who enter into cross border transactions which in essence is residence taxation.³² Secondly, it deals with the taxation of foreign residents who enter into cross border transactions involving the country, which amounts to source taxation.³³ The key challenge which international taxation faces, is determining the principles of an equitable allocation of revenue from cross border transactions between treaty countries. Although this may seem to be peculiar to international taxation, domestic taxation, in certain instances, faces this same issue. In Nigeria, which operates a three-tier federal system, multiple taxation occurs on the same profit of corporations despite legislation which otherwise proscribe this.³⁴ Nevertheless, this is still an ongoing problem with the domestic law of taxing corporations and individuals. Like international tax law, there is an inherent need to overcome this problem. This aspect will be analysed and discussed further on in the thesis.

In order to determine the jurisdiction to tax, international organisations produced tax treaties, which allocate taxing rights between residence and source states. These essentially work at protecting state revenue and foreign investors by supplementing and complementing domestic law by determining which country has the right to tax. These organisations also provide guidance or directives that are accepted by domestic law to counter tax avoidance and evasion. All these are essentially aimed at promoting and fostering economic growth and development especially for developing countries.

Globalisation and cross border trade has created an avenue for cross border taxation of profits derived from the location of businesses and movement of employees. International tax law has

³¹ Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy*, (Cambridge University Press 2011).

³² Ibid.

³³ Ibid.

³⁴ The 1999 Nigerian Constitution, by specifying the tier of government responsible for particular taxation, ideally removes the occurrence of multiple taxation.

thus become an important source of tax law that forms the basis of taxing the profits of multinational corporations (MNCs). MNCs in weighing the cost of taxation of their profits against their losses and other factors have resorted to using loopholes in both domestic and international tax law to avoid and evade the payment of tax. In the quest to deter MNCs from achieving this, international tax law and domestic tax are combined to fight avoidance. According to Devereux and Vella, the present international system for taxing the profit of MNCs is plagued by criticism.³⁵ They posit that the crux of the problem lies in the perception of governments, commentators, the media and public that MNCs are able to arrange their affairs to take advantage of deficiencies in the tax system to reduce their tax liabilities.³⁶ This will be discussed further in forthcoming chapters.

2.2 Classification of taxes - Direct and Indirect Taxes

Taxes are broadly classified into two categories – direct and indirect. The distinction between direct and indirect taxes in some countries is not fundamentally important, as it has been attributed to be more of a historical significance than a current importance.³⁷ In some countries, for instance the UK, this distinction is not important for its tax law.³⁸ This may be because the UK does not operate a federal system of government and does not have a written constitution. In countries such as Nigeria, coincidentally a commonwealth member state, but where there is a federal system and a written constitution this distinction is made clear. This could be justified

³⁵ Michael P Devereux and John Vella, 'Are we heading towards a corporate tax system fit for the 21st century?' (Oxford University Centre for Business Taxation 2014)
<https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/2014/iipf_summer_school/devereux-vella.pdf> accessed 19 March 2016

³⁶ Ibid.

³⁷ Ibid note 26 at 14.

³⁸ John Tiley and Glen Loutzenhisser, Revenue Law: Introduction to UK Law; Income Tax; Capital Gains Tax; Inheritance Tax (7th ed. Hart 2012).

on the basis that the distinction between direct and indirect taxes will aid in apportioning taxing rights to the right government.³⁹

A direct tax is one that is demanded from the very persons who it is intended or desired, should pay it.⁴⁰ This is usually tax on income, property or profits. In a strict sense, under a direct tax, the incidence of this tax cannot be passed on from one taxpayer to another either in the form of wages, dividends, goods or services.⁴¹ In other words, the taxpayer must bear its burden. Taxes such as Income tax, capital gains tax and corporation tax are classified as direct tax. Unlike the former two taxes mentioned, corporation tax has been argued by economists to be a mix of direct and indirect tax as the incidence of this tax is moved to employees through wages and shareholders through dividends. Notwithstanding, this tax is still classified as being a direct tax. On the other hand, indirect taxes are those taxes that are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another taxpayer.⁴² These are charged on the realisation of assessable goods and services, which is eventually paid by the consumers of these goods and services.⁴³ Such taxes include Value Added Tax (VAT), sales taxes and excise and custom taxes.

The most important aspect of the direct taxes is the income tax that is said to account for up to one-third of volume of revenue raised in modern developed countries.⁴⁴ The income tax is levied on the profits of both individuals and corporations alike. Income generated by these taxes together with the VAT, have accounted for government revenue in both developed and

³⁹ Schedule II of the 1999 Nigerian constitution, sets out the different levels of government which has the power to tax certain types of taxes.

⁴⁰ Mill, in John Tiley and Glen Loutzenhiser, *Revenue Law: Introduction to UK Law; Income Tax; Capital Gains Tax; Inheritance Tax* (7th ed. Hart 2012).

⁴¹ Angharad Miller and Lynne Oats, *Principles of International Taxation* (3rd ed. Bloomsbury Professional 2012) 5.

⁴² Ibid note 2.

⁴³ Ibid note 19 at 6.

⁴⁴ Ibid.

developing countries. Although different countries classify and structure their income tax specifically the corporation tax differently, there is very a global influence on how this is done.

Taxes can also be classified as being proportional or progressive and regressive. A tax is classified as being proportional and progressive, when it increases with an increase in the taxpayer's income.⁴⁵ If there is no increase in taxpayer's income, then the tax liability stays at the same level (flat rate) with the income and is then proportional. This tax is largely targeted towards the rich and to higher income taxpayers rather than lower income taxpayers. On the other hand, regressive taxation occurs when the tax rate decreases as the income increases.⁴⁶ In this situation, the tax liability does not rest on the taxpayer's ability to pay; rather it rests on the percentage of a service or goods purchased by taxpayers. This will mean that low income earners, will pay a higher amount of tax than higher income earners. Craig argues that such situations are less typical, given that regressive taxation, resulting in wealth accumulation, would be contrary to social and fiscal priorities of most governments.⁴⁷ This notwithstanding, the VAT is seen to be a regressive tax as the VAT is taxed on a flat rate and does not take into consideration the income of the taxpayer. Thus, it can be concluded that the lower income earners in the society bear the incidence of VAT. In forthcoming chapters, this thesis will explore the incidence of the corporation tax.

2.3 Exploring theories and principles in tax and economic growth

The preceding classification and definitions identify the options, rules and considerations applied to taxation. However, in deciding how to apply the appropriate type and level of taxation, it is important to understand theories of tax. Therefore, in this section, several taxation theories will be analysed and discussed. These theories were developed in a bid to create an

⁴⁵ Ibid 19.

⁴⁶ Ibid.

⁴⁷ Ibid at page 6.

optimal tax system to best serve state governments in generating revenue. Tax theories are closely related to economic growth theories as both theories work collectively to create an optimal system for economic growth and development.

Several tax theorists have proffered different theories of taxation. Of note is Hobbes who, in his most famous work *Leviathan*, observed that tax should be equated not to man's wealth rather, it should be equated to a perceived debt he owed to the state for his defence and the maintenance of rule of law.⁴⁸ Furthermore, he advocated for the provision of those unable to earn a living.⁴⁹ Hobbes view could be likened to Locke's social contract theory in which he saw the imposition of taxation through voluntary alienation of individual rights in exchange for state protection of property.⁵⁰ He went on to observe that if governments cannot be supported without charge, then everyone who benefits from the government, should pay a proportion of their estate for the maintenance of the government.⁵¹ Albeit this has to be with the consent of the citizen, otherwise it would be classified as a legitimate theft by the government.⁵²

Another theory of taxation is the benefits theory that advocates that the state levies taxes on individuals according to the benefit conferred on them.⁵³ In other words, this theory suggests that the more benefits a person derives from the government, the more he should pay to it. This according to Craig suggests a case for hypothecation and earmarking taxes for specific goods and services.⁵⁴ He observed that, for example, government expenditure on roads should be financed from taxes on car ownership such as the vehicle excise licence and taxes on fuel.⁵⁵

⁴⁸ Thomas Hobbes, *Leviathan* (Penguin Books 1968) and Jane Frecknall-Hughes, *The Theory, Principles and Management of Taxation: An Introduction* (Routledge 2015) 20.

⁴⁹ Ibid

⁵⁰ Ibid note 5 at 21.

⁵¹ John Locke, (Second Treatise of Government 1970) [1690] in Jane Frecknall-Hughes, *The Theory, Principles and Management of Taxation: An Introduction* (Routledge 2015) 22.

⁵² Ibid.

⁵³ Ibid.

⁵⁴ Ibid at note 15.

⁵⁵ Ibid

Likewise, Musgrave asserts that earmarked taxes, or hypothecation, could increase efficiency and equity and lead to better expenditure decisions.⁵⁶ Deran in supporting earmarking taxes argues that by so doing, resistance to new taxes or increased rates of tax can be overcome and it assures the minimum level of expenditure for government functions.⁵⁷ Adopting the benefits principle as the underlying principle in a tax system however negates the foundation of a tax consequently there are some critiques of this theory.

It was previously discussed that if tax is a compulsory levy by the government for which nothing is directly expected in return, then it means that taxpayers should not pay tax with the thought of receiving something in return from the government. Although in essence, taxpayers do receive certain goods and services from the government in return for their tax payments, as the majority of government spending is aimed at providing for the general wellbeing and benefits of all its citizens, it is highly unlikely to be able estimate or earmark what particular benefit each citizen enjoys.

This is therefore one key disadvantage of this theory. Added to this, it is also impossible to hypothecate and earmark taxes for the benefits theory. Finally, the benefits theory can be said to support regressive taxation in the sense that the poor tend to need and are more likely to benefit from government expenditure. If this theory is rightly applied, it then means that the poor will have to bear the most of the tax burden and this may not only be considered untenable, but also reasonable to the public.

Another taxation theory, the Ability-to-pay theory, advocates that citizens' tax liabilities are commensurate with what they earn or own.⁵⁸ Distinct from the benefit theory, which seeks to

⁵⁶ R Musgrave and P Musgrave, *Public Finance in Theory and Practice* (5th ed. McGraw Hill 1980) and William Craig, *Revenue Law* (3rd ed. Edinburgh University Press 2013).

⁵⁷ E Deran, 'Earmarking and Expenditures: A Survey and a New Test', (1965) *National Tax Journal* 354 and William Craig, *Revenue Law* (3rd ed. Edinburgh University Press 2013).

⁵⁸ M Slade Kendrick, 'The Ability-To-Pay Theory of Taxation' (1939) 29 *The American Economic Review* 92.

match government spending in taxation in proportion to the benefit received. This theory is based on the idea that the burden of taxation should be spread in such a way as to give rise to an equality of sacrifice among the taxpaying community.⁵⁹ According to Kendrick, this theory is considered the dominant theory of taxation and is usually interpreted in terms of sacrifice; it is based on the existence of sacrifice arising from the payment of taxes by high earning taxpayers.⁶⁰ This theory further views tax as progressive and as such maintains that taxes should be levied in accordance to a taxpayer's ability to pay.

An analysis of this theory indicates that it places an increased tax burden on individuals and businesses with higher income. The justification for this is perhaps based on the expectation that individuals and businesses with a higher earning threshold should and can afford to pay more in taxes. Governments seem to prefer this system of taxation and aim towards setting their tax systems as such. Unfortunately, day-to-day realities defeat this theory. For instance in the UK, it has been argued that small and medium enterprises (SMEs) and sole proprietors pay higher taxes than the multinational corporations (MNCs) pay due to cuts and incentives granted to them by the government.⁶¹ Furthermore, categorising taxpayers on their ability to pay may not prove feasible especially for developing economies that may lack the resources in identifying and defining what constitutes a taxpayers' ability to pay a high amount of tax.

Amongst the theories and philosophies of taxation and economic growth, the notable Scottish economist Adam Smith is credited with having created the most suitable canons or theories of taxation to serve countries. In his most noted book, *An Inquiry into the Nature and Causes of the Wealth of Nations*⁶², he set out what is currently called the "canons of taxation" which reflects his concern on economic growth and development. The first canon of equality or ability

⁵⁹ Ibid note 15.

⁶⁰ Ibid 26.

⁶¹ Rebecca Murray, *Tax Avoidance* (Sweet and Maxwell 2012).

⁶² Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (University of Pennsylvania) Book V, 676-677.

⁶³ reflects the need for citizens to support the government in a manner that is commensurate to their wealth and income. This can be interpreted as citizens sacrificing or paying taxes that are directly proportionate to their income or what they own. It can be deduced that this canon supports the ability to pay principle, which in turn supports progressive taxation. The second canon of certainty⁶⁴ implies that the tax burden for every taxpayer should be certain and clear. Uncertainty according to Smith could lead to tax avoidance or evasion where the taxes are to be paid or collected are not clearly identified or stated. Taxes such as Personal Income tax tend to portray a level of certainty as this is taxed at source and clearly stated and the likelihood of avoiding or evading this tax is minimal. On the other hand, the corporation tax and VAT could be said to exhibit some uncertainty as these are not clearly stated and left to the taxpayer to make the expected returns. This canon helps the government especially in terms of PAYE, to make projections based on the expected payment by taxpayers. In the same spirit of the preceding canons, the third canon is that of convenience.⁶⁵

This canon advocates for the tax payments to be levied at the most convenient time for the taxpayer to be able to pay this tax. Once again, the PAYE, CIT and in the UK, the Council Tax are all set at strategic times which is designed to be convenient for the taxpayer. PAYE is paid at source, which is deemed convenient and practical, as the taxpayer would have already paid the tax before receiving a salary. Additionally, most council tax due on the first of the month⁶⁶, possibly to match salary payment dates. As such, this could be classified as being a convenient time for taxpayers. Finally, the fourth canon of economy⁶⁷ advocates for administrative costs

⁶³ Ibid at 676.

⁶⁴ Ibid at 676, “the tax which each individual is bound to pay, ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.”

⁶⁵ Ibid at 677, “Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.”

⁶⁶ Aberdeen city council set their council tax to be paid on the first of every month.

⁶⁷ Ibid note 107 at 678, “Every tax ought to be so contrived, as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state”.

involved in tax collection not to be excessive. They should be kept at a minimum, consistent with administration efficiency. It is surmised that low administrative cost for example, the costs for filing returns will aid compliance by taxpayers.

Principles and theories underlying a good and sustainable tax system has been the subject of debate in recent times especially as it pertains to developing countries' ability to generate much needed revenue. Economists, lawyers, tax practitioners and governments reject and modify the existing theories to suit the times and economic challenges they face. In the UK for instance, the economist Richard Murphy, rejects the Smith canons as outdated and in his opinion, fail to recognise the obligation of the state to the citizen with regard to the provision of public goods.⁶⁸

He posits that the canons relate to the practice of taxation rather than its underpinning principles. He maintains that taxation should be viewed as a human right and therefore, included in the Universal Declaration of Human Rights (UDHR).⁶⁹ Dissenting from this what has been described as a pedantic view of Murphy's, it can be argued that Smith, through his canons, set out clear justification and understanding of the relationship between taxpayers and the taxman (government). Furthermore, it serves as an instruction for the foundation of drafting tax legislation while at the same time, clearly setting out the responsibilities of the taxpayers and citizens towards the government in respect of taxes.

Therefore, although one could argue and justify classifying tax as a human right, in this instance and based on Murphy's arguments, this is unlikely. Despite the existence of the UDHR, different states governments have conflicting ideas as to what constitutes a human right especially if it cuts into the very core of their culture. Frecknall-Hughes suggests that the canons do not explicitly address the state's obligations to its citizens, which she sees as a much more

⁶⁸ Richard Murphy, 'A Code of Conduct for Taxation' (Association for Accountancy and Business Affairs, Tax Justice Network and Tax Research LLP 2007) < http://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code_long.pdf> accessed 15 January 2016.

⁶⁹ Ibid.

modern concept.⁷⁰ She argues that it does not necessarily follow that the ideas of equity, certainty, convenience and efficiency are outmoded with the passing of time; rather it has become necessary to structure a tax system in such a manner as not to preclude avoidance and abusive behaviour.⁷¹

Through the canons of taxation, Adam Smith laid the foundation of the classical economic growth theory. This theory was expanded upon by David Ricardo⁷² and Thomas Robert Malthus⁷³ and is essentially based on the ‘progress’ for citizens of a state in terms of their material wellbeing which is measured in real gross domestic product (GDP). Smith based his economic growth theory on two factors – productive labour and capital accumulation. He stated that the main source of wealth for a state lay in the supply of goods produced and made available to the citizens.⁷⁴ He further stated that a nation’s output depends on the accumulation of capital and the efficiency of labour. He discussed that in order to have a high level of working population employed in productive labour, the accumulation of capital must be high. His summarises it thus:

this great increase of the quantity of work which, in consequence of the division of labour, the same number of people are capable of performing, is owing to three different circumstances; first is the increase in dexterity in every particular workman; secondly, to the saving of the time which is commonly lost in passing from one species of work to another; and lastly, to the intervention of a great number of machines which facilitate and abridge labour, and enable one man to do the work of many.⁷⁵

⁷⁰ Jane Frecknall-Hughes, *The Theory, Principles and Management of Taxation: An Introduction* (Routledge 2015) 65.

⁷¹ Ibid.

⁷² David Ricardo, *The Principles of Political Economy and Taxation* (Batoche Books 2001) <<http://socserv.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf>> accessed 20 March 2016.

⁷³ Thomas Malthus, ‘An Essay on the Principle of Population’ (Electronic Scholarly Publishing Project 1998) <<http://www.esp.org/books/malthus/population/malthus.pdf>> accessed 20 March 2016.

⁷⁴ Víctor Lanza, ‘The Classical Approach to Capital Accumulation’ (Thesis in Economics, UEMA Universitet 2012) <<http://www.diva-portal.se/smash/get/diva2:562865/FULLTEXT01.pdf>> accessed 20 March 2016.

⁷⁵ Ibid 109.

The process of capital accumulation plays an important role in this economic growth theory. Smith believed that with more capital, labour is well-appointed to perform specific actions which leads to an increase in wages above the subsistence level, thereby increasing the population which increases demand and hence expanding the market.⁷⁶ In other words, for growth to exist there has to be capital accumulation. All these depend on the allocation of capital towards consumption and investments. By investing capital to productive areas, revenue and profits will be generated without constantly infusing capital. Smith thought that the capitalists of the economy would be the ones deciding where to allocate the investment.⁷⁷ Capitalists that were willing to increase their profits would invest in those activities that could provide the highest contribution to the nation.⁷⁸

Smith articulated that the government was inadequately equipped to direct investment in the right direction and rather should be left in the hands of private individuals. Looking at the way investment is carried out and directed in the world currently, it could be rightly said that investment is best in private hands. In the 1960's, the UK government, trialled running a corporation and this proved unsuccessful.

During his time, Smith stressed that capital could be accumulated from both agriculture and the manufacturing industry. Relating this to the objectives of this thesis, it begs the question of how economic growth can be achieved in the current global climate by applying Smith's theory. Although the world has evolved from the time of Smith, certain factors remain the same for example the need for economic growth and development is static especially for developing countries. Foreign direct investment (FDI) in this time of globalisation will generate the needed capital and technological knowledge needed to enhance economic growth and development.

⁷⁶ Ibid 109.

⁷⁷ Ibid 109.

⁷⁸ Ibid.

As indicated earlier, economic development and growth is one of the major objectives of government anywhere in the world. Economic development has been described as the process of the enhancement of various features of the economy and the society it supports.⁷⁹ This ranges from a reduction in the level of unemployment, poverty, death rate and mortality to; an increase in the output of goods and services, wages, improvement in literacy, housing and health services and improvement in the production capacity. In the past, economic development was normally seen in terms of the planned shift of the structure of production and employment so that agriculture's share of both declined while that of the manufacturing and service industries increased.⁸⁰ It could therefore be said that development strategies initially focused on rapid industrialization, often at the expense of agriculture and rural development.⁸¹ In present times when the majority of developed countries and to some extent developing countries are considered to have achieved a certain level of development in terms of industrialization, other economic and social aspects of developing countries still lacked development. This has resulted in a rise in poverty, high illiteracy and a lack of basic infrastructure. Todaro and Smith surmise that development must therefore be conceived of as a multidimensional process involving major changes in social structures, popular attitudes, and national institutions, as well as the acceleration of economic growth, the reduction of inequality and the eradication of poverty.⁸²

Furthermore, Todaro and Smith stated that development in its essence must represent the whole gamut of change. This refers to the method by which an entire social system, tuned to the diverse basic needs and evolving aspirations of individuals and social groups within that system, moves away from a condition of life widely perceived as unsatisfactory; toward a

⁷⁹ EB Akpakpan, *The Economy: Towards a New Type of Economics* (Belpot Port Harcourt 1999).

⁸⁰ Michael P Todaro and Stephen C. Smith, *Economic Development* (11th ed. Addison-Wesley 2011).

⁸¹ Ibid.

⁸² Ibid.

situation or condition of life regarded as materially and spiritually better. They concluded that development is both a physical reality and a state of mind in which society, through some combination of social, economic, and institutional processes, has secured the means for obtaining a better life. From the above discussion, it demonstrates that to achieve economic development; a state government has to work at raising the level and standard of living for its citizens with the provision of jobs, better education as well as increasing the availability of and distribution of basic infrastructure.

More ‘locally’, in Nigeria, the level of economic development has been very low even with the abundant human and natural resources. The poor economic situation in the country has led to a high level of illiteracy, high mortality rate and lack of basic infrastructure. The new government came into power with a plan at achieving economic development in line with the above. Unfortunately, this has proved abortive as Nigeria is amongst the five countries most affected by the fall in oil prices and consequently is at the forefront of countries facing particularly difficult economic challenges.⁸³ With oil accounting for over 96 percent of Nigeria's export revenue earnings and 75 percent of government revenue; it is fundamental for the government to diversify its revenue source in order to achieve economic growth and development in the country.

In line with the above discussion, the theoretical underpinning of this thesis rests on the classical economic growth theory that finds its basis on the Adam Smith's canons of taxation. The trust of this thesis is twofold; recommending a sustainable structure for Corporation Tax legislation as a source of revenue generation for economic growth and development and recommending a strategy for tax compliance through which state governments can retain

⁸³ Abhishek Agarwal, Udechukwu Oguagha and Stephen Vertigans, ‘Declining Oil Price and the Nigerian Economy: An Opportunity for National Oil and Gas Industry and Local Content Reform’ (Oil Voice 19 October 2015) < <http://www.oilvoice.com/n/Declining-oil-price-and-the-Nigerian-economy-An-opportunity-for-/e5760480bf53.aspx> > accessed 12 December 2015.

revenue to meet its obligations. This will be achieved by evaluating the effects of corporation tax on national economies with a part aim of recommending a sustainable framework for corporation tax, which will effect economic growth in Nigeria.

As an alternative to using tax enhancing economic growth, developed countries with advanced tax systems that generate a good percentage of revenue have considered the universal basic income scheme. A basic income is one granted to all individuals unconditionally without a means test or requirement to work. The idea behind the basic income can be traced back to Thomas More who in the 16th century advocated for the minimum income as a means of public assistance.⁸⁴ Over the centuries, such payments have been advocated for by scholars and politicians alike to be used to help the poorer class. In the United States of America, for instance, Martin Luther King advocated for a basic income while President Nixon experimented with versions of the basic income in the 1970s.⁸⁵

In recent years, the inability to challenge unemployment through conventional means combined with the rise of job automation has prompted academics, politicians and commentators to revisit this concept. In Africa where almost all countries are classified as either developing or least developing countries (LDC)⁸⁶, some form of basic income is being trialled. In the UK, the introduction of the basic income is being advanced by some of the

⁸⁴ See Thomas More, *Utopia* (1st Latin edition, Louvain, 1516), English translation by Paul Turner, (Harmondsworth: Penguin Classics, 1963) 43-44. "The Portuguese traveller Raphael Nonsenso, walking on the central square of the City of Antwerp, narrates a conversation he says he had with John Morton, the Archbishop of Canterbury. Such a scheme, he argued, would be a more astute way of fighting theft than sentencing thieves to death, which had the unpleasant side effect of increasing the murder rate." For further discussions on the basic income tax in history see generally, J.S. Mill, *Principles of Political Economy* (2nd ed. Augustus Kelley 1987), Book II, 212-214. Bertrand Russell, *Roads to Freedom. Socialism, Anarchism and Syndicalism* (Unwin Books 1918) 80-81,127.

⁸⁵ Basic Income Earth Network, 'History of Basic Income' (BIEN) <<http://www.basicincome.org/basic-income/history/>> accessed 21 March 2016.

⁸⁶ See generally, José Antonio Alonso, Ana Luiza Cortez and Stephan Klasen, 'LDC and Other Country Groupings: How Useful Are Current Approaches to Classify Countries in a More Heterogeneous Developing World?' (2014) CDP Background Paper 21 <http://www.un.org/en/development/desa/policy/cdp/cdp_background_papers/bp2014_21.pdf> accessed 21 March 2016.

political parties such as the Green party while Labour advisers have shown their support for this.⁸⁷

The premise of this is that every qualifying person, without exception, in the UK would be paid a basic income by the state. Therefore, it would be greater than the current inadequate old aged pension, and replace it. It is expected that the payment would, when joined with the payment due for each child, ensure that no family would live in poverty.⁸⁸ Trialling the universal basic income for the UK could be a positive step as it may provide a safety net for people who may wish to retrain from one career to another. Importantly, if well administered, it could lead to a reduction in poverty as well as an increase in economic growth. In Nigeria, the present government has proposed a basic income for the poor, unemployed and uneducated, which is expected to help reduce poverty and crime – in particular armed robbery – whilst reducing the mortality rate.⁸⁹

While this scheme may reflect a positive approach to ameliorating poverty and inequality, the technicality of funding should not be overlooked. Consequently, Murphy proposes that giving a reduced personal allowance while making other taxes more progressive will provide the funding to make this scheme successful.⁹⁰ While the author aims at suggesting such a scheme for Nigeria, the problem of it succeeding rests on the government's ability to sustainably fund and administer such scheme. A possible funding option could be using value added tax (VAT).

⁸⁷ Richard Murphy, *The Joy of Tax* (Bantam Press 2015).

⁸⁸ Ibid.

⁸⁹ George Agba, 'Unemployed, Poor Nigerians to Get N5000 Monthly – FG' *Leadership* (Abuja, Nigeria 14 June 2015) <<http://leadership.ng/news/440494/unemployed-poor-nigerians-to-get-n5000-monthly-fg>> accessed 21 March 2016.

⁹⁰ Ibid note 81.

2.4 A discussion on tax systems

A tax system offers itself as one of the most effective means of mobilising a nation's internal resources and it lends itself to creating an environment of economic growth.⁹¹ Ideally, the optimal tax system for all economies will be one that raises essential revenue to counter excessive government borrowing.⁹² This should be achieved either without discouraging economic activity or without deviating too much from tax systems in other countries.⁹³ According to Moore, the formation of accountability and the effectiveness of states is closely linked with tax systems.⁹⁴ Taxes underwrite the capacity of states to perform their goals and without the ability to generate revenue, they are limited in the extent to which they can provide for its citizens and particularly foster economic development. Thus creating a suitable tax system rests on the ability to extract maximum revenue while encouraging and maintaining investment and development in the economy. The importance of the tax system to individuals and society cannot be undermined as it benefits both a government and its populace and as such, a poor one will discomfit individuals and discourage business, which negatively influences them both.

The effects of economic challenges have brought about considerable competition between developing and developed economies to attract foreign investment, and the use of tax laws and tax systems has become a large player in this struggle. Revenue generation for governments, especially since the financial crises in the eighties and the current oil crash has become paramount. Thus, the use of taxation and tax structures is fundamental because until a better idea is brought forward, taxation remains the most practical means of raising revenue to

⁹¹ Akwe James Ayuba, 'Impact of Non-Oil Tax Revenue on Economic Growth: The Nigerian Perspective. (2014) 3 International Journal of Finance and Accounting 303.

⁹² Vito Tanzi and Howell Zee, 'Tax Policy for Developing Countries' (International Monetary Fund 2001) <http://www.imf.org/external/pubs/ft/issues/issues27/> accessed 10 January 2016.

⁹³ Ibid.

⁹⁴ M Moore, 'How Does Taxation Affect the Quality of Governance?', (2007) Tax Notes International 47.

finance government spending.⁹⁵ As global and current economic demands change in line with the variable market situations and consumer preferences, tax systems and laws in any nation tend to change in order to keep up with demands.⁹⁶ Such changes would affect the approach to which businesses operate in a given country, ranging from having a permanent establishment to the employment rates down to the level of FDI decisions. Governments often manipulate the competition of businesses through reforms in laws⁹⁷ considering that every nation requires sustainable economic development. The collection of tax revenue is fundamental to any stable and sustainable economy, as it plays different roles in every country's national growth. The effect of taxation on growth depends on what is taxed and how it is taxed and enforced. If governments tax all the profits of both individuals and corporations, the tendency is that this will negatively impact on growth is high as this constitutes a great burden on them. Generated revenue through taxation is regarded as the most established system of government revenue⁹⁸ of which the personal income tax, corporation tax, inheritance and sales tax are deemed to be of utmost importance. One of the major obligations of the government of any nation is to meet all its debts.⁹⁹ Achieving such an obligation would require enforcing laws on taxation in order to collect taxes from its citizens, individuals and corporations.¹⁰⁰

Tax systems are fundamentally designed to finance public expenditure and address social and economic concerns. Therefore, there is a need for them to be structured in such a way to

⁹⁵ Ibid.

⁹⁶ Confederation of British Industry, 'UK Corporation Tax System: 12 Misunderstood Concepts' < http://www.cbi.org.uk/media/2049172/tax_misunderstood_concepts.pdf > accessed on 6 August 2014.

⁹⁷ Governments tend to create an atmosphere for the growth of its economy either by creating businesses that will in turn provide employment or by giving businesses breaks in order to flourish. From 1945-1979, the UK government created public corporations which were owned and run by the state. These did not last long as the government could not provide a competitive business environment for these corporations to function effectively. These public corporations were sold off to private shareholders in order to create a more competitive business environment and in turn help boost the economy.

⁹⁸ Simon James and Christopher Nobes, *The Economics of Taxation: Principles, Policy and Practice* (13th ed. Fiscal Publications 2013). When contrasting the other sources of government income which has no certainty,

⁹⁹ Brian Scott-Quinn, *Commercial and Investment Banking and the International Credit and Capital Markets: A Guide to the Global Finance Industry and Its Governance* (Palgrave Macmillan 2012).

¹⁰⁰ Ibid.

minimise taxpayers' compliance and government administration costs while discouraging tax avoidance and evasion.¹⁰¹ These additional costs can impose a burden on the economy. This raises problems for developing and emerging economies, without well-structured or developed tax administration and adequate legal bodies. The structure of a tax system by a nation's government is fundamental as it affects a wide range of issues; ranging from saving decisions for households, to the supply of labour and most importantly, the decision by firms to locate businesses or invest.¹⁰² The latter will determine the quality or quantity of the FDI that is channelled through MNCs. These have motivated developed nations to embark on a continuous reformation of tax systems as well as development of different tax instruments and laws that generate revenues for their economy.

Failing to do this can hinder economic growth for the nation and lead to an over dependency on other revenue sources. Many developing and emerging economies, for instance Nigeria, and some developed economies have complex tax laws that distort their tax structure and thereby make their country unfavourable for foreign investment.¹⁰³ For instance, Harris argues that the UK tax laws have become so complex that they have largely lost any semblance of structure.¹⁰⁴ Accordingly, to ensure that tax systems are internationally competitive, and the barriers for a sustainable inflow of FDI are removed, nations invest time in reforming and restructuring their tax systems.¹⁰⁵

Developed nations introduce a range of taxes to their tax systems that generate revenue that is utilised to meet their objectives to their citizens.¹⁰⁶ The taxes that make up a nation's tax

¹⁰¹ Åsa Johansson and others, 'Tax and Economic Growth' (2008) OECD Economics Department Working Paper 620 < <http://www.oecd.org/tax/tax-policy/41000592.pdf> > accessed on 27 November 2014.

¹⁰² Simon James and Christopher Nobes, *Economics of Taxation* (14th ed. Fiscal Publications 2015).

¹⁰³ Peter Harris, *Corporate Tax Law; Structure, Policy and Practice* (Cambridge University Press 2013) 3.

¹⁰⁴ Ibid.

¹⁰⁵ Agnes Benassy-Quere, Lionel Fontanne, and Amina Lahreche-Revil 'How does FDI react to Corporation Taxation' (OECD 2004) < <http://www.oecd.org/tax/public-finance/36986898.pdf> > accessed 30 November 2014.

¹⁰⁶ These taxes can include VAT, PIT, CIT, Sales tax etc.

structure are thought to be a reflection of its specific economic, social, political conditions and its historical colonial roots.¹⁰⁷ For most developed OECD and EU countries as well as some developing countries, the most significant taxes as measured by their input to total tax revenues are the corporate and personal income taxes.¹⁰⁸

These are seen to be major revenue attractors¹⁰⁹ with the corporation tax being considered as having a great influence on the economy, mostly because corporation tax can be, and is used as, a vehicle for attracting FDI. The corporation tax has also added to the continuous complexity of tax systems, which has necessitated the need for constant reform. An instance of such complexity is the taxation of the corporations and its business or investment. Complexities caused by corporations for tax systems are based on or depending on the type of taxes imposed on them by governments.¹¹⁰ A complex tax system could impose costs on corporations that have to understand and comply with all of the various requirements. A major complexity caused by the corporate tax systems is economic double taxation. This occurs when a company is subjected to taxation on its profits whether or not these profits are distributed.¹¹¹ It also occurs when the shareholders are taxed on any dividends received from the company without any allowance for credit in respect of the tax already paid on the profits from which the dividends were derived (the issue of double taxation will be addressed in another chapter).¹¹²

Another demerit of a complex or underdeveloped tax structure or system is that it easily leads to transfer pricing, tax evasion and avoidance. Recently, the OECD has outlined rules to

¹⁰⁷ Ibid 150.

¹⁰⁸ Ibid.

¹⁰⁹ These income taxes have incentives attached to them for instance, the corporate tax rate can be reduced in order to attract investments, allowances and credits, tax breaks and other tax breaks are applied through these two taxes.

¹¹⁰ Ibid 105 at 150.

¹¹¹ Michael Feeney, *The Taxation of Companies 2012: A Guide to Irish Law* (Bloomsbury Professional Dublin 2012).

¹¹² Ibid.

manage issues regarding the Base Erosion and Profit Shifting (BEPS). BEPS is considered to be one of the tactics used by corporations to minimise tax paid on profits and thus creates an unfavourable business environment for competition, but mostly cheats governments of revenue especially governments of developing countries. Again, this will be discussed in another chapter.

A good tax system should also be able to stimulate employment while enhancing economic growth,¹¹³ which plays a major role in any country's efforts in reducing poverty and increasing the standard of living for its citizens. There are certain factors that enhance the economic growth of nation, the scope of which is greatly influenced by government policies and legislation. In recent years, while considering the economic crisis in countries such as Greece, the role played by a complicated and poorly structured tax system cannot be downplayed. Conversely, well-structured tax systems generate considerable revenue for the government. An example can be found in Ireland, which despite its recent economic and financial crisis was able to progress with the help of its tax system that was structured to attract FDI.

Furthermore, in the United Kingdom for example, governments tend to fund projects and services through revenue derived from taxation after ascertaining the feasibility of such projects within a certain timeframe. For example, the government would identify a service or a need and then work towards raising the money needed to actualize this, mostly through taxation. A projection is made and targets are set for a certain number of years to test the feasibility of funding the service. Its success or failure will determine whether it will continue. From the above discussion, it can be agreed that taxation is necessary and can function as a sustainable means of revenue for the government. For this to be successful, a tax system ought

¹¹³ Regina G Okafor, 'Tax Revenue Generation and Nigerian Economic Development' (2012) 4 European Journal of Business and Management 19

to be able to achieve sustainable and economic growth and be able to reflect the goals detailed below.

2.4.1 Foundations of a good tax system

Government policies in regards to taxation and the tax system are to be designed to best reflect the fundamentals of the system. It is advocated that the ideal foundations of an optimal tax system lie in its simplicity, certainty and stability.¹¹⁴ They suggest that the vital driver of simplicity in a tax system is the proposed role of tax.¹¹⁵ A system designed purely to raise revenue is more likely to be simple, as the only design constraints are neutrality and efficiency. On the other hand, a tax system designed with the intention of introducing choices for taxpayers, and taxes designed to influence behaviour, are more likely to increase complexity.¹¹⁶ Implementing tax can be complex, whether it is founded on legislation, supplementary guidance or case law. Further, tax authorities, taxpayers and advisers will interpret the rules – not necessarily in the same ways.

The Association of Certified Chartered Accountants (ACCA) observes that in practice, much of the complexity experienced by taxpayers and advisers stems from policy implementation.¹¹⁷ Drafting simpler tax legislation does not necessarily mean shorter legislation. It also needs to be usable and understandable. This is particularly important in countries where taxpayers self-assess their liability and will be the primary users of the

¹¹⁴ Ibid, see also note 1, Konstantinos Angelopoulos, James Malley, and Apostolis Philippopoulos, 'Tax structure, growth, and welfare in the UK' (2011) 64 (2) Oxford Economic Papers 237.

¹¹⁵ Ibid note 1.

¹¹⁶ Jason Piper, 'Certainty in tax' (Association of Chartered Certified Accountants Global Forum for Taxation 2014) < <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/tax-publications/ea-certainty-in-tax.pdf> > accessed 16 December 2015. An opportunity cost is an economic term which is the cost of an alternative that must be forgone in order to pursue a certain action. This essentially means the sacrifice made by taking an alternative action i.e. the difference in return between a chosen investment and one that has been passed up.

¹¹⁷ Ibid.

legislation as is the case in Nigeria where the system of self-assessment is in place. However, still a good number of the taxpayers do not understand the legislation and policy.¹¹⁸ The advantages of a simple tax system will include having a reduced cost of administration, and greater accountability, which is achieved by having a clear and transparent system.

Additionally, certainty and stability in a tax system is vital as without them neither governments nor taxpayers can effectively budget or plan for their future actions. Where there is uncertainty over the tax position of a transaction, prudent taxpayers may reserve funds against the potential liability, restricting additional investment and so creating an opportunity cost.¹¹⁹ For taxpayers, stability is essential for effective planning and efficient ongoing compliance. Furthermore, changing tax laws that affect the tax base, tax rate and administration has an economic and compliance cost impact on both the taxpayer on the government. The more regular the change, the greater the cost to comply and this could easily lead to tax avoidance and evasion.

Finally, Piper concludes that the balance of the factors that form the foundation of a good tax system will be different in different cases, but identifies the key component as simplicity. Once that is in place, certainty and stability will flow as a natural consequence.¹²⁰ Policy makers therefore should try not to make any one tax do too many things, and should not use too many different taxes to try to achieve the same aim.

2.5 Conclusion

Economic growth and development is necessary for both developing and developed countries alike. The above analysis and discussion sets the foundation for the rest of the thesis as it affirmed the obligation to charge tax by the government but most importantly, the need for taxation. By analysing the different theories of taxation, it found that despite globalisation and

¹¹⁸ Ibid note 111.

¹¹⁹ Ibid note 114.

¹²⁰ Ibid.

the emergence of e-commerce, the foundations of an optimal tax system remains the same. Rather, reforms are to be made bearing in mind the historical foundations especially concerning the persistent and negative effects of tax evasion and avoidance. The previous discussion has also shown that a good tax system can be effective in generating revenue for this needed growth and development. The next chapter will therefore, analyse the economic effects of corporation tax on national economies using the corporate tax systems of the illustrative countries.

CHAPTER 3: The Corporation Tax, Multinational Corporations and their impact on National Economies

3.0 Introduction

It has long been accepted that a clearly defined and sustainable revenue stream is indispensable for a government to meet its fiscal responsibilities towards its citizens. To achieve this, particular attention has been paid to establishing legally effective tax systems and structures as they play a fundamental role in the development of national economies. Certainty and sustainability in the source of revenue generation is essential because it tends to lead to economic growth and consequently, governments pursue an objective to find avenues through which they can generate revenue. With the proposition of corporation tax as a part of the sustainable revenue source for national economic development in Nigeria, the need arises for an examination and analysis of both the effect of and the legal influences that affect the establishment of an optimal corporation tax regime in a stable economy.

It has been considered that a low corporation tax rate, combined with other features of the tax system, is most effective for the high influx of FDI.¹ In developed economies, a number of empirical studies exist which establish the importance or effectiveness of corporation tax laws, and in this regard such studies have been fundamental for projecting and planning tax systems. In developing and emerging economies, there is a need to consider the tax systems in developed economies as the latter continually use their tax systems to improve their ability to attract investments, compete globally, and thereby, positively influence the national economy as a source of revenue. In view of this, this chapter seeks to analyse, from a legal perspective, the

¹ See generally, the works of MP Devereux, R Griffith and A Klemm, 'Corporate Income Tax Reforms and International Tax Completion' (2002) 17 Economic Policy 451; MP Devereux and PB Sorensen, The Corporate Income Tax: International Trends and Options For Fundamental Reform (2005) University of Copenhagen Economic Policy Research Unit EPRU-Analysis no 4
<http://www.econ.ku.dk/eprn_epru/Analyse/analyse24.pdf> accessed 11 December 2015.

economic effects of corporation tax and its legislation in both developing and developed economies.

This analysis aims to illustrate the methods corporation tax systems in developed countries such as the United Kingdom has used to sustainably generate revenue through FDI. The experiences of developed economies may be useful for developing and emerging economies in reforming their tax systems and legislation in order to generate revenue. This will be achieved through a study of empirical literature in this area by lawyers, economists and financial analysts. The strategy used in the majority of the literature studied is to assess the impact of the tax rate on investment of chosen sample countries, and correlate the differences in the investment flows with the different tax rates across the chosen sample. It is expected that an understanding of the effectiveness of corporation tax and its impact on national economies, will assist in establishing the basis for a framework of corporation tax legislation for an emerging economy. This chapter purposes to justify the thesis aim of creating a framework for a sustainable corporation tax system in Nigeria.

3.1 Taxes and National Economies- a review

As part of a country's legal system, the tax system is considered a major factor of economic development. Consequently, the level of economic development in a country at different stages can be based on the tax policy and different tax legislation in place. In both developed and developing economies, a relationship between tax structure and the level of economic growth and development exists² and the relationship between taxation and economic growth can be

² Libabatu Samaila Garba, 'Tax Revenue and Economic Growth In Nigeria' (PhD Thesis, Ahmadu Bello University, Nigeria 2014) <
<http://kubanni.abu.edu.ng:8080/jspui/bitstream/123456789/6508/1/TAX%20REVENUE%20AND%20ECONOMIC%20GROWTH%20IN%20NIGERIA.pdf>> accessed 01 February 2016.

assessed in terms of an increase in economic activities.³ This can be misleading in the sense that despite a perceived high level of activity, economic growth might still not be attained. Certain factors, which include corruption, can be a hindrance to economic growth despite high levels of economic activities. In Nigeria for instance, despite perceived high levels of economic activity especially in the oil and gas industry in the last year, only 3.2 percent growth was achieved. The present downturn of oil prices, has negatively affected the Nigerian economy with reported cases of lack of funds for government workers' salaries.⁴ In contrast the UK government has also been affected in the oil price crunch, but has not been negatively affected to the extent to which Nigeria has been affected other than the petroleum companies lacking funds. This may be because the UK has in place a tax system that has been able to generate income for the government and hence there is no over-dependence on oil revenue.

3.1.1 Taxes and Economic Development

In exploring the relationship between taxation and economic growth, Kuznets defined economic growth as a “long-term rise in capacity by a government to supply *increasingly*⁵ diverse economic goods to its population”.⁶ Given that a country's ability to increasingly supply products and services does not overtly portray growth, it then means that if sustainable economic growth and development occurs that citizens should be able to provide certain amenities for themselves and the government will only have to cater for a certain or reduced number of its citizens. In this way, the government is not heavily burdened and is left to provide

³ C Olopade and DO Olopade, 'The Impact of Government Expenditure on Economic Growth and Development in Developing Countries: Nigeria as a case study' (EcoMod2010 conference, Istanbul, July 2010) < <http://ecomod.net/sites/default/files/document-conference/ecomod2010/1369.pdf>> accessed on 02 February 2016.

⁴ At present, Nigeria is experiencing the ill effects of overdependence on petroleum generated revenue, as such; the government is seeking ways to in which to generate sustainable revenue for the country. It has started seeing taxation as the new oil and is in the process of implementing and reforming existing laws. Victor Ahiuma-Young and Levinus Nwabughio, 'We can no longer pay N18, 000 minimum wage' Vanguard (Nigeria November 2015) < <http://www.vanguardngr.com/2015/11/we-can-no-longer-pay-n18000-minimum-wage-govs/>> accessed 29 January 2016.

⁵ Emphasis is made by the author.

⁶ Simon Kuznets, 'Economic Growth and Income Inequality' (1955) 45 The American Economic Review 1.

the necessary basic infrastructure for its citizens.⁷ Governments are determined to create and maintain avenues through which they can reasonably expect an optimal rate of economic growth.

Consequently, they structure economic growth programmes in the form of policies and legislation that are geared towards raising the standard of living for its citizens through the improvement of their economic and social conditions. Chigbu maintains that for both developed and developing countries, taxes play a vital role in their economic history. He expounds that taxation creates fiscal goals that influence the direction of investment while at the same time taming the consumption of production of certain goods and services.⁸ Furthermore, taxes are imposed to regulate the production of certain goods and services, protection of small businesses, control business and commerce, curb inflation and reduce income inequalities.⁹ All these in turn result in economic growth. However, this does not represent the reality of tax systems. In the UK, small businesses seem to bear the burden of taxes while big businesses (MNCs) pay tax as they can arrange their tax payments to suit them.¹⁰ In this sense, tax will not have a positive effect on an economy. Similarly, as presented in the previous chapter, Nigeria's imposition of CIT on businesses that did not immediately yield profit, or were facing problems, showed a negative effect of tax on economic growth.

⁷ The necessary infrastructure for its citizens can be classified as roads, water, schools, health facilities protection etc. These are necessities that citizens are not expected to provide for by themselves.

⁸ EE Chigbu, LE Akujuobi and E Appah, 'An Empirical Study on the Causality between Economic Growth and Taxation in Nigeria' (2012) 4(2) Current Research Journal of Economic Theory 29.

⁹ For more detailed reading and empirical literature on the effects of tax on economic growth, see the following Ergete Ferede & Bev Dahlby, 'The Impact of Tax Cuts on Economic Growth: Evidence from the Canadian Provinces' (2012) 65 National Tax Journal 563; Karel Mertens & Morten Ravn, 'The Dynamic Effects of Personal and Corporate Income Tax Changes in the United States' (2013) 103 American Economic Review 1212; Jens Arnold and others, 'Tax Policy For Economic Recovery and Growth' (2011) 121 Economic Journal F59; Norman Gemmell, Richard Kneller and Ismael Sanz, 'The Timing and Persistence of Fiscal Policy Impacts on Growth: Evidence from OECD Countries' (2011) 121 Economic Journal F33; Young Lee and Roger Gordon, 'Tax Structure and Economic Growth' (2005) 89 Journal of Public Economics 1027.

¹⁰ Ibid.

This may be because a tax system, which protects small businesses, encourages entrepreneurial development in the country and in turn, stimulates economic growth.

According to Tosuu and Abizadeh,¹¹ taxes are used as an alternative for fiscal policy. They argue that taxes, affect national economic growth either positively or negatively. They further present instances through which taxes can affect economic growth. They argue that taxes, especially corporation and personal income taxes, may either have a positive or negative affect national economic growth, considering the uncertainty and ambiguity in the laws that govern them. This uncertainty is reflected in different forms, which will be addressed in more detail later in this chapter. Further, the OECD states that taxes not only affect the decisions of households to save, supply labour and invest in human capital; but also the decisions of firms to produce, create jobs, invest and innovate. It also affects the choice of savings channels and assets by investors.

The essential factor that drives these decisions, does not rest on the level of the taxes imposed, rather, it rests on the different mechanisms through which taxes are designed to generate optimal revenue. This confirms that the legislation and policy instruments that regulate taxation are an important factor in the relationship between taxes and economic growth and development. Essentially, these instruments form the guide, which advisers to foreign investors use within the business environment of the country in which it seeks to invest. Tax revenue plays a crucial role in promoting economic activity and growth. With revenue generated through taxation, government ensures that resources are channelled towards important projects in the society.¹² The positive effect of tax revenue of promoting economic activity and growth is not felt primarily because of the poor administration of the tax system or regime.

¹¹ Mehmet Serkan Tosun and Sohrab Abizadeh, 'Economic Growth and Tax Components: An Analysis of Tax Changes in OECD' (2005) 37 *Applied Economics* 2251 <

<http://www.tandfonline.com/doi/pdf/10.1080/00036840500293813>> accessed 25 February 2016.

¹² Ibid.

Furthermore, in a study carried out in Nigeria, it was discovered that an indirect relationship exists between tax revenue and economic growth through infrastructural development.¹³ The results of the study identified several channels such as FDI, real GDP, and infrastructural development through which tax revenue influences economic growth in Nigeria. With the availability of well-structured tax systems with possibly reduced tax rates, sustainable economic development and growth will be achieved. However, the above can only be achieved if the government can put in place comprehensive fiscal legislation and policies and at the same time, strengthen already existing legislation and policy in line with its economic objectives for the country.

The relationship between, and the effects of tax on economic growth and development are varied and largely positive and can be evidenced in three main ways. Firstly, there is a positive financial impact. Considering tax as one of the indicators for the location of FDI, the tax system provides a fiscal platform that encourages FDI while promoting regional and international trade. National tax policies and legislation, determine the attraction of FDI. With a sustainable and well-structured tax regime, investors will bring stable and free capital, technology and infrastructure and create employment, all of which will improve the economy. Additionally, there is a positive impact in terms of the equity of the system.

Taxes also promote a fair relationship between developed and developing economies to ensure that developing economies get a fair allocation of taxing rights in bilateral relations using tax treaties. When this is properly applied, both economies benefit through the quantity and quality of investment, through either tax receipts, or technology and infrastructure. Further, it has a positive impact on FDI. Through taxes, developing countries are able to raise funds for

¹³ Christian N Worlu and Emeke Nkoro, 'Tax Revenue and Economic Development in Nigeria: A Macro Econometric Approach,' (2012) 1 Academic Journal of Interdisciplinary Studies 211 <<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.660.9641&rep=rep1&type=pdf>> accessed 5 January 2016)

sustainable development of its economy. An effective and well-functioning tax regime and administration is also essential for financing sustainable development. Without a sufficient tax structure or regime, the governments' ability to achieve and enhance sustainable development goals is limited. For developing economies, a well-structured tax regime, eases the burden of the constant need for borrowing funds to fund its economy.¹⁴

As the above discussion suggests, taxes affect a country's economic growth in different ways. It could be through the fostering of relationships and cooperation between developing and developed economies through the allocation of taxing rights in international taxation. This removes the issues of double taxation and fosters international trade. Furthermore, through taxes, developing countries raise funds for sustainable development for the needs of its citizens. Most importantly, tax (tax system, structure and regime) as a recently accepted FDI indicator bring amongst others, infrastructure, technological development, free capital, employment which all develop the economy.

3.2 Corporation Tax and National Economies

The essence of assessing the effects of corporate tax legislations lies in the fact that a significant amount of revenue could be accrued through such taxes if properly structured and managed.¹⁵

As this chapter aims at examining the underlying reasons for the sustainability of corporation tax as a revenue source, it will explore the empirical literature surrounding the effects of corporation tax on economic growth. It achieves this through an illustrative analysis of the amount of revenue generated by corporation tax in developed and developing economies. The

¹⁴ Nigeria's economy is Africa's largest and has been hit hard by the fall in crude prices because of the country's dependence on oil generated revenue. With this development, Nigeria has asked the World Bank and African Development Bank for \$3.5 billion in emergency loans to fill a growing gap in the budget.

¹⁵ A perusal of the United Kingdom budgets, it can be seen that taxes derived from businesses with particular reference to corporation taxes bring about a sizeable amount of revenue.

UK is used as an example of a developing country and the effects of the changes and stability in the legislation is analysed with the end of determining if legal uncertainty plays a role in the investment locations in the countries used for illustration. Although there has been some indication that an earlier reduction in CIT has helped increase investment in Nigeria,¹⁶ there is little data for an extensive analysis to be undertaken. The link between corporate tax and economic growth or development will be demonstrated by highlighting its influences for creating a stimulating environment for business.

3.3 Mapping the terrain

This section reviews the current studies and research that examine the relationship between tax and the economy. In particular, it reviews the literature on corporation tax and its impact on economic development.

3.3.1 Effects of Corporation tax on Economic Development

Corporate tax systems are designed to minimize economic distortions and can help promote an efficient economy. Taxation of corporations has great importance especially as CIT revenue from MNCs and domestic corporations is important as a source of much needed government revenue for economic development. It has been suggested that MNCs are more profitable than are domestic corporations, consequently, it is expected that they should pay a higher amount of tax in developing countries.¹⁷ Regardless of this, evidence suggests that MNCs more easily shift income to low-tax jurisdictions to reduce their tax liabilities.¹⁸ These companies use a variety of devices for example transfer pricing, with consequent harmful results. This creates a problem of reduced income for developing countries as there is an illicit

¹⁶ Ibid 14.

¹⁷ Clemens Fuest, Michael Devereux and Giorgia Maffini, 'The Taxation of Multinationals in Developing Countries' (International Growth Centre 2016) < <http://www.theigc.org/project/the-taxation-of-multinational-corporations-in-developing-countries/>> accessed 13 February 2016.

¹⁸ Ibid.

flow of revenue out of its border and this, in effect, affects economic growth and development. In the composition of taxes, the CIT can be seen to be relatively more important for developing countries than for developed countries. Using data from the ICTD data set, a study found that developed countries generate more revenue from PIT than CIT.¹⁹ It was found that CIT yields about 15 percent of all income taxes in developing countries. Consequently, CIT amounts to 4 percent of GDP in developing countries against the 2 percent in developed countries. This may be a consequence of the type of economy predominantly found in developing countries. In many of these countries, there is a larger informal and mostly unaccounted for economy. In this instance, CIT is easier to collect than PIT as the tax office could more readily keep track of corporate income than individual income.

Additionally, countries have sought to offer lower than average corporate tax rates in order to attract more investment from foreign investors. This race to the bottom can easily lead to harmful tax consequences however if it is well coordinated, it can have a positive impact on the national economy. Most MNCs make decisions that are driven by the cost of, and the expected return from investment projects. Corporate tax can therefore have a negative effect on corporate investment by reducing its profits after tax return. Empirical literature suggests that there is a relationship between corporation tax and FDI. Furthermore, corporate tax rates and the tax base are essential to investment, which is vital to national economic growth. Having a tax base that is adequately taxed, will also be an influencing factor for MNCs. The Meade Report and the subsequent Mirrlees review, alludes to taxing economic rent as these taxes, do not distort the scale of investment or financing choices between debt and equity.²⁰ Additionally,

¹⁹ Kyle McNabb and Philippe LeMay-Boucher, 'Tax Structures, Economic Growth and Development' (2014) ICTD Working Paper 22, < <http://www.ictd.ac/publication/2-working-papers/15-tax-structures-economic-growth-and-development> > accessed 1 February 2016

²⁰ JE Meade, *The Structure and Reform of Direct Taxation* (IFS London 1978).

taxing economic rent discourages parasitical rent seeking while promoting efficient use of capital and labour in production.²¹

Cummins, Hassett and Hubbard identified that changes in corporation tax in the United States can have significant effects on investment, which positively affects the economy.²² In their research, they used major US reforms as natural experiments to assess the impact of net reforms on investment.²³ In his thesis (a compilation of published papers), Wallis finds that tax policy changes can have a significant impact in the long run level of capital stock and investment.²⁴ He investigated the effectiveness of the UK tax policy in boosting the long run level of investment by using an extended UK dataset that incorporates a number of permanent tax changes.²⁵ He argues that the 2010 UK Emergency Budget corporation tax reforms increased market sector capital stock by as much as 1.2percent, which led to an additional £13 billion of investment.²⁶

As far back as 1993, Bond, Denny and Devereux assessed the impact on investment from the permanent post S1986 Corporation Tax changes and found that a 1-2 percent fall in the cost of capital could permanently increase investment by 5 percent.²⁷ Adding to the literature, Djankov et al (2008), using a large cross-section of data across various countries, found a 10 percent increase in the effective corporate tax rates reduces investment to GDP ratio by a 2 percentage

²¹ See the following; James Mirrlees, Adam Stuart et al “Tax by Design: The Mirrlees Review” (Oxford University Press 2011) Michael P Devereux, “Issues in the Design of Taxes on Corporate Profit” 2012 65 (3) National Tax Journal 709.

²² JG Cummins and others, ‘A Reconsideration of Investment Behaviour Using Tax Reforms as Natural Experiments.’ [1994] Brookings Papers on Economic Activity, 2,1.

²³ Ibid.

²⁴ GE Wallis, “Essays in Understanding Investment” (PhD thesis, University College London 2012).

²⁵ Ibid.

²⁶ Ibid.

²⁷ S Bond, K Denny and M Devereux, ‘Capital Allowances and the Impact of Corporation Tax on Investment in the UK’ (1993) 14 Fiscal Studies 2, 1.

point.²⁸ However, Kawano and Slemrod, argue that corporate tax rates no longer have a statistically significant relationship with corporate tax revenues.²⁹

Brookmeyer's work supports other related literature as it was found that the tax rate change could be used to stimulate investment.³⁰ Brookmeyer used data from the HMRC data lab (2001 and 2007) to examine how a tax rate change affects investment. The interaction of positive or negative effects of the tax rate changes with variation in capital depreciation was explored.³¹ Further, Li Liu uses empirical evidence to demonstrate the distortionary effect of corporate income taxes on the allocation of capital investment in the US economy.³² Domestic research carried out in Ireland by Conefrey and Fitzgerald in 2011 found that the reduction in the rate of corporation tax in the business and financial sector from 40 percent in 1994 to 12.5 percent in 2003 brought about an increase in the level of Gross National Product (GNP) by 3.7 percent in 2005.³³ The ESRI examined the effects of country characteristics and corporation tax on firm location decisions using data on newly established multinational subsidiaries across 26 EU countries. They found a consistently negative effect of tax on locational decisions of firms.³⁴

A study conducted in Nigeria, which investigated the revenue implications of Nigeria's tax system, concluded that CIT together with the PIT are the most economically sensitive taxes as

²⁸ HM Treasury and HM Revenue & Customs, 'Analysis of the Dynamic Effects of Corporation Tax Reductions' (HM Treasury and HM Revenue and Customs 2013)
<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263560/4069_CT_Dynamic_effects_paper_20130312_IW_v2.pdf> accessed 13 November 2015

²⁹ Laura Kawano and Joel Slemrod, 'The Effect of Tax Rates and Tax Bases on Corporate Tax Revenues: Estimates with New Measures of the Corporate Tax Base', (2012) National Bureau of Economic Research Working Papers 18440, < <http://www.nber.org/papers/w18440>> accessed 12 November 2015

³⁰ Anne Brockmeyer 'The Investment Effect of Taxation: Evidence from a Corporate Tax Kink' (2013) Oxford Centre for Business Taxation Working Paper 13/17< <http://www.sbs.ox.ac.uk/ideas-impact/tax/publications/working-papers/investment-effect-taxation-evidence-corporate-tax-kink>> accessed 2 November 2016.

³¹ Ibid.

³² Liu Li, 'Do Taxes Distort Corporations Investment Choices? Evidence from Industry Level Data' (PhD thesis, (Rutgers University, New Brunswick, 2011).

³³ Thomas Conefrey and John D FitzGerald, 'The Macro-Economic Impact of Changing the Rate of Corporation Tax,' (2011) 28 Economic Modelling 991.

³⁴ Ibid.

they respond positively to changes in the current state of the economy; rising when the economy rises and declining when the economy declines.³⁵ The ideas expressed in this research is congruent with this study and agrees that when a national economy is negatively affected and its citizens lose their source of income, PIT revenue is reduced and in most situations, CIT too is reduced, as corporations do not realise profit. An example of this can be seen in the recent oil price crunch that has negatively affected Aberdeen, with the economic impact felt by not only the local council, Scottish and UK governments but also other institutions.³⁶

Using Chi-square and multiple linear regression in analysing primary and secondary data, Adegbie and Fakile, found that there is a significant relationship between CIT and economic development in Nigeria.³⁷ They concluded that because of inadequate tax administration, tax avoidance and evasion has negatively affected CIT revenue. Similarly, Umoru and Anyiwe found that direct taxation in the form of CIT, PPT and PIT is growth enhancing in Nigeria.³⁸ They assert that a transition from direct taxation to indirect taxation in Nigeria lacks empirical justification.³⁹ Arguably, while it is true that PPT and CIT (together with PIT) are the most effective sources for generating taxable income for growth enhancement in Nigeria, at present, the CIT structure in place is neither sufficiently sustainable nor well-structured enough in order to generate adequate revenue for economic growth. Furthermore, the crash in oil price has led to drastically reduced income in Nigeria and as such cannot be a sustainable source of revenue for economic and growth development. In this instance, CIT from other non-oil dependent MNCs and domestic corporations can well be used as sources of revenue generation. In

³⁵ Patterson C Ekeocha, Ekeocha, Chidinma Stella, Malaolu, Victor Oduh and Moses Onyema 'Revenue Implications of Nigeria's Tax System' (2012) 3 Journal of Economic and Sustainable Development 213.

³⁶ Aberdeen Scotland, is deemed to be the oil capital of Europe, with the crunch in oil price, and has seen the wounding up of small sized corporations and redundancy of oil workers.

³⁷ FF Adegbie and AS Fakile, 'Petroleum Profit Tax and Nigeria Economic Development' (2011) 1 International Journal of Research in Computer Application & Management 11.

³⁸ David Umoru and MA Anyiwe, 'Tax Structures and Economic Growth in Nigeria: Disaggregated Empirical Evidence' (2013) 2 Research Journal of Finance and Accounting 65.

³⁹ Ibid.

addition, indirect tax in the form of VAT can be easily considered as another source of worthwhile revenue for economic growth and development. Likewise, in another study, on the relationship between the CIT and the Nigerian economy, it was found that the CIT is a major source of revenue in Nigeria but non-compliance with tax laws and regulations by taxpayers which is as a result of a weak administration, has hindered a high return of revenue from this tax.⁴⁰

Despite the positive effects of corporation tax on economies, it is accepted that it negatively affects economies as well. Constant changes in corporate tax rates increases the output price in the corporate sector and this leads to reduced demand for corporate sector output, while there is an increase towards output in the unincorporated sector.⁴¹ Another negative effect of the CIT is that it leads to double taxation. Double taxation, occurs when an MNC pays tax on the same corporate income earned from economic activity in a foreign country twice; once to the tax authorities of the foreign country, which is host to the economic activity, and once to the tax authorities of the home country, in which the company is domiciled.⁴² Double taxation has to be avoided, through double tax agreements, as it could represent an obstacle or barrier to foreign investment, thus distorting the efficient allocation of scarce financial resources across countries of the world.⁴³

Nevertheless, Baranová and Janíčková, argue that tax policy mainly determines the method of a corporation's financing⁴⁴ with high tax rates reducing corporate profits and thus the possibility of subsequent reinvestment. The international movement of capital enables simple

⁴⁰ Ibid.

⁴¹ Adegbite Tajudeen Adejare, 'The Analysis of the Effect of Corporate Income Tax (CIT) on Revenue Profile in Nigeria' (2015) 1 American Journal of Economics, Finance and Management 312, 314.

⁴² Bruce A Blonigen and Ronald B Davies, 'Do Bilateral Tax Treaties Promote Foreign Direct Investment?', (2002) National Bureau of Economic Research Working Paper 8834 < <http://www.nber.org/papers/w8834> > accessed 1 October 2015.

⁴³ Ibid.

⁴⁴ Baranová Veronika and Janíčková Lenka, 'Taxation of Corporations and Their Impact on Economic Growth: The Case of EU Countries' (2012) 4 Journal of Competitiveness 96.

selection of investment allocation. For small open economies that are mostly investment recipient, the high taxation can be a competitive problem.⁴⁵

Understanding that MNCs bring in FDI into developing and developed countries alike, the relationship between FDI and MNCs, and corporate tax structures will be explored in the following section. The FDI brought in by MNCs aid in the economic growth and development of countries.

3.4 Multinational Corporations, Corporate Tax Structures and Foreign Direct

Investment

3.4.0 Context

Globalisation viewed as a double-edged sword, has made economic development a serious challenge for both developed and developing countries but more so for developing countries. On the one hand, it has contributed to an international economy, which in turn may have contributed to Foreign Direct Investment (FDI) through increases in investment for both developing and developed countries. On the other hand, globalisation may have also contributed to the loss of revenue for countries through tax evasion and avoidance carried out by multinational corporations (MNCs). MNCs, strive to shift their profits from one location to another based on their own corporate preferences and as a result, have contributed to a short fall of revenue for states. This results in a decline in the economic growth and development for states and in particular, developing countries. Consequently, they do not achieve this much needed growth and development and tend to lean towards foreign aid. Ideally, to achieve economic growth, a state government must divert part of its resources from present consumption and invest it on capital formation. However, developing and lower income

⁴⁵ Ibid.

countries suffer a dearth of domestic savings and capital that can be put into such investment purposes.⁴⁶ Thus to overcome this, such state governments turn to attracting direct foreign investments in order to bridge the gaps created by shortage of domestic savings or capital.⁴⁷ One of the key ways of managing this situation is through the imposition of stringent legislation.

The various phases of economic crises ranging from the financial crises in the later part of 2000⁴⁸ to the present oil price crash which has affected economic growth and development in the world, portrays the reality of the interconnectivity of the global economy. This calls for a unified front by the international community to address and find ways to overcome this. Many oil-producing states are seeking avenues through which they can generate revenue to fund their economy. For developing countries that are significantly affected with this concern by being solely dependent on oil revenue as a means of funding their economy, there is a need for the diversification and generation of revenue through alternative sustainable sources. Likewise, the persistent need to fund the different health challenges and the low quantity and quality of public services and infrastructure especially in developing countries has laid the burden on state governments to raise funds for the continuous and sustainable economic growth of their countries.

3.4.1 Corporations and Multinationals

To understand multinational corporations, one first has to understand the corporation itself as it could be surmised that multinationals are born out of corporations. Corporations are fundamental to all aspects of business life particularly to the government and citizens in the

⁴⁶Adewale Stephen Bakare, 'The Crowding-Out Effects of Corruption in Nigeria: An Empirical Study' (2011) 2 (2) *Journal of Business Management and Economics* 059.

⁴⁷ *Ibid.*

⁴⁸ The failures from over reliance on property (mortgage), finances and petroleum has shown the need for a sustainable avenue for revenue generation. These were instrumental to the financial crash back in 2008 where the property industry in Ireland suffered a large meltdown.

sense that they provide largely a means of livelihood to them. It follows that its taxation is also fundamental to them.⁴⁹ Determining what entities or organisations should be subject to tax is vital in deciding the structure of corporations' tax systems.⁵⁰ There are different forms of legal entities that can be used to perform business, each with their different benefits and drawbacks.⁵¹

Corporations, or specific legal entities of persons and material resources chartered by governments, have existed for thousands of years.⁵² Legal entities similar to modern corporations existed as far back as ancient Rome, where there existed a limited set of recognized legal personalities, including municipalities; associations, guilds, and public bodies like universities.⁵³ However, the nature of modern day corporations and their historical origins are most often traced to the development of corporations in Western legal traditions.⁵⁴ Avi-Yonah indicates that the terms used to define or describe these entities for tax purposes should not be vague or contradictory as this causes issues for tax officials to define or determine the precise definition to ascribe to such entity.⁵⁵

In modern times, corporations are usually firms that meet certain legal requirements to be recognized as distinct from its owners.⁵⁶ As the world has become more interconnected and interdependent owing to economic and technological developments, corporations have evolved

⁴⁹ Peter Harris, *Corporate Tax Law: Structure, Policy and Practice* (Cambridge University Press 2013)35.

⁵⁰ Hugh J Ault and Brian J Arnold, *Comparative Income Taxation: A Structural Analysis* (University Press of Virginia 2004).

⁵¹ Reuven Avi-Yonah, Nicola Sartori, and Omri Marian, *Global Perspectives on Income Taxation Law* (Oxford Scholarship Online 2011)

<<http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780195321357.001.0001/acprof-9780195321357>> accessed 1 November 2015.

⁵² Jacob Steinberg-Otter, 'Taxing Multinational Corporations'

<<http://internationalschoolbarcelona.com/web/english/files/2015/03/Group-of-7-Taxing-Multinational-Corporations-.pdf>> accessed 1 November 2015.

⁵³ Ibid.

⁵⁴ Ibid

⁵⁵ Ibid.

⁵⁶ Otokiti Bisayo Oluwatosin, 'Mode of Entry of Multinational Corporation and Their Performance in The Nigerian Market' (PhD thesis, Covenant University Nigeria 2012). The notable case of *Salomon v Salomon* set out the doctrine of separate legal personality and limited liability for corporations.

into multinational concerns as they seek to find new markets for business while at the same time generating profits. There is no precise definition of the term multinational corporations but the different definitions, all drive towards the same purpose of introducing FDI to countries while at the same time maximising profit-yielding opportunities.⁵⁷ Lazarus suggests that from an economics perspective, any definition of an MNC will emphasize the ability of their owners and managerial agents in one country to control the operations of the MNC in a foreign country.⁵⁸ While this may have been the case of MNCs in the past, with the need for greater accountability especially in the taxation of MNC profits, international organisations like the OECD and the EU, call for transparency in the governance of MNCs. This transparency is best emphasised in the separation of control between parent organisations and their subsidiaries in other countries.

MNCs have been defined as ‘business organisations with activities located in more than two countries either through the establishment of branches or subsidiaries in foreign countries while retaining a head office in its home country’.⁵⁹ Over the years, MNCs have, in different ways exerted influence on both global and domestic economies, probably as it is the most favoured organisation for the location of FDI. In the 1970s, MNCs rapidly expanded their business activities from developed economies to a wider range of countries that included developing countries, through international trade.⁶⁰ According to UNCTAD, by the 1990s, the number of MNCs had increased to more than 35,000 with more than 150,000 subsidiaries or affiliates.

⁵⁷ For different definitions of the MNC see the following; Dunning J H, ‘Multinational Enterprises and the Growth of Services: Some Conceptual and Theoretical Issues’ (1989) 9 Services Industries Journal 5.

Multinational Corporations consist of a firm with foreign subsidiaries that extend the firm’s production and marketing beyond the boundaries of a single country. International production is therefore a value adding activity, owned or controlled, and organized by a firm or group of firms outside its national boundaries per

⁵⁸ AA Lazarus, ‘Multinational Corporations’ (2001) <

https://www0.gsb.columbia.edu/faculty/bkogut/files/Chapter_in_smelser-Baltes_2001.pdf> accessed 15 April 2016.

⁵⁹ Ibid 219.

⁶⁰ Ibid.

This could be attributed to the structural changes in the world economy and the growth of trade liberalization.

As Gilpin asserts, the principal objective of MNCs is to secure the most profitable means of producing goods for world markets.⁶¹ Profitable in this regard may be defined in terms of cost and profits. MNCs achieve this through acquiring the most efficient locations for production facilities or obtaining taxation concessions from host governments. This objective aligns with Marxist views, which consider MNCs as progressive agents of capitalism in the sense that, the MNCs try in every way possible to reduce expenses and maximize profit.⁶² These notwithstanding, activities of multinational corporations are supportive of the growth and development of many countries. From the literature, it can be deduced that MNCs generally make both positive and negative contributions to national economies. In a positive light, MNCs contribute to the growth of real output direct investment in the production of tangible goods.⁶³ Through multinational direct investment, MNCs generate and expand businesses, stimulate employment, raise wages and replace declining market sectors. Furthermore, MNCs reduce a country's inclination to importation and therefore leads to increased competition in the host countries, which in turn promotes efficient allocation of production resources. This is achieved by locating their businesses in different states whereby both the MNCs and the host state benefit from each other.

Although this has led to increase in wealth for some countries through FDI, MNCs at some point started to embed or encourage some fundamental changes in the organisation of their activities, especially in terms of their cross border activities. A particular aspect of this change is seen in their tax planning activities. It is argued that the new structures that are created by

⁶¹ Robert Gilpin, *The Political Economy of International Relations* (Princeton University Press 1987).

⁶² Ibid.

⁶³ Adewale Stephen Bakare, 'Multinational Direct Investment and Economic Growth in Nigeria: An Empirical Study' (2010) 4 *International Business Management* 171.

the large sized MNCs through complex networks and strategic alliances make national boundaries largely redundant, and reduce the efficacy of national and regional policy instruments.⁶⁴ This led to a call for a need to reverse certain concepts and to establish rules in some areas that are not well covered in an international framework relating to FDI. Furthermore, these same large MNCs have accumulated so much power with the amount of revenue that they are able to gain increased leverage so much so that it could be argued that this leverage has placed MNCs in a state where they can be equated as being as powerful, if not more powerful than state governments.⁶⁵ Despite the number of MNCs, the majority of them are concentrated in developed countries while their links with developing countries are via subsidiaries.⁶⁶ Economists proffer that the movement from developed to developing countries on the part of MNCs, stems from the need to seek a high return for capital.⁶⁷ In recent times, the taxation of corporations and MNCs has been most prominent in the news and it has been a matter of concern for both developed and developing nations. This is due to the impact of MNCs on the economies through foreign direct investment

3.4.2 Foreign Direct Investment (FDI)

Previous chapters have shown that with globalisation, world trade has caused MNCs to become dominant players in global economy. MNCs have been credited for the high economic growth and performance through the FDI they bring into countries. The liberalisation of developing

⁶⁴ Ibid 219.

⁶⁵ It is widely reported that MNCs in both developed and developing countries, can 'hold to ransom' state governments in order for them to achieve some means. In terms of taxation, Vodafone has been accused of having coerced or manipulating its tax liability by threatening to move out of the UK. This would have resulted to loss of jobs and revenue for the government and this led to having a reduction in their tax liability. See for example, Gary Younge, 'Who's in Control – Nation States or Global Corporations?' *The Guardian* (London, 2 June 2014) < <http://www.theguardian.com/commentisfree/2014/jun/02/control-nation-states-corporations-autonomy-neoliberalism>>, accessed 15 April 2015.

⁶⁶ Ibid 219.

⁶⁷ Adegbite Tajudeen Adejare "The Analysis of the Effect of Corporate Income Tax (CIT) on Revenue Profile in Nigeria" (2015) 1 American Journal of Economics, Finance and Management 312.

markets and development of FDI attractive policies has increased the investment of MNCs in not only developed economies but also increasingly, developing economies as well. The trend of MNC FDI location, tended to rest largely in the West but recently, Latin America, Asia and Africa has seen a high increase in investment by MNCs thereby attracting FDI. Further governments implement policies that are geared towards stimulating FDI influx mostly through legislation covering corporations, business and commerce. Developed economies such as Ireland, has reported increase in its economy especially after the crash of the Celtic Tiger⁶⁸ with a change in its legislation especially in the reduction of its corporation tax rate. Similarly, in an endeavour to stimulate growth, the UK implemented policies to attract investment by MNCs. This was done by creating a competitive environment amongst MNCs. However, such competitiveness creates opportunities for harmful tax practices by the MNCs. This occurs because of the distortions in the trade and investments, which arise from taxes imposed by the authorities in each country, could easily lead to harmful tax practices.⁶⁹ Apart from this, there is a notion that this could also affect the quality and quantity of the investment as large multinationals could easily shift their mobile capital to less mobile factors.⁷⁰ Providing an environment attractive for FDI is critical as a national policy to secure productivity gains and economic growth. However, it is necessary to have a tax system or tax structure that will adequately incorporate incentives for economic growth while at the same time not engaging in harmful competition.

Despite FDI being defined in many ways and from different contexts, fundamentally, these definitions all have the same characteristics, evidenced in the definition by United Nations

⁶⁸ The Celtic Tiger is used to refer to the booming Irish economy between the 1990s and 2000s. There was a rapid economic growth through property investment which eventually crashed.

⁶⁹ Ibid.

⁷⁰ According to the IMF, large multinational could easily redistribute their tax burden to smaller subsidiary small national firms or could transfer their investment from mobile capital to labour and thereby affecting the quality of FDI it brings to a country.

Conference on Trade and Development (UNCTAD). UNCTAD in 1999 defined FDI, “as an investment involving a long term relationship and reflecting lasting interest and control of a resident entity in one economy in an enterprise resident in an economy other than that of the foreign direct investment”.⁷¹ Likewise, The International Monetary Fund (IMF) in its *Balance of Payments Manual* defines FDI as ‘an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor.’⁷² Essentially, governments work at attracting foreign direct investment to their countries in order to capitalize on their benefits.⁷³ FDI generates new jobs, brings on new technologies, skills, innovative capacity and of utmost importance, it promotes growth and development.⁷⁴ Furthermore, not only does FDI add to investment, it contributes to a competitive business environment when MNCs from developed economies transfer skills, and innovation, to the domestic firms in developing economies. This helps strengthen the resident industries by increasing their capabilities to compete with the MNCs, and this in turn enhances productivity. The resulting net increase in domestic income is shared with the government through the taxation of wages and profits of foreign-owned corporations and other possible tax on businesses.⁷⁵

A study by Becker, Fuest and Riedel measured the relative importance of quality and quantity effects of corporation tax on FDI and concluded that corporation tax had a positive effect on both the quantity and quality of FDI.⁷⁶ This was carried out by using detailed data on European

⁷¹ UNCTAD ‘World Investment Report 1999: Foreign Direct Investment and the Challenge of Development’ (UNCTAD 1999) < http://unctad.org/en/Docs/wir1999_en.pdf > accessed 3 May 2015.

⁷² International Monetary Fund ‘*Balance of Payments and International Investment Manual*’ (6th ed. IMF 2009) < <https://www.imf.org/external/pubs/ft/bop/2007/pdf/bpm6.pdf> > accessed on 15 October 2014.

⁷³ FDI benefits include but limited to generate new jobs, bring in new technologies and, more generally, promote growth and employment.

⁷⁴ Ibid note 69.

⁷⁵ Ibid.

⁷⁶ J Becker, C Fuest and N Riedel, ‘Corporate Tax Effects on the Quantity and Quality of FDI.’ (2012) 56 *European Economic Review* 1495.

For empirical literature on the effects of corporation tax on FDI, see generally the following Thiess Buettner, and Martin Ruf, ‘Tax Incentives and the Location of FDI: Evidence from a Panel of German Multinationals. (2007) 14 *International Tax and Public Finance* 151; Thiess Buettner and G Wamser, (2006) ‘The Impact of Non-Profit Taxes on Foreign Direct Investment: Evidence from German Multinationals’ (European Tax Policy Forum Conference’ *The Impact of Corporation Taxes Across Borders*’,

MNCs to empirically measure quantity and quality effects on corporation tax. They found that despite according taxing rights on a developed economy (resident country); the developing economy (source country) is not left at a disadvantage considering what it would have gained in either the quantity or quality of FDI.⁷⁷ Consequently, tax should not play a fundamental role in investment location by MNCs. Economic determinants such as the size and growth of a market, access to resources, cost of factors of production all considered relevant and important for location decisions. Furthermore, the stability and strength of the business climate and commercial law is also very relevant and as such, tax is not necessarily considered as determinants for FDI. These indicators are not only used to measure the level of FDI inflow but are also used to understand the influence behind the high level of FDI in particular locations.

However, in recent times, tax, especially the corporation tax has been lauded as a major determinant for MNC FDI locator. For example, despite rates of the corporation tax playing a considerable role in the location of MNCs in Ireland, it has been perceived and debated to encourage harmful tax practices.⁷⁸ Tax decisions have become key investment determinants that influence the attractiveness of a location or an economy for international investors. According to UNCTAD, the above-mentioned determinants – size of market and production - still depend on tax decisions.⁷⁹ Foreign investors often invest or operate through joint ventures, subsidiaries with domestic firms or corporations in order to serve both domestic and

London, April 2006) <http://www.ifs.org.uk/conferences/etpf_buettner.pdf> accessed 1 February 2015; Michael P. Devereux and Georgia Maffini, 'The Impact of Taxation on the Location of Capital, Firms and Profit: A Survey of Empirical Evidence' (2006) Oxford University Centre for Business Taxation Working Paper WP 07/02 <<http://www.sbs.ox.ac.uk/faculty-research/tax/publications/working-papers/impact-taxation-location-capital-firms-and-profit-survey-empirical-evidence>> accessed 13 September 2015.

⁷⁷ Ibid note 48.

⁷⁸ The European Union has investigated the practices of MNCs such as Apple, Google etc. and their tax arrangements in Ireland.

⁷⁹ UNCTAD 'World Investment Report 2015:Chapter 5 Reforming International Investment Governance' <http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf> accessed on 16 February 2016.

international markets. Certain empirical studies, have found that corporate taxes affect both the extent and location of international investment.⁸⁰

3.4.3 Uncertainties in locating FDI by MNCs

Taxation affects investment decisions but the risk is not whether tax would be paid, it is the uncertainty of what, when, how and how much to be paid that matters to them. Thus, law is fundamental for all transnational economic integration.⁸¹ Within the global or regional area, legal systems affect cross-border business transactions for both individuals and MNCs through the number of legal provisions and processes involved. Therefore, it is reasoned that a central function of the state, apart from its primary care for its citizens, is to create and enforce rules that support economic growth.⁸² From the perspective of MNCs decision for FDI location, it is believed that the foreign investor, which in this case is the MNC, should generally get what it wants.⁸³ In this regard, the question of what does an investing MNC want from its host country other than its profits and economic power can be asked. This can be narrowed down to efficiency and certainty in the legal system of its host country.

It is argued that the ideal legal system for attracting FDI is one that is efficient and promotes certainty.⁸⁴ Imperfect legal systems generate uncertainty, which according to Wagner presents an investment risk to both domestic and foreign investors.⁸⁵ With regards to MNCs and FDI

⁸⁰ See generally, T Buettner, T. and M Ruf, 'Tax Incentives and the Location of FDI: Evidence from a Panel of German Multinationals' (2007) 14 International Tax and Public Finance 151. T Buettner and G Wamser, 'The Impact of Non-Profit Taxes on Foreign Direct Investment: Evidence from German Multinationals' (European Tax Policy Forum Conference 'The Impact of Corporation Taxes Across Borders', London, April 2006) <http://www.ifs.org.uk/conferences/etpf_buettner.pdf> accessed 1 February 2015.

⁸¹ Helmut Wagner, 'Legal Uncertainty – Is Harmonization of Law the Right Answer? A Short Overview' (2009) Diskussionsbeiträge der Fakultät für Wirtschaftswissenschaft der FernUniversität in Hagen discussion paper, p2 <<https://www.fernuni-hagen.de/wirtschaftswissenschaft/download/beitraege/db444.pdf>> accessed 27 January 2016.

⁸² Amanda Perry-Kessaris, 'The Relationship between Legal Systems and Economic Development: Integrating Economic and Cultural Approaches'. (2002) 29 Journal of Law and Society 282.

⁸³ Amanda Perry-Kessaris, 'An Ideal Legal System for Attracting Foreign Direct Investment? Some Theory and Reality (2000) 15 American University International Law Review at 1629.

⁸⁴ Ibid.

⁸⁵ Ibid.

location, an inefficient legal system increases transaction costs by failing to provide cheap mechanisms for enforcing legal rights and obligations.⁸⁶ It is expected that low transaction costs are ensured where the laws of the host state are modern and its courts and administrations are provided with sufficient infrastructure, and trained, adequately compensated staff to in order deter corruption.

This is akin to what is obtainable in the developed countries, whilst on the contrary; in the developing countries, there remains a vacuum in this respect. Based on the above, MNCs seek investment in foreign countries where there is reasonable or no risk. Certain developing countries such as Nigeria are regarded as high-risk for foreign investment because of uncertainties and factors such as bad governance, and unstable macroeconomic policies.⁸⁷ Despite being considered as high risk with regard to foreign investment, Nigeria has sought to reform its overall approach to macroeconomic policies in order to foreign investment to improve the business environment for MNCs to invest.

Davies proffers that while certainty is generally considered a virtue in a legal system; legal uncertainty on the other hand is regarded as a vice.⁸⁸ Legal uncertainty has been credited with undermining both the rule of law in general and the law's ability to achieve specific objectives such as deterring anti-social conduct or encouraging trade and investment.⁸⁹ Lord Mansfield in *Vallejo v Wheeler* stated, "In all mercantile transactions, the great object should be certainty: and therefore, it is of more consequence that a rule be certain than whether the rule is established one way or the other because speculators in trade then know what ground to go upon."⁹⁰ MacNeil suggests that legal uncertainty differs from legal risk in the sense that

⁸⁶ Ibid at note 59

⁸⁷ TA Adegbite, 'The Analysis of the Effect of Corporate Income Tax (CIT) on Revenue Profile in Nigeria' (2015) 4 American Journal of Economics, Finance and Management 312

⁸⁸ Kevin E. Davis, 'The Concept of Legal Uncertainty' (2011)

<<http://www.law.uchicago.edu/files/files/Davis%20paper.pdf>> accessed 5 September 2015.

⁸⁹ Ibid.

⁹⁰ *Vallejo v Wheeler* (1774) 1 Cowp 143 at 153.

the latter focuses on the chances of being sued or being the subject of a claim or the possibility that a technical defect in a transaction will result in loss. In essence, legal risk could be likened to the tax evasion and avoidance schemes due to the risk taken by the tax adviser to circumvent the law.⁹¹ On the one hand, legal uncertainty can be likened to pre-conceived issues that can or will hinder investment. In other words, legal uncertainty is that subset of risk that focuses on circumstances in which structures.⁹² Wagner describes that legal uncertainty occurs when ‘actors’ are uncertain of the effects of the provisions of the dominant legal system on the results of their actions.⁹³ Characterising legal uncertainty, Wagner posits that these will include:

i. Absence of law- where there are no statutory rules or regulations, legal instability and denial of justice.⁹⁴ In certain instances, known traditional norms of a country or aspect could well serve as law. It is recognised that as long as it is established and internationally or domestically recognised, such norms can have a force of law. A lack of understanding or knowledge of these norms can cause uncertainties for investors.

ii. Legal instability- Wagner suggests that legal uncertainty is rife where regulations are unstable. This can be reflected on investments by foreign investors (MNCs) due to frequent amendments to statutes. This creates a lack of clarity for tax advisors of investing MNCs. In Nigeria for instance, the wording and structure of the tax legislation especially that of the corporation tax, is confusing.⁹⁵ A number of taxpayers do not understand and know nothing of the laws under which they are to pay their tax liabilities. Furthermore, the overlapping

⁹¹ Tax evaders and avoiders, take a risk in avoiding or evading tax and will be at the mercy of the tax officer if apprehended.

⁹² Iain MacNeil, ‘Uncertainty in Commercial Law’ (2009) 13 *Edinburgh Law Review* 68.

⁹³ Ibid note 86.

⁹⁴ Ibid.

⁹⁵ Ayodele Odusola, ‘Tax Policy Reforms in Nigeria’ (2006) United Nations University-World Institute for Development Economics Research Paper 2006/03 < <https://www.wider.unu.edu/sites/default/files/rp2006-03.pdf> > accessed on 01 February 2016.

legislations that deal with the same tax are entirely confusing and not attractive to foreign investors.

In addition, the process of creating legislation and policies can in their own way create instability in the law. In Nigeria for instance, the Nigerian National Assembly like the British legislature is bicameral in nature and consists of the House of Representatives (lower house) and Senate (upper house). For a bill to become law, it must first be introduced in both houses and then pass through four stages that consists of three readings in both houses before it can be passed into law. At the end of the process, if the bill is approved by both houses, this is sent to the President for signing. Ministers generally formulate policies that are used to administer the legislation already in place and perhaps could be taken as law. In the case of taxation specifically the CT, the Ministry of Finance in conjunction with the FIRS produce the policies pertaining to this after consultations with stakeholders. One common set back with the legislation and policy making process, lies in the political will of the lawmakers to pass a bill into law or make amendments to existing legislation.⁹⁶ Additionally, the lack of stability and continuation of policies by different governments in power could as well be a problem with policy implementation in Nigeria.⁹⁷

iii. Denial of justice- this refers to the obstruction or prevention of the enforcement of legal rights by state authorities or employees. In analysing these characteristics, the effects of corruption negatively influence the legal system and create an air of uncertainty for foreign and domestic investors. It has been noted that corruption is especially destructive in developing

⁹⁶ An instance of this can be seen with the Nigerian Petroleum Industry Bill (PIB) which was first introduced in 2008 and has dragged on till now where the bill has been segmented into separate bills as part of the new legislative proposals.

⁹⁷ There are instances of unsubstantiated reports by government officials which indicate that there is a difficulty of policy implementation or amendment due to a fact that such policy was enacted by the previous government.

countries with delicate economic situations as it has critically hobbled and skewed Africa's development.⁹⁸ Making the fight against corruption should be made a priority as the price for not doing so leads to a loss of resources, and in foreign investment, distorted decision making and a failing in the public confidence.⁹⁹ It is said that corruption is the single most important factor mitigating economic growth, development and democracy in Nigeria.¹⁰⁰ Further, the level of corruption in both domestic and foreign corporations has had a very damaging impact on the Nigerian economy as it has staunched the inflow of FDI into the country.¹⁰¹ This problem can be traced to a lack of good governance and administration in the country, which has permeated legislation on matters such tax incentives, and tax compliance.¹⁰² It should be noted that at 2015, Nigeria ranked 26th in the world by Transparency International in their country corruption index.¹⁰³ The uncertainty created by corruption, thus creates an unfavourable business environment for FDI, which in turn will hinder economic growth and policy if it is not fully resolved as the present Nigerian government is working to do. Unfortunately, the after effects of this widely reported corruption has already created an illusion of Nigeria being fantastically corrupt. Therefore, ensuring a proactive approach to reducing corruption should be a priority as the price for not doing so leads to lost resources, foreign investment, distorted decision-making and a failing in the public confidence.¹⁰⁴ In

⁹⁸ Van Vuuren H, 'Corruption, Perception and Foreign Direct Investment: Counting the cost of Graft' (2010) African Security Review <<http://www.tandfonline.com/doi/pdf/10.1080/10246029.2002.9627970?needAccess=true>> accessed 16 August 2016.

⁹⁹ Ibid

¹⁰⁰ Maurice Ayodele Coker, Dave Ude Ugwu and Adams John Anyabe, 'Corruption and direct foreign investments in Nigeria: Challenges of implementing anti-corruption programmes under Obasanjo, 1999 – 2007' (2012) 1(4) Global Advanced Research Journal of History, Political Science and International Relations 079 Corruption in Nigeria, is manifested mainly in the form of bribery and embezzlement of public funds, and advanced fee fraud, activities of dubious internet scammers, settlement, among others.

¹⁰¹ Ibid at 83.

¹⁰² David Uchenna Enweremadu, 'Anti-corruption policies in Nigeria under Obasanjo and Yar'Adua: What to do 2011? Discussion Paper, 1 (2010) Friedrich-Ebert-Stiftung <<http://library.fes.de/pdf-files/bueros/nigeria/07813.pdf>> accessed 17 August 2016.

¹⁰³ See, Transparency International Corruption Perceptions Index <<https://www.transparency.org/cpi2015/>> accessed 17 January 2017.

¹⁰⁴ Ibid.

considering legal uncertainty and its effect on MNCs, corporation tax and FDI, tax law is considered ambiguous in many cases as it can be interpreted in different ways by different parties. This often means that neither the taxpayer nor the tax administrators always understand the law in the same way. This results in both parties arriving at different tax consequences. Tax law in itself has innate complexities and frequent changes in the law intensify this problem.¹⁰⁵ Legal uncertainty therefore creates problems for not just taxpayers but for tax officials too. Uncertainty in tax laws creates further consequences ranging from business location decisions, to tax evasion and avoidance and risk of potential loss for some taxpayers. The next chapter will analyse existing uncertainties in the Nigerian Corporate tax legislation.

The FDI indicators stated above do not solely determine the location of FDI; Legal uncertainties can also affect the location of FDI by MNCs. Currently, the traditional indicators are no longer the main concern for MNCs that wish to invest in developed and developing economies although this affects the developing economies more.¹⁰⁶ Zagler maintains that the effect of corporation income tax on FDI cannot be ascertained without considering the impact of legal uncertainty on their relationship.¹⁰⁷ He argues that in order to attain a beneficial environment for FDI in developing countries, there must be clarity of laws.¹⁰⁸ This is necessary as investing MNCs from developed economies is assumed to enjoy clear and unambiguous laws in their home countries. Zagler identifies certain basic principles that are necessary in addition to the traditional indicators mentioned above.¹⁰⁹ He posits that the publicity of the rule

¹⁰⁵Yehonatan Givati, 'Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings' (2009) 29 Virginia Tax Review 138.

¹⁰⁶ Developing economies face challenges in the adoption and mostly in effectively having a rule of law that can be relied on. Developed countries could be said to have achieved a stability certainty in their laws and as such, MNCs will be more disposed to locate their business in such environments.

¹⁰⁷ Martin Zagler and Cristiana Zanzottera, 'Corporate Income Taxation Uncertainty and Foreign Direct Investment' (2012) WU International Taxation Research Paper Series No. 2012-07.
<<http://ssrn.com/abstract=2174928>> accessed 30 October 2015.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid.

of law is imperative, as this will enable all concerned parties to have access to the laws by which they have to abide.¹¹⁰ In other words, the law should be clear and certain. In the previous chapter, the ambiguity in the overlapping laws surrounding corporation tax especially in the taxation of foreign and non-resident companies, is uncertain and clear which creates a hindrance on the proper applicability of this law.

Further, having predictability in the application of the law, which supports the implementation, interpretation and enforcement, will create a certainty for investing MNCs in developing economies. Furthermore, this will help deter tax evasion and avoidance. The stability of the legal, political and policy frameworks will provide investors with assurances that the government neither will unilaterally nor unfavourably change the basic conditions underlying their investment decisions. This will be analysed in detail in the next section. Finally, fairness and trust in the possibility of legal recourse and due process seals the deal for foreign investors.

¹¹⁰ Ibid.

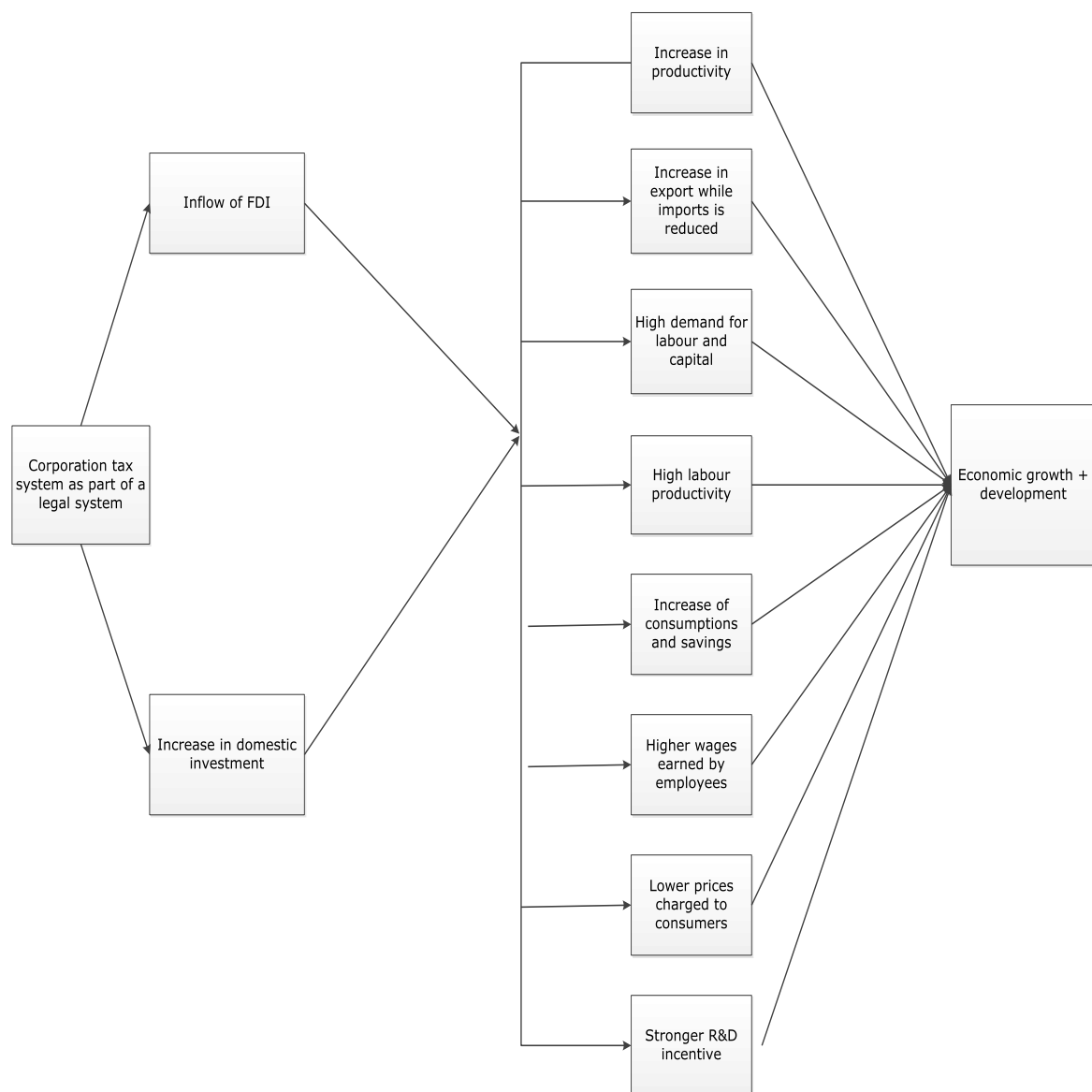


Figure 1: The relationship between FDI, and corporate tax system and the resulting effects on economic development.

The diagram above summarizes the effects of corporation tax on economic development. A well-structured corporation tax regime will positively increase and attract FDI while at the same time increasing domestic investment. These will produce an increase in productivity. Similarly, exports will increase while the level of imports will decrease due to technological and knowledge transfer. All the above will inevitably lead to economic growth and development.

3.5 Specific Country Illustration

3.5.1 United Kingdom

Corporation tax revenue

In developed economies, for example the UK, corporation tax law especially the corporate tax rate, has been manipulated to suit the necessities of each country. Manipulating business tax laws has been a necessary strategy by successive governments in order to attract foreign owned business to invest in the economy. The former Chancellor of the Exchequer, the Rt. Hon George Osborne MP said in reference to the most recent tax reform,

The government is backing business, which is vital for the UK economy to grow and create jobs. The tax changes taking effect today will reduce the cost of employment, ease the tax burden on businesses and stimulate investment. Since 2010, we have cut all major business taxes and the reforms we are delivering are already having a positive impact on the UK's competitiveness.¹¹¹

Likewise, in Ireland its Finance minister also stated that Ireland is open for business and is committed to attracting foreign direct investment through their corporate tax system and their low corporate tax rate is one of the core strategies for achieving this.¹¹² This could imply that the corporation tax laws and its components play a strategic role in each country's economic development.¹¹³ As discussed earlier, the OECD in its research on tax effects on FDI arrived at a conclusion that by providing greater certainty and predictability in the application of

¹¹¹ HM Treasury, 'Tax cuts for businesses worth over £11 billion per year in 2014-2015' <<https://www.gov.uk/government/news/tax-cuts-for-businesses-worth-over-11-billion-per-year-in-2014-2015>> accessed 25 November 2015.

¹¹² Ernst and Young Ireland 'Ireland International Strategy (Ernst and Young 2013) <[http://www.ey.com/Publication/vwLUAssets/EY-Irelands-International-Tax-Strategy/\\$FILE/EY-Irelands-International-Tax-Strategy.pdf](http://www.ey.com/Publication/vwLUAssets/EY-Irelands-International-Tax-Strategy/$FILE/EY-Irelands-International-Tax-Strategy.pdf)> accessed 25 November 2015.

¹¹³ Although corporation tax plays an abundant role in investment generation, it should not be mistaken that it is the only factor that contribute to attracting investment as it works hand in hand with other factors to attract FDI.

corporate income taxes may lead to higher investment, which in turn, could enhance growth performance.¹¹⁴

As initially stated, changes are made annually to the existing corporate tax laws and new reforms are made in order to stimulate the business environment. The Chancellor of the Exchequer has maintained that beneath the desire for growth of the UK economy and the creation of jobs lays the need for tax changes in order to ease the tax burden on business, which in his view would stimulate investment in the country.¹¹⁵ When there are successful reforms and changes in the corporation tax, the post-tax earnings of corporations are raised and these are channelled into different aspects of the economy. For the UK economy to thrive and for foreign and domestic business to play its role in this success, there is the need for a tax system that provides certainty, stability and confidence in the rule of law.¹¹⁶ The government aims at having a joint lowest corporate tax rate of 20 percent in the G20 by April 2015.¹¹⁷

With an attractive corporation tax law regime which sets a stimulating business environment, there is a higher rate of investment and inflow of capital through FDI. This stimulates an increase in productivity and a higher level of local and domestic investment. High productivity influences high employability, which comes with higher salaries for the employees and increases consumption and spending. The concurrent increase in consumption and spending generates more revenue for the government through the sales tax of VAT.

¹¹⁴ Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys and Laura Vartia, 'Tax and Economic Growth' (2008) OECD Economics Department Working Paper 620 < <http://www.oecd.org/tax/tax-policy/41000592.pdf> > accessed 27 November 2014.

¹¹⁵ HMRC 'The Corporation Tax Road Map' < <https://www.gov.uk/government/publications/the-corporation-tax-road-map> > accessed on 6 August 2014

¹¹⁶ Deloitte, 'Tax: A Force for Stability and Investment' (Deloitte 2014) < <http://www.deloitte.co.uk/impact/trust-and-confidence/tax-force-for-stability-and-investment/> > accessed 25 November 2014.

¹¹⁷ Ibid.

According to the office of National Statistics, in the 2011/2012 tax year, UK residents paid about £550 billion in tax to the UK government and the EU.¹¹⁸ This is inclusive of corporations. Corporations are intertwined in all aspects of life in the UK and proceeds from its taxation play an important role in the tax system¹¹⁹ as evidenced by the more than £39.3 billion received from corporation tax receipts in the year 2013-14.¹²⁰ To have derived such an amount of revenue through taxation in times of economic turbulence, there seems to be a driving force for compliance with the tax laws. The ability of the UK government to fund its economy through taxation ensures that there is no over dependence on any one source of income and subsequently diversifies its revenue base.

Companies require capital to invest and when there is a reduction in the corporation tax rate, the inflow of capital enables reinvestment.¹²¹ In the United Kingdom, studies have shown that corporation tax has a significant impact on the level of foreign investment decisions, as there has been a record of inflow of investment after changes are made to existing laws or new laws are enacted. The works of Bond, Denny and Devereux,¹²² and Wallis¹²³ amongst others tend to show from a financial and economic discipline the impact of taxation on investments.

In practice, FDIs are mostly carried out by MNCs due to the expansion of consumer markets that allow them to conduct cross-border transactions.¹²⁴ As these inbound investments come into the UK from all parts of the world, there is an establishment of a presence in the UK. This is either by having permanent establishments or subsidiaries, or for corporation tax, purposes may operate as such. Subsidiaries are treated like any other UK resident company for taxation

¹¹⁸ Ibid.

¹¹⁹ P Harris, *Corporate Tax Law; Structure, Policy and Practice* (Cambridge University Press 2013) 12.

¹²⁰ HM Revenue and Customs, 'Corporation Tax Statistics 2015' (HMRC 2015)
<<http://www.hmrc.gov.uk/statistics/corporation-tax.htm>> accessed 6 August 2015.

¹²¹ Ibid.

¹²² S Bond, K Denny and M Devereux, 'Capital Allowances and the Impact of Corporation Tax on Investment in the UK' (1993) 14 *Fiscal Studies*, 1.

¹²³ Gavin Wallis, 'Essays in Understanding Investment' (PhD thesis, University of London 2012)

¹²⁴ Ibid note 51

purposes. These changing contexts often need a responsive legislative. Tax legislation can be changed in a variety of ways to maintain currency and relevance to the economic system. These changes affect different stakeholders in diverse ways. Over the years, the UK has seen a number of corporate tax law reforms. These changes have been deemed necessary in order to encourage business and encourage growth. As far back in 1978, the corporation tax rate was 52percent. In 1984, it was significantly reduced to 35percent and subsequently, further cuts followed through the years. In recent years, there have been more changes and reforms, which could arguably be said to be because of the liberalization of world economy and a bid for a stimulating business environment.

In the drive to ensure economic growth and job creation, and making the UK a more competitive environment for business, the HM Treasury announced some more changes to the tax laws.¹²⁵ The reforms brought a reduction in corporation tax from 23 percent to 20 percent, reducing the burden of business rates by two percent and doubling the annual investment allowance.¹²⁶ In 2010, the UK government published a report that clearly portrayed the ambition and intention of the government to make the UK corporation tax regime the most competitive in the G20 with the aim to provide more certainty in business.¹²⁷ It set to introduce a guideline for corporation tax reforms and reducing existing distortions.¹²⁸ This agrees with the OECD's tax policy reforms that show that if corporation taxes are not changed or reformed regularly, they can hinder economic growth, capital investment and productivity improvements.¹²⁹ Empirical studies have shown the impact on the economy when corporation

¹²⁵ Gov.UK <<https://www.gov.uk/government/news/>> accessed on 13 January 2017. It is necessary to note that this rate will be further reduced to 19 percent in April 2017.

¹²⁶ Ibid.

¹²⁷ Gov.UK, 'Corporation Tax Road Map' <<https://www.gov.uk/government/publications/the-corporation-tax-road-map>> accessed on 06 August 2014.

¹²⁸ Ibid.

¹²⁹ OECD (2010), 'Tax Policy Reform and Economic Growth. OECD Tax Policy Studies, No. 20' (OECD 2010). <<https://www.oecd.org/ctp/tax-policy/46605695.pdf>> accessed 25 May 2015.

tax laws where reformed.¹³⁰ It is argued that with the reforms, especially the reduction of the tax rates, there has been increase in the substantial contribution of revenue through corporation tax.¹³¹

A major impact of changes of corporation tax laws lies not just in the economy but also on the high rate of litigation and case law. A negative influence of high and static tax law could lead to tax evasion or avoidance and invariably to litigation. Recently, corporate tax avoidance has become a high profile issue and that has since pushed the government to enact and change the existing corporation taxes.¹³²

The Confederation of British Industry (CBI) argues that the government should avoid making further changes to the tax system but should rather allow positive reforms already made to the corporate tax regime to take effect.¹³³ The IFS also commented that the degree of chopping and changing seen in the UK's tax regime in recent years is not sensible.¹³⁴ It was stressed that corporations need more clarity about the direction of the policy as stability of the tax regime is necessary to encourage business investment.¹³⁵ All these create an efficient and certain environment for FDI location by MNCs.

¹³⁰ See generally, the works of MP Devereux, R Griffith and A Klemm A., (2002)'Corporate Income Tax Reforms and International Tax Completion' (2002) 17 Economic Policy 451; MP Devereux and PB Sorensen, 'The Corporate Income Tax: International Trends and Options for Fundamental Reform' (2005 University of Copenhagen EPRU-Analysis) 2005/24 < http://www.econ.ku.dk/eprn_epru/Analyse/analyse24.pdf> accessed 13 November 2015.

¹³¹ Auerbach Alan J, Devereux Michael P, Simpson Helen, 'Taxing Corporate Income' (2007 CESifo working paper) 2139, 13 <<http://hdl.handle.net/10419/26183>> accessed 13 November 2015.

¹³² Google, Amazon and Starbucks are examples of high profile MNCs that have been targeted by the HMRC for not paying corporation tax.

¹³³ Confederation of British Industry- Don't chop and change the tax rules <<http://www.cbi.org.uk/media-centre/press-release/2013/07/dont-chop-and-change-the-tax-rules-warns-cbi/>> accessed on 06/08/2014.

¹³⁴ Hugo Duncan, Budget Analysis: Chancellor warned tax stability needed to encourage business investment. 20 March 2014 < <http://www.thisismoney.co.uk/money/news/article-2585676/BUDGET-ANALYSIS-Chancellor-warned-tax-stability-needed-encourage-business-investment.html>> accessed on 25 November 2014.

¹³⁵ Ibid.

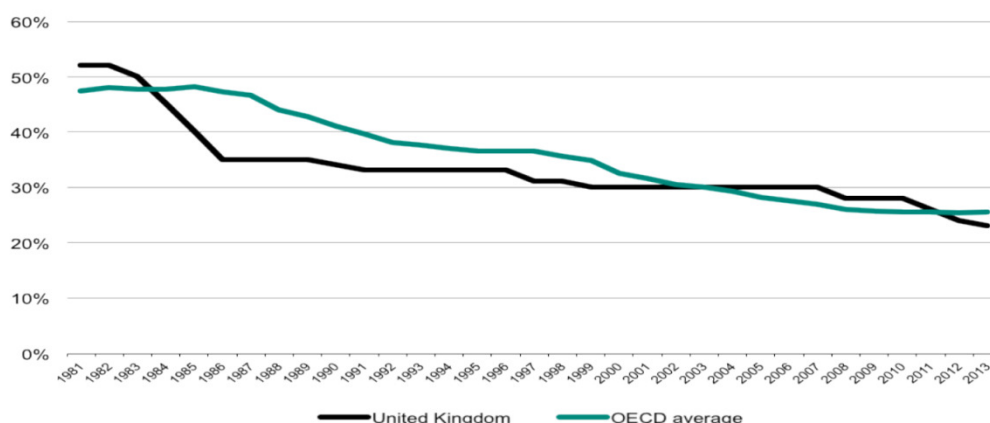


Figure 2: Corporation income rates from 1981-2013

Figure two, shows a downward trend of corporation tax for OECD member states from 1981-2013. It demonstrates the changes and reforms in the corporation tax regime in the UK over the years against the OECD average tax rate for its members.¹³⁶ This shows a gradual reduction in the CIT rate in order to attract investment as seen in the Irish example. This ‘race to the bottom’ is one of the key ways in which countries attract investment; however, this allows for the creation of loopholes for companies to avoid and evade tax. If Nigeria's CIT figures were to be incorporated into this figure, it would show a steady rate of 30%, this indicates the extent to which the country's tax rate appears static and may add to the unfavourable business environment. A review of the CIT is therefore necessary in order to become more responsive to change although not to the extent of creating a tax haven.

3.5.2 Nigeria

3.5.2.1 Corporate tax revenue generation

Unlike developed countries such as the UK illustrated above, many developing countries Nigeria for example, are faced with challenges in monitoring the statistics of their revenue

¹³⁶ Office of Budget Responsibility Economic and Fiscal Forecast
<http://budgetresponsibility.org.uk/wordpress/docs/March-2013-EFO-44734674673453.pdf> accessed on 06 August 2014.

flows and related issues. As a result of this limitation, the economic effects of CIT cannot be easily determined. In previous chapters, it was shown that tax revenue generation in developing economies especially Nigeria, is besieged with issues mostly due to improper tax administration and a well-structured tax regime. Thus, the revenue from company income tax has been low due to tax concessions, rebates and tax holidays allowed to newly established companies. Tax evasion and tax avoidance are also responsible for this low yield¹³⁷

Empirical literature shows that tax revenue has a significant effect on economic growth in Nigeria¹³⁸ as it stimulates economic growth through infrastructure development. Nevertheless, it has been argued that tax revenue especially that from CIT does not have an independent effect on growth through FDI.¹³⁹ The high corporate tax rate of 30 percent in Nigeria has both positive and negative economic effects for the government where on the one hand, it increases revenue, which is used by the government to finance its goals as set out in the budget. On the other hand, there are negative effects that discourages investment whilst encouraging tax evasion and avoidance that comes with the need to protect profits.

Although there has been an increase of CIT revenue collected as depicted in the table below, whether this is because of FDI influx has not been determined by the FIRS. Furthermore, the extent and amount of revenue generated by MNCs in Nigeria is not determined. The 2014 Nigerian budget analysis depicts that revenue from corporation tax accounted for 12 percent, which amounted to N454.54 billion.¹⁴⁰ This sum, as the rest of the budget, represents a forecast of what the government expected to accrue that year. The table below shows that revenue from

¹³⁷ OT Ebiringa, and Emeh Yadirichukwu, 'Analysis of Tax Formation and Impact on Economic Growth in Nigeria' (2012) (2) 2 International Journal of Accounting and Financial Reporting.

¹³⁸ JU Ihendinihu, Jones E. and EA Ibechukwu, 'Assessment of the long run equilibrium relationship between tax revenue and economic growth in Nigeria: 1986-2012.' (2014) 2(2) The standard Int'l Journals (2014) 45.

¹³⁹ Christian N Worlu and Emeke Nkoro, 'Tax Revenue and Economic Development in Nigeria: A Macro Econometric Approach,' (2012) 1 Academic Journal of Interdisciplinary Studies 211
<<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.660.9641&rep=rep1&type=pdf>> accessed 5 January 2016).

¹⁴⁰ Understanding budget 2014, Budget Office Nigeria
<<http://www.budgetoffice.gov.ng/pdfs/2014/Understanding%20Budget%202014.pdf>> accessed 8 May 2016.

corporation tax in 2014 amounted to N1180.4071bn. This suggests that corporation tax can generate revenue, which can fund a higher percentage of the budget especially when compared with the VAT contribution of 3 percent of the funding of the budget that year. With the present decrease in oil prices, there has been a negative knock-on effect on the Nigerian economy, the government has now turned to tax, especially business taxation as its new ‘oil’. As a consequence of this, the government is considering creating and encouraging environment for foreign investment.¹⁴¹ Taxes on corporate businesses are targeted to generate a great amount of the revenue that the country needs. The FIRS, proposed revenue target from tax for the 2016 fiscal year is N4.957 trillion, which is N385 billion higher than the N4.572 trillion in 2015. The non- oil revenue will account for 80 percent of the gross target with VAT accounting for N2 trillion, representing 40.35 percent while the CIT is expected to bring in N1.877 which accounts for 37.87 percent.¹⁴²

¹⁴¹ The Nigerian Vice president as part of the aim to diversify the country’s revenue source mostly through business taxation, says that the country has practically what it takes to run a solid economy that is not dependent on oil, but on business and commerce. See Daily Trust newspaper Wednesday 03 February 2016.

<<http://www.dailytrust.com.ng/news/general/nigeria-can-survive-without-oil-osinbajo/131850.html#jxtORRwAa3HhGDAQ.99>> accessed 03/02/16.

¹⁴² FIRS, ‘Optimising Non- Oil Tax Revenue Collection through Compliance and Enforcement’ culled from This Day Live Newspaper of Wednesday 3 February 2016 < <http://www.thisdaylive.com/articles/firs-targets-n5tn-revenue-in-2016-non-oil-revenue-to-account-for-80-of-earnings/230955/> > accessed on 03 February 2016.

Table 1: Corporation tax revenue generation in Nigeria 2011-2015¹⁴³

QUARTERS	COMPANY INCOME TAX (in billions/Naira)									
	2011		2012		2013		2014		2015	
	FIRS Quarterly Target	Actual Collection	FIRS Quarterly Target	Actual Collection	FIRS Quarterly Target	Actual Collection	FIRS Quarterly Target	Actual Collection	FIRS Quarterly Target	Actual Collection
1ST	189.75	113.59 7	171.18 65	116.50 74	241.83	154.29 39	257.57	174.16 39	241.89 5	160.92 44
2ND	63.25	63.917 5	201.88 5	289.08 13	241.82 93	400.66 94	241.89 5	556.27 03	80.631 7	501.65 61
3RD	171.18 65	240.17 15	201.88 5	254.44 92	241.82 93	240.77 24	241.89 5	273.12 9	117.03 14	65.287 6
4TH	171.18 65	151.39 37	201.88 56	156.48 12	241.82 93	167.81 49	241.89 5	176.84 39	351.09 42	265.31 92
TOTAL	595.37 3	569.07 97	776.84 21	816.51 91	967.31 79	963.55 06	983.25 5	1180.4 071	790.65 23	993.18 73

Table 1 above shows corporation tax revenue generated in Nigeria in the last four years.¹⁴⁴ The information is derived from FIRS raw data. A number of patterns have been observed that in certain quarters of the year the targets are met or exceeded. Certain arguments arise from this. Firstly, it is argued that if these figures are not due to a rise in investment by MNCs, then it may be due to a fluctuation in the way that tax regimes are applied. Secondly, it could also be argued that the fluctuations might be due to either a) lack of compliance by the MNCs, b) lack of adequate enforcement and c) corruption by the tax officers who many have misappropriated some of the received funds. The thesis contends therefore that if the tax regime is reformed or restructured considering the problems enumerated previously in the thesis, there should be an increase in the collection. This is consistent with the thesis that if the corporation tax regime is

¹⁴³ Federal Inland Revenue Service Tax Revenue Statistics' < <http://www.firs.gov.ng/tax-revenue-statistics/>> accessed 11 January 2017. Source: Compiled by Chisa Onyejekwe (2016) adapted from raw data provided by FIRS Nigeria.

¹⁴⁴ Available data is for 2011-2015 from the FIRS.

reformed, it will form part of sustainable revenue source, which should positively affect the Nigerian economy.

Presently with the state of the Nigerian economy, revenue generated from CIT will successfully achieve growth and development. Empirical studies in economics, accounting and finance in Nigeria, found that there is a positive relationship between CIT and GDP. An increase in CIT revenue, results in an increase in GDP. Such studies also found that revenue from CIT has a positive effect on economic growth in Nigeria.

3.6 Discussion and Conclusion

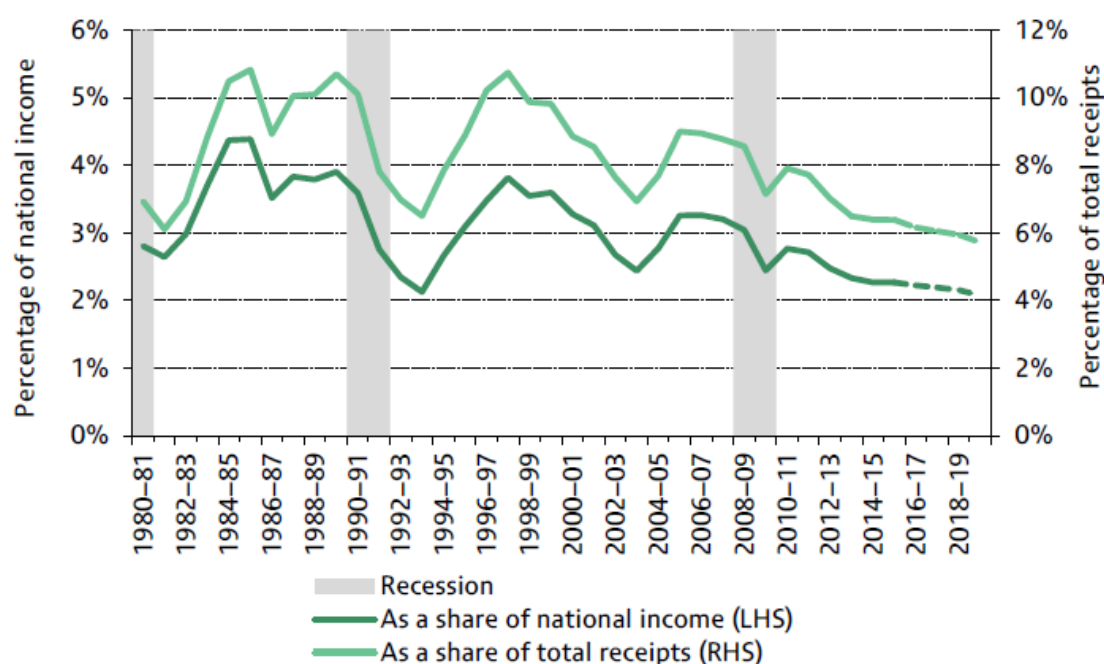


Figure 3: UK corporation tax receipts 1980-2015¹⁴⁵

An analysis of Figure 3 shows that in the last decade, the receipts from CIT as a proportion of GDP have steadily declined since the mid-1980s. The depressions between 1990-91, 2000-01

¹⁴⁵ HM Revenue & Customs, 'HMRC Tax & NIC Receipts Monthly and Annual Historical Record' < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/539194/Jun16_Receipts_NS_Bulletin_Final.pdf> accessed 20 January 2016.

and 2009-10 and 2012-2015 each reflect declining profits in economic slowdowns. This may be due firstly to the financial crisis in the eighties, and subsequently fall in the price of oil in late 2015 and beyond.¹⁴⁶

After the financial crash, the reductions in the main rate of CIT have also affected receipts favourably. Similarly, bank levy receipts grew in both 2013-14 and 2014-15. The UK has gone through a period of tax evasion and avoidance by MNCs, which has negatively affected the corporation tax receipts.¹⁴⁷ The effects of this evasion and avoidance will be analysed in the next chapter.

The reduction of corporation tax receipts in the UK, especially when recognising that the UK has moved from a manufacturing based economy to a more service based economy, raised questions about the continued viability of corporation tax as a source for revenue generation. Furthermore, it also begs the question of whether globalisation has made corporation tax redundant for developed countries. To attempt to answer these questions, especially given the economic effects of avoidance and evasion by MNCs in both developed and developing countries, one could see the need for a change or move from corporation tax to some other type of taxation. In 2005, media corporation Google came to public attention because of issues with the amount of tax payments they made for tax liabilities in the previous 10 years. This suggests that until there is a reform of the tax legislation in the UK, CIT receipts will continually reduce and this will not only affect government funding, it will also create a burden on an already overburdened government.¹⁴⁸ To attempt to answer the question regarding the usefulness and efficacy of CIT will mean making a call for a new form of tax that will replace the current CIT, which has become so easily manipulated and avoided by MNCs. The nature of this new tax is

¹⁴⁶ Ibid.

¹⁴⁷ MNCs such as Google, Amazon, Starbucks etc. has been accused of not paying corporation tax. Google has just recently agreed to pay £130 million as its corporation tax of for the past 10 years.

¹⁴⁸ Kamal Ahmed, 'Google agrees £130m UK tax deal with HMRC' BBC News (23 January 2016) <<http://www.bbc.co.uk/news/business-35381130>> accessed 2 March 2016

uncertain however, it should benefit both businesses and governments. Further, corporate tax receipts have reduced and in its place, there is an increase in PIT and VAT receipts, which are easier to collect.¹⁴⁹ Despite clear and well-structured legislation and policies in place, a fundamental issue that may hinder or limit the growth of MNC location to the UK lies in the continued membership in the EU.

Notwithstanding the above, developing countries like Nigeria, still need corporation tax and the revenue it generates for its economy. With a proper CIT structure, countries similar to Nigeria that are heavily dependent on oil and other natural resources could diversify their economy. Furthermore, it could help eliminate a dependence on foreign aid and borrowing by the government. By setting this in place, it will encourage the formal taxation of Nigeria's informal economy, which can be supposed to positively impact on the economy.

It is generally considered that lower CIT rates, through increased investment and economic growth, would lead to higher wages for workers and may encourage employers to hire more workers. These notwithstanding, governments, lose revenue through the loopholes in their tax legislation and policies that these MNCs manipulate to help minimise their tax liabilities and negatively affect economic growth and development. This major problem, which affects both developed, and developing countries, is one that could be addressed through domestic tax reform and international cooperation. In the present Google situation especially in the UK, the HMRC insists that the present UK tax laws needs to be changed as under the present laws, it could not have demanded more payment from Google.¹⁵⁰ Once again, the issue of the efficiency of the legal system is highlighted. This shows a clear need for it to be strengthened

¹⁴⁹ Stephen Herring, 'Has globalisation made corporation tax redundant?' The Director Institute of Director's Policy 2 February 2016, < <http://www.director.co.uk/has-globalisation-made-corporation-tax-redundant-9827/>> accessed on 2 March 2016.

¹⁵⁰ BBC News, 'Google defends UK Tax Arrangements' (11 February 2016) <<http://www.bbc.co.uk/news/business-35550487>> accessed 1 March 2016.

in order to avoid tax avoidance and evasion in any form with the aim of achieving economic growth and development.

Taxation as a form of revenue has a pivotal role in developing and fostering economic growth. This is especially so of corporation tax as a way of encouraging FDI. The next chapter will discuss and analyse the systems for taxing multinational corporations – both domestic and international. It provides examples of specific problems with the Nigerian domestic corporation tax legislation that has hindered economic growth. This chapter also provides an analysis and discussion of the present international system for taxing corporations.

CHAPTER 4: Systems for the taxation and legislation of Corporations and Multinationals Corporations

4.0 Introduction

Governments need money. Modern governments need lots of money.

How they get this money and whom they take it from are two of the most difficult political issues faced in any modern political economy

–Sven Steinmo¹⁵¹

This chapter aims to explore and analyse corporate tax regime domestically and internationally. It analyses the corporate income tax regime of Nigeria and reflects on the findings on the UK regime. In the previous chapter, it was shown that an interrelationship between domestic and international tax law exists, which provides a foundation for these two systems in which MNCs are taxed. These systems set out the foundation of both the positive and negative effects of corporate tax on national economies especially in terms of economic growth and development.

Two arguments are raised in this chapter; first, that the existing system for taxing domestic and MNCs in Nigeria is flawed and therefore creates complexities for the taxpayer resulting in an unfavourable business environment for FDI. Secondly while Devereux and Vella, together with international campaigners indicate that the international system of taxing MNCs is beset with problems; it can further be argued that the existing international system is a product of the developed world economies and in essence does not favour developing countries despite the initiatives introduced by international organisations.

¹⁵¹Sven Steinmo, 'Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State' (1993) Yale University Press < <http://www.jstor.org/stable/j.ctt32bsrs> > accessed 26 October 2015.

It is necessary for developing economies to set up efficient, fair and sustainable tax systems with well-designed tax structures to raise revenue for government finance. Taxes underwrite the capacity of states to carry out their goals. Therefore, the inability to generate revenue through taxation places limitations on states ability to provide for its citizens and foster economic development. Moreover, creating a suitable tax system lies in the ability to extract maximum revenue while encouraging and maintaining investment and development in the economy. The following sections analyse the, domestic and international mechanisms for taxing MNCs and highlight the flaws with the aim of providing a solution to the existing problem. This will be beneficial in creating a framework of best practices for a sustainable corporate tax regime to best serve the developing national economy at the end of this thesis

4.1 The taxation and legislation of Corporations and MNCs

Corporate income tax refers to the tax imposed by governments on incorporated entities that run businesses. This tax is imposed on the net taxable income at the end of the financial year.¹⁵² As a corporation has a separate legal personality, legally it can sue and be sued and equally, make and receive payments. Similarly, corporations are taxed income tax just as individuals are taxed. Smith identifies the possible effects of corporation tax; he states that corporation tax increases the output prices in the corporate sector.¹⁵³ Therefore, when prices rise, consumers bear a portion of the burden of the corporation tax.¹⁵⁴ Consequently, this may lead to reduced demand for corporate sector output and consumer substitution towards output of unincorporated sectors. A corporate tax system encompasses the special rules of income tax law that exists only because of the peculiar nature of the corporation and specifically, its

¹⁵² Austan Goolsbee, 'The Impact of the Corporate Income Tax: Evidence from State Organizational Form Data', [2004] *Journal of Public Economics* 88.

¹⁵³ See Stephen Smith, *Taxation. A Very Short Introduction*, (Oxford University Press 2015)

¹⁵⁴ *Ibid.*

separate legal personality.¹⁵⁵ There are certain features of income tax, which bears on corporation tax. Under income tax, wealth accrued to an individual through payments made by another individual is taxed based on the individual netting it falls on.¹⁵⁶

Corporate tax reforms and corporate tax systems are designed to minimize economic distortions and can help promote an efficient economy.¹⁵⁷ Empirical literature argues that corporation tax is a variable on the location decision for FDI and therefore it is fundamental to tax systems.¹⁵⁸ This will be analysed in the next chapter. Corporation tax is imposed at a specific rate or range of rates on taxable income as set out in the legislation or the different legislations regulating it.¹⁵⁹ However, in Nigeria for instance, apart from the companies' income tax, which taxes the profits, a further tax called the Education Tax is imposed on all profits of corporations and is chargeable at 2 percent.¹⁶⁰ The education tax is imposed on all corporations as a means of contributing to the growth of education in Nigeria. Whatever the good intention or purpose of the tax may be, this extra charge on corporate profit creates an additional burden on the corporation and can easily be a reason for the avoidance and evasion of tax payments. Governments and international corporations, constantly work towards curtailing prevailing tax avoidance and evasion. For instance, in the UK diverted profits tax was introduced in order to clamp down on tax avoidance by MNCs who artificially divert profits from the country.

¹⁵⁵ The case of *Salomon v Salomon* brought about the separate legal personality of corporations.

¹⁵⁶ Peter Harris, *Corporate Tax Law; Structure, Policy and Practice* (Cambridge University Press 2013) 13.

¹⁵⁷ Adegbite Tajudeen Adejare 'The Analysis of the Effect of Corporate Income Tax (CIT) on Revenue Profile in Nigeria' (2015) 1 (4) *American Journal of Economics, Finance and Management* 312-319.

¹⁵⁸ OECD (2010), *Tax Policy Reform and Economic Growth*, OECD Publishing <<http://dx.doi.org/10.1787/9789264091085-en>> accessed on 15 June 2015.

¹⁵⁹ *Ibid* 150.

¹⁶⁰ Although many jurisdictions United Kingdom and Nigeria inclusive impose taxes such as property tax, withholding tax, stamp duty tax, national insurance contributions, excise tax, customs duties, value added tax etc. profit from such or the tax in itself is not categorised as corporation tax.

Although this tax is levied on corporate bodies, there are arguments that the tax is not borne by the corporations themselves. Rather, it is passed on to its employees and consumers.¹⁶¹ The incidence of tax or the tax burden is closely similar to the tax base which otherwise is the analysis of the effect of a particular tax on the economy. Most producers and employers try to shift the burden of taxation to consumers and employees, which confirms the proposition that no one likes to pay tax.¹⁶² Producers try to shift taxes onto the consumers while employers do this through wage reductions. This highlights the difference between the statutory incidence of taxation and the economic incidence of taxation.¹⁶³ As the IFS states, eventually the tax burden will be shared – but who pays the biggest share will depend on how easy it is for both sides to avoid the taxed activity.¹⁶⁴

Further, it is argued that since corporations are legal, not physical entities, they cannot actually bear the burden of taxes. Instead, the tax is transferred to individuals connected with corporations, who in effect are the shareholders, employees and consumers.¹⁶⁵ In recent years, a number of economists have conducted empirical studies on the incidence of corporation tax in developed economies, which have provided some insight into the phenomenon.¹⁶⁶ Despite

¹⁶¹ An example is an increase in the tax of £1 on a product for instance IrnBru, is passed on to consumers by raising the retail price by £1. Similarly, businesses could reduce wages by the amount of the national insurance employer's contribution paid for each employee. In this sense, the burden and incidence of the tax lies on the employee's wages.

¹⁶² Antoine Bozio, 'Who pays taxes? A short introduction to tax incidence' (2008) 25 (4) Economic Review < https://www.ifs.org.uk/economic_review/fp254.pdf > accessed 15 June 2016.

¹⁶³ Ibid

¹⁶⁴ Ibid

¹⁶⁵ Mark P Keightley and Molly F Sherlock, 'The Corporate Income Tax System: Overview and Options for Reform' Congressional Research Service (December 2014) < <https://www.fas.org/sgp/crs/misc/R42726.pdf> > accessed 15 June 2016.

¹⁶⁶ For empirical literature on this subject, see the following; Arulampalam, Wiji, Michael P. Devereux, and Georgia Maffini 'The Incidence of Corporate Income Tax on Wages' (2007) 56(6) European Economic Review 1038; Alan J Auerbach, 'Who Bears the Corporate Tax? A Review of What We Know,' in James M. Poterba (ed.), (2006) 20 Tax Policy and the Economy Cambridge: MIT Press; Harberger, Arnold C 'The Incidence of the Corporation Income Tax' (1962) 70 (3) Journal of Political Economy 215; Harberger, Arnold C 'Corporation Tax Incidence: Reflections on What is Known, Unknown and Unknowable' in John W. Diamond and George R. Zodrow (eds.), *Fundamental Tax Reform: Issues, Choices, and Implications*, (Cambridge: MIT Press 2006), Gentry William M, 'A Review of the Evidence on the Incidence of the Corporate Income Tax', US Department of the Treasury, (2007) 101 Office of Tax Analysis Paper < <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-101.pdf> > accessed 15 June 2016.

limitations to data and literature to inform the basis of the incidence of corporation tax in Nigeria, a study carried out showed that the price of goods and services were determined by market forces of demand and supply and the rate of corporation tax.¹⁶⁷ It was found that the high rate of the corporation tax resulted in an increase in price, which in turn reduced the demand for their products and services.¹⁶⁸ The arguments surrounding the incidence of corporation tax has formed one of the bases on which it is suggested that the corporation tax should be replaced with a new system for the taxation of MNCs.

Snape indicates that from an economic perspective, corporations should not be taxed at all especially in view of their separate legal personality and the distinction from their shareholders.¹⁶⁹ It would seem from this perspective that it would be better to tax the shareholders themselves. His argument rests on the basis that the tax base of CIT is the return to the shareholder on the equity in the company itself, while the corporation is just the vehicle for collecting the tax.¹⁷⁰ Analysing Snape's argument, this could lead to double and possibly multiple taxation and will still result in tax evasion and avoidance at the same or higher level by individuals. Although, if this is accepted, income tax has to be reformed to incorporate this, and the extent to which this will be accepted by state governments is debatable. For developing countries that lack labour and resources to make this significant reform, this might not be viable.

¹⁶⁷ Ezugwu C I and Akubo D, 'Analysis of the Effect of High Corporate Tax Rate on the Profitability of Corporate Organisations in Nigeria – A Study of Some Selected Corporate Organisations' (2014) *Mediterranean Journal of Social Sciences* 5 20.

¹⁶⁸ Ibid.

¹⁶⁹ John Snape, *The Political economy of Corporation Tax: Theory, Values and Reform* (Hart Publishing 2011).

¹⁷⁰ Ibid.

4.2 Analysing the international system for taxing MNCs

MNCs unlike domestic corporations are taxed under two different systems. MNCs are taxed under both domestic and international tax system, while domestic corporations are taxed under the domestic corporate tax system in place in the domestic government. Domestic corporations can be contentious as the domestic tax system for the taxation of MNCs is largely influenced by the international tax system. Each country has a different set of rules or legislation for the taxation of MNCs, which could slightly differ, from the set for domestic corporations. The international system of taxing corporations or MNCs has faced various criticisms and calls for reformation. This thesis analyses this issue from two different perspectives, the academic view and campaigners for developing country rights view. To understand the problem with the present international tax system or regime, it is useful to understand the foundation of the current system. As a result of growing international trade and investment, the need for a bilateral agreement amongst nations has increased because double taxation affected the equitable distribution of burdens and interfered with the free flow of capital.¹⁷¹ Furthermore, double taxation creates an unjust burden on the taxpayer.¹⁷² This steered the League of Nations, after the First World War to develop a model for tax treaties, as there had been a growing need for the elimination of double taxation.¹⁷³ This eventually led to the drawing up in 1928 of the first model bilateral Convention and the Model Conventions of Mexico in 1943 and London 1946.¹⁷⁴ In the 1940s, for the first time economists submitted a report to the League of Nations setting out the basic principles underlying international tax jurisdiction.¹⁷⁵ The report resolved

¹⁷¹ Ibid at note 146.

¹⁷² Asif Qureshi and Andreas R Ziegler, *International Economic Law*, (3ed. Sweet and Maxwell 2011) 569.

¹⁷³ Christiana Hijpanayi, 'Double Taxation, Tax Treaties, Treaty-Shopping and the European Community' (PhD Thesis London School of Economics 2006), citing the League of Nations Report of 1923 explains that stemming from an appeal by the 1920 Brussels International Financial committee to the League of Nations led to an appointment of four eminent economists to examine the issue of double taxation. The report which followed can be credited as setting out the basic principles which underlie international jurisdiction to tax.

¹⁷⁴ Ibid at note 149.

¹⁷⁵ H. David Rosenbloom, "Tax Treaty Abuse: Policies and Issues." (1983) 15 Law and Policy in International Business 14.

the question of which state had the burden to tax income. It pointed out that an international income tax based on the ability to pay tax does not determine the right to tax in each taxing jurisdiction. In reaching this conclusion, it came up with a solution for double taxation by developing the "doctrine of economic allegiance", which underlies modern discussions of jurisdiction to tax.¹⁷⁶ It proposed the following indices for economic allegiance to justify a country's imposition of tax; where income is produced, that is, the source jurisdiction and where it is consumed or saved which is the residence jurisdiction.¹⁷⁷

In addressing the issue of double taxation, it set a distinction between the source and residence jurisdictions, differentiating between which one has the prior claim to tax income deriving from one jurisdiction by a resident of the other and which has the obligation to prevent double taxation by giving up its claim.¹⁷⁸ In international cross-border transactions, countries are concerned with the taxation of the activities of foreign residents in its country and the taxation of activities of its citizens in foreign countries.¹⁷⁹ Therefore, the classification of states in international taxation for the purposes of asserting taxing rights as source states and residence states can be justified as a meaning for determining taxing rights. Avi-Yonah affirms the position that there is a coherent international tax regime, which is embedded and set in a body of tax treaties and domestic laws.¹⁸⁰ Nevertheless, countries are not free to adopt any particular rule they please but rather operate within the context of this tax regime.¹⁸¹ This questions the

¹⁷⁶ Ibid.

¹⁷⁷ Sol Piccioto, *International Business Taxation* (London, 1992).

¹⁷⁸ Ibid.

¹⁷⁹ Reuven S. Avi-Yonah, *International Tax as International Law*. (Cambridge University Press Cambridge 2007).

¹⁸⁰ Ibid. For literature supporting the existence of an international tax system see; Hugh J. Ault, 'The Importance of International Cooperation in Forging Tax Policy', 26 *Brooklyn Journal of International Law* 1693. Hugh J. Ault, 'Corporate Integration, Tax Treaties, and the Division of International Tax base: principles and Practices', 47 *Tax Law Review* 565, Reuven S. Avi-Yonah, 'The structure of International Taxation: A proposal for Simplification' 74 *Texas Law Review* 1301, Reuven S. Avi-Yonah, 'Comment on Rosenbloom, International Tax Arbitrage and the "Int'l Tax System"' 53 *Tax Law Review* 165.

¹⁸¹ Ibid.

supremacy of the international tax regime against domestic tax laws especially in terms of state sovereignty, which is the ability of states governments to enact and choose laws that will suit their countries' need. Perhaps, Avi-Yonah, reasoned that the distinct nature of MNCs precludes them from domestic laws, which alone are inadequate to tax them. Therefore, countries, irrespective of their state sovereignty, cannot adopt any particular rule they please. These issues notwithstanding, between the 1990's and until the mid-2000's, there have been arguments that international tax regime does not exist¹⁸² Avi-Yonah particularly opposed this reasoning on the restriction of countries in adopting a particular tax rule. Most have argued that countries can easily adopt any tax rule as long as it serves their interests.¹⁸³ Rosenbloom argues that the need for an international tax regime is negligible to non-existent because developed countries have already reached a level of consensus when faced with similar problems in tax issues.¹⁸⁴ This logic, while sound, fails to take into consideration the need that globalisation has created to monitor MNCs from developed countries that have subsidiaries located in developing countries. Thus, not every problem can be solved by borrowing or mutual assistance by tax lawyers and authorities.

It could be argued that despite a seemingly existing convergence between states in international law, particular states' demographics do not allow for an absolute convergence in international law. Hence, the need and recognition for an international tax regime is necessary to meet the needs of every country.

¹⁸² For literature about the argument against the existence of an international tax system see the following; Michael Graetz, 'Taxing International Income: Inadequate Principles, Outdated Concepts and Unsatisfactory policy, 26 Brooklyn Journal of International Law 1357, David Rosenbloom, Cross-border Arbitrage: The Good, the bad and the Ugly, Taxes (2006), International Tax Arbitrage and International Tax System,' 53 Tax Law Review 137, Roin Julie, Competition and Evasion: Another Perspective on International Tax Competition, 89 Georgetown Law Journal 543.

¹⁸³ Ibid.

¹⁸⁴ Ibid.

In recent years, the existing international system has faced a number of issues notably that of tax evasion and avoidance. Two notable academics, Devereux and Vella, proffer that the international system for taxing the profit of multinational companies is beset by criticism.¹⁸⁵ According to them, the immediate problem with this system lies on the perception of governments, commentators, the media and the public that MNCs are able to arrange their affairs to take advantage of deficiencies in the tax system to reduce their aggregate tax liabilities.¹⁸⁶ This is in addition to already existing arguments that tax distorts economic activity which invariably affects investment and location decisions for MNCs.¹⁸⁷ Devereux and Vella argue that this problem is twofold the first lies in the allocation of taxing rights which is currently entrenched in the OECD MTC¹⁸⁸ as explained above. The second is the effect of tax treaties depends on the credits and exemptions included in them to eliminate or reduce double taxation.¹⁸⁹

The tax systems of the major OECD countries are based on worldwide income taxation principles, hence, their MNCs are frequently subject to some degree of double taxation when their profits are taxed both in the country of source and in the country of residence. This creates an unfavourable business environment for not only MNCs and their staff, but also for both source and resident countries especially, as it is unlikely that any entity would choose to lose a high percentage of profit or income to taxation alone. This form of taxation not only deters international investment, but also provides incentives for the use of tax havens to channel cross-

¹⁸⁵ Michael Devereux and John Vella, 'Are We Heading towards a Corporate Tax System Fit for the 21st century?' 14/25 (2014 Oxford University Centre for Business Taxation) <http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/2014/iipf_summer_school/devereux-vella.pdf> accessed 25 November 2015.

¹⁸⁶ Ibid

¹⁸⁷ Ibid

¹⁸⁸ Ibid, The OECD MTC allocates taxing rights between source and resident countries in the taxation of cross border profits.

¹⁸⁹ Oliver R Hoor, *The OECD Model Tax Convention- A Comprehensive Technical Analysis* (Legitech 2010).

border capital flows through the incorporation of offshore holding companies.¹⁹⁰ The use of these schemes is detrimental to both the home and host country because of the reduced tax revenues and distorted investment inflows. Most schemes are created by more developed countries, hence a higher percentage of investment profits are remitted to them to the detriment of the underdeveloped or developing source country.¹⁹¹ For this purpose, tax treaties are justifiably needed to regulate and clarify issues arising from cross-border transactions. However, in the past decade, there has been a drastic move from preventing double and multiple taxation to preventing what is now known as ‘non- taxation’ of profits arising from the different strategies used by MNCs to minimise their tax liabilities in an assumed bid to save on profit.¹⁹²

The second problem with the international tax system lies on the ‘race to the bottom’ between countries in the bid to attract economic activity and to favour “domestic” companies.¹⁹³ By manipulating their tax laws and policies, countries bid to attract FDI through MNCs and loopholes in these laws are in turn manipulated by MNCs. In the last few years, this has led to gradual reductions in effective rates of taxation of profit.¹⁹⁴

Similarly, the ActionAid asserts that internationally, the corporation tax is governed by a multitude of rules and treaties between countries, some of whose underlying principles date back nearly a hundred years.¹⁹⁵ Therefore, the structure of the corporation tax is based on the needs of the developed country, and neglects to reflect the economic or demographic needs of

¹⁹⁰ D Tsilly, ‘The Tax Treaties Myth,’ (2002) 32 Journal of International Law and Politics 939.

¹⁹¹ UNCTAD, ‘World Investment Report 2015’ < http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf> accessed 20 April 2016.

¹⁹² Ibid note 12.

¹⁹³ Ibid

¹⁹⁴ Notably, Ireland has reduced its corporation tax rate to 12.5% in a bid to attract more MNCs. Likewise; the UK has over the years reduced its rate all in the view of creating an attractive business environment.

¹⁹⁵ ActionAid, ‘Levelling Up: JULY 2015 Ensuring a fairer share of corporate tax for developing countries’ < https://www.actionaid.org.uk/sites/default/files/publications/levelling_up_final.pdf> accessed 20 April 2016.

developing countries. This highlights the need for reform of the present international system of taxing MNCs in order for developing countries to adequately and sustainably achieve the best use of corporate tax structures.

The thesis contends that the genesis of problems with the international taxation of MNCs is the developed countries, which created a system that solely benefited their needs. Although FDI has shifted from developed to developing countries, the system still favoured the developed economies. Despite the UN having an MTC that was created to allocate taxing rights to developing source countries, developed countries still choose to use the OECD, which favours the developed countries. This favouritism was strengthened as taxing rights stems from the substantive economic nexus of the income and capital and most income in the OECD MTC is reserved for residence states most of which are developed states.¹⁹⁶

The OECD works at finding avenues through which tax evasion and avoidance by MNCs can be reduced as it affects developing countries more than developed countries.¹⁹⁷ The overall application and acceptance of the initiatives produced by OECD is debatable as most developing countries, are not wholly represented in the consultation process and thus their rights may not have been fully captured. This is necessary as UNCTAD suggests that there is a greater reliance on corporation tax revenue by developing countries than developed

¹⁹⁶Ibid. It is notable that most developing states are source countries, the tax priority of residence countries became a cause of concern for them, which led the United Nations to develop a Model treaty which allocated taxing rights to source countries. This was aimed at allowing developing states the right to tax as a number of them did not want to lose their source taxing rights and emphasised the right of a country to impose tax at source. This is so to help source countries of which the majority are developing countries. The major difference between the OECD and UN MTCs lies in the assignation of taxing rights as the UN MTC advocates for more taxing rights for source countries in an aim to help them retain a greater percentage of investment profits. The likely downside to this is the fact that developing nations will generally not concede their taxing rights to developing countries which makes the use of the UN MTC not popular.

¹⁹⁷UNCTAD. 'World Investment Report 2015' < http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf > accessed 20 April 2016. This report, suggests that developing countries may lose "some US\$100 billion" a year in tax due to foreign investment being channelled through offshore hubs. Furthermore, analysis from the IMF in 2015 offered an even larger figure: a "highly speculative" estimate that developing countries could lose US\$213 billion a year to tax avoidance.

countries.¹⁹⁸ While negotiating treaties, developed countries do not wish to relinquish their taxing rights and will rather negotiate based on the OECD's tax treaty. Consequently, due to the need for FDI, developing countries are seen to follow the dictates of developed countries during negotiations.¹⁹⁹

A convergence or harmonization between the UN and OECD treaties as a result of treaty negotiations between developing and developed nations can strengthen the developing country of the international tax system. An ideal situation will be when there is a harmonization of both treaties in order to serve both parties. It is recognised that the OECD especially through its Base Erosion and Profit Shifting action plan is working at protecting revenue for developing countries, which is avoided by MNCs from developed countries.²⁰⁰ This will be analysed in chapter 5. On the issue of competition highlighted by Devereux and Vella, the problem of the country competition and 'race-to-the bottom' by developed countries, can be categorised because of the world economic crises and the need for governments to provide for its people. Almost all countries manipulate their tax system to encourage and create an attractive business environment all in the bid to attract FDI.

4.3 An Analysis of the Corporation Tax Regimes

This section provides an analysis of the corporation tax regimes used in this thesis.

4.3.1 Nigeria

¹⁹⁸ Ibid.

¹⁹⁹ Marc Lautier and François Moreau, 'An empirical criticism of the "FDI development" convention' (2012) 16 (3) Journal of Contemporary Economics.

²⁰⁰ OECD, 'Action Plan on Base Erosion and Profit Shifting' < <https://www.oecd.org/ctp/BEPSActionPlan.pdf> > accessed 17 September 2016.

4.3.1.1 Overview of Corporate tax legislation in Nigeria

Corporation tax in Nigeria, similar to other laws especially tax laws has evolved through a series of ordinances and laws from the time of colonisation by Great Britain. With the expansion of the British Empire and the establishment of colonies, the colonial governments choose to either introduce taxation or modify an already existing system to suit its imperial interests.²⁰¹ At the earliest time of colonisation, direct taxation was imposed on the different regions of what later became Nigeria. The colonial government made it clear from the outset that it had the sovereign and unquestionable rights to impose tax. This showed a disregard for the existing traditional settings which were not equally accepted by the different regions²⁰². After the amalgamation of Nigeria, several pieces of legislation were put into place with the aim of “consolidating and cleansing the pre-colonial tax system of its imperfections, as well as to provide a source of revenue for both the government and the native authorities”.²⁰³ This laid the foundation for taxation in Nigeria and became the main reason for imposing taxes. The extent to which the native Nigerians enjoy the proceeds of this revenue is highly debatable.

Nigeria gained its first experience of corporate income tax in 1939 when the first Companies Income Tax Ordinance No. 14 1939 was promulgated.²⁰⁴ Prior to the enactment of this ordinance, the regulation of both personal and business taxation was vested in one ordinance.²⁰⁵ This imposed a tax of two shillings and sixpence on every pound of a company’s chargeable income.²⁰⁶ The administration of the tax was vested in a commissioner to be appointed for that purpose by the Governor and the proceeds from the tax were to be remitted to the government treasury to form part of the general revenue of Nigeria. The Ordinance imposed tax on a

²⁰¹ Federal Inland Revenue Service, *The Comprehensive Tax History of Nigeria* (Ibadan 2012) at 201

²⁰² With the amalgamation of the different regions in 1914, the Native Revenue Ordinance was enacted in 1917 in the North and in 1918 in the South. The ordinance was not in existence in the East until 1928 and led to the Aba Women’s Riot of 1929 that kicked against tax payment.

²⁰³ Agbetunde L Ayodele, *The Principles and Practice of Nigerian Personal Income Tax* (Feetal Lagos 2004).

²⁰⁴ Ibid note 198 at page 164.

²⁰⁵ Joseph Ajibola Arogundale *Nigerian Income Tax and its International Dimension*, (Spectrum 2005).

²⁰⁶ Ibid note 198.

preceding year basis on certain sources of a company's income. These were gains or profits from any trade or business, for whatever period of time such trade or business had been carried on; dividends, interest or discounts; any charge or annuity; rents, royalties, premiums and any other profits arising from property.²⁰⁷ The imposition of tax on the sources of Nigerian companies' income at that time was an imposition of the same rules that were in place in the UK at that time. During the colonial times in Nigeria, companies were evolving and issues like royalties and dividends were not set in place. The Companies' Income Tax Ordinance lasted less than a year, after which it was repealed on the basis that it failed to bring individuals into the tax net.²⁰⁸ How a law that is designed to cater solely for businesses and trades was expected to tax individuals as well is difficult to understand. Perhaps previous governments may have been trying to combine direct taxes as one tax and place both individuals and companies on the same terrain.

Again, this could have been as a result of applying what was in place in Great Britain at that time.²⁰⁹ Up until 1965, companies and individuals in Great Britain paid the same income tax with an extra profits tax levied on companies.²¹⁰ The Finance Act of 1965 repealed this tax structure for companies and associations and replaced it with a single corporation tax. The structure was derived from the income tax system and the same was applied in Nigeria and perhaps all of the imperial colonies. The Income Tax Ordinance of 1940 was passed with the aim to regulate both personal and business taxation. This seemed to have suited them as it lasted for 21 years before an exclusive Companies Income Tax Act was promulgated in 1961.²¹¹ This Act also established by the Federal Board of Revenue as the statutory body to

²⁰⁷ Ibid.

²⁰⁸ Ibid.

²⁰⁹ In the 1920s in the UK, both corporations and individuals were taxed under the same ACT. James S and Nobes C, *Economics of Taxation* (14th ed. Fiscal Publications 2014)

²¹⁰ Ibid note 198.

²¹¹ Ibid.

administer these taxes and set out the scope for taxing companies and businesses.²¹² This was repealed and in 1979, the Companies Income Tax Act No.28 1979 replaced it. This underwent several amendments after independence and through the various military regimes that plagued the country with the last two major amendments made in 1990 and 2007 respectively. Corporations in Nigeria are largely regulated by three pieces of legislation. They include the Companies and Allied Matters Act 2004 (CAMA)²¹³ which defines and regulates the incorporation of corporations. Additionally, there is the Companies Income Tax Act 1990 (CITA)²¹⁴ which also defines a corporation especially for tax purposes and at the same time, sets out the taxing parameters of each corporation and the Petroleum Profits Tax Act 1990 (PPTA)²¹⁵ which regulates the taxation of corporations in the oil and gas industry. However, other legislation affects them and their profits, and this will be discussed further on in the next section.

These pieces of legislation tend to overlap and seem to address similar issues in different ways. An instance can be seen on the issue of the definition of a corporation²¹⁶ and foreign corporations operating in Nigeria. This ambiguity causes problems in terms of setting out the right amount of tax to be paid and furthermore, allows a foreign MNC to duly divert profits from Nigeria. CAMA in Section 54(1) defines a foreign company as follows:

Subject to Sections 56 - 59 of this Act, every foreign company which, before or after the commencement of this Act, was incorporated outside Nigeria, and having the intention of carrying on business in Nigeria shall take all steps necessary to obtain incorporation as a separate entity in Nigeria for that purpose, but until so incorporated the foreign

²¹² Ibid.

²¹³ Companies and Allied Matters Act, (CAMA), Cap C20, LFN 2004. CAMA was formerly known as the Companies and Allied decree 1990 and following the consolidation of Nigerian Laws after Nigeria changed from military rule to civilian rule it became known as the Companies and Allied Matters Act, Cap 59 and with further amendments, it is now the Companies and Allied Matters Act, Cap C20 2004 LFN.

²¹⁴ Companies Income Tax Act, (CITA) Cap C21 LFN 2004.

²¹⁵ Petroleum Profits Tax Act, Cap P 13, LFN, 2004.

²¹⁶ Although in Nigeria, the word 'companies' is used, the author uses the corporation in this thesis to clearly distinguish between an incorporated business entity which is separate from its owners (shareholders) and business entities which could be proprietorships.

company shall not carry on business in Nigeria or exercise any of the powers of a registered company and shall not have a place of business or an address for service of documents or processes in Nigeria for any purpose other than the receipt of notices and other documents as matters preliminary to incorporation under this Act

This can be interpreted to mean that CAMA does not recognise the existence of such corporations for business and tax purposes rather it only recognises them for the purpose of compliance with the incorporation laws in Nigeria.²¹⁷ On the other hand, both the CITA and the PPTA, define a corporation in a broader sense.²¹⁸ CITA defines a corporation as, “any company or corporation (other than corporation sole) established by or under any law in force in Nigeria or elsewhere” while the PPTA defines a company as, “a body corporate incorporated under any law in force in Nigeria”.²¹⁹ Though it recognises both foreign and indigenous corporations for tax purposes, one thing that comes to mind about the definition from both Acts is that it comes across as recognising all types of companies’ or corporations for tax purposes. John further suggests that a thorough examination of CITA reveals many variations of the word ‘company’ including those about to commence business, a profit-making company, and a company on liquidation, a reconstituted company and a holding company.²²⁰ Thus, these varied and competing definitions of the notion of ‘company’ show an ambiguity, which may lead to a misunderstanding in the implementation of the law by tax authorities.

²¹⁷ John, DC, ‘Corporate Taxation Laws in Nigeria: A Review’, (2011) 2 (1) International Journal of Advanced Legal Studies and Governance 239.

²¹⁸ See, section 105 CITA in Appendix B and section 2 (c) PPTA in Appendix C.

²¹⁹ Section 105 CITA in Appendix B and Section 2 PPTA in Appendix C. By this definition, it could seem that both Acts acknowledges the importance of the CAMA as the foundation legislation for corporations.

²²⁰ Ibid at note 214.

4.3.1.2 Complexities in the Nigerian Corporate Tax Regime

Both the government and the taxpayer cannot fully plan for future actions, if there is uncertainty in the tax system particularly with the policies and legislation.²²¹ Certainty is a necessity for the proper operation of a good corporate tax system and legislation is the major complexity with the structure of the Nigerian Corporation tax. The legal uncertainties that proliferate in these legislations hinder the location of FDI by MNCs. Further, depending on where the MNC chooses to locate, the legal uncertainty may lead to tax evasion and avoidance. Additionally, the multiplicity of taxes other than the corporation tax levied on the profits of MNCs can be considered a major concern. This thesis argues that the burden placed on MNCs by numerous unaccounted tax payments may contribute to tax evasion. Different taxes on the profits of MNCs may also lead to MNCs evading paying tax in order to retain some profits. This study identifies the following complexities and provides the following analysis.

A. Analysis of Legal Uncertainties in the Tax legislation

CITA and various other pieces of legislation tax the profits of both MNCs and indigenous corporations. The multiplicity of these pieces of legislation is considered a major source of concern as these myriad arrays of legislation intersect with each other to the end of creating uncertainties and avenues for tax evasion and avoidance. This thesis identifies the following pieces of legislation that impose tax on corporations in Nigeria, further additional legislation specific to MNCs formed as a result of a Joint Venture Agreement (JVA) is identified. The author argues that this tax legislation fundamentally creates an avenue for tax evasion and avoidance including CITA, CAMA, PIT and Industrial Development (Income Tax Relief)

²²¹ Association of Chartered Certified Accountants, 'Foundations for a sound tax system: Simplicity, Certainty and Stability' (ACCA 2015) < <http://www.accaglobal.com/content/dam/accaglobal/PDF-technical/tax-publications/ea-tax-fundamentals.pdf> > accessed 02 April 2015.

Act.²²² Following a JVA between the Nigerian government and the foreign partners²²³ of the Nigeria Liquefied Natural Gas Company (NLNG), the *Nigeria Liquefied Natural Gas Company ACT* was enacted. This Act allowed for extended tax exemptions above the allowed duration.²²⁴ The NLNG through its Act was granted a ten-year tax break from paying tax and at the end of the ten years; the MNC claimed a further 2 years of unused tax benefits built up during the 10 years of the tax break. The government's reason behind the tax holiday and exemption was based on the assumption that Nigeria had more potential in gas than in crude and the need to explore this led to the grant of such a tax break. It has been suggested that due to the tax holidays and tax breaks the Nigerian government lost approximately US\$ 3.3 billion of tax revenue.²²⁵

For CITA and PPTA to be effective, there must be a CAMA approved corporation. If this is so, then the legal basis for foreign corporations operating in Nigeria based on the wording of CAMA is questionable. Given that corporations that are in oil and gas are also corporations and are incorporated in the same way with non-petroleum companies, the question of the need for separate legislations for such corporations is also raised. A better solution might be to harmonize some of the legislation or at least the CITA and the PPTA. The UK Corporate Tax Act incorporates both oil and gas corporations and other types of corporations albeit they are taxed differently and separately and this is clearly set out in different parts of the Act.²²⁶ This separation creates an imbalance for the different sets of corporations. The CITA in Part IV sets out incentives for the 'gas industry' referring to corporations dealing in natural gas, which falls

²²² Industrial Development (Income Tax Relief) ACT CAP. 179 L.F.N. 1990 ACT CAP I7 L.F.N. 2004

²²³ Shell (UK/Netherlands), Total (France) and Eni (Italy).

²²⁴ The Industrial Development Act and the Pioneer Status Incentive Regulations 2014, grants Pioneer status to newly registered companies in Nigeria, are given a tax exemption from CIT period for 3-5 years based on certain approved activities.

²²⁵ Mark van Dorp, 'How Shell, Total and Eni benefit from tax breaks in Nigeria's gas industry: The case of Nigeria Liquefied Natural Gas Company (NLNG) 2016 < <https://www.somo.nl/wp-content/uploads/2016/02/How-Shell-Total-and-Eni-benefit-from-tax-breaks-in-Nigerias-gas-industry.pdf>> accessed 2 July 2016.

²²⁶ See Part 8 of United Kingdom Corporate Tax Act 2010.

under the umbrella of PPTA.²²⁷ Furthermore, different bodies regulate these pieces of legislation; both the CITA and PPTA are administered and regulated by the Federal Inland Revenue Service (FIRS) while the CAMA is regulated by the Corporate Affairs Commission (CAC). This inherently will increase the cost of compliance, as audits will be carried out by the different bodies, which shows a lack of coordination. It is argued that the contagion effect of these legislative pieces, not only leads to uncertainties which deters the location of FDI by MNCs but most importantly lead to tax evasion and avoidance through which the government loses much needed revenue.

Another key issue with the domestic tax structure of Nigeria, which negatively affects MNCs and domestic corporations, is the issue of the multiplicity of taxes by the different tiers of government and different parastatals. Once again, this problem can be traced back to the legislation. The Taxes and Levies (Approved List for Collection) Act (TLA),²²⁸ lists and imposes tax collection powers but not the power to impose tax on the different tiers of the government in Nigeria.²²⁹ Notwithstanding, this has not deterred different state governments or parastatals to impose a further tax on the profits of domestic and MNCs as they see fit. In *Registered Trustees of Association of the Licensed Telecommunications Operators of Nigeria and Others v Lagos State Government and Others*, the Lagos State Infrastructure Maintenance and Regulatory Agency Law, 2004 (IMRA) imposed tax on the telecommunication companies operating in the state. This was challenged on the basis that the law imposed tax on their operations. Findings for the telecommunications operators revealed that the court held the law and its regulatory agency was a means of the state generating revenue through the imposition

²²⁷ See CITA Part VI sec 39ff in Appendix B.

²²⁸ The Taxes and Levies (Approved List for Collection) Act CAP T2, Laws of the Federation of Nigeria 2004.

²²⁹ See Sections 1(1), 2 (1) and (2), 3 (a) and (b).

of tax. The court further held that the state government had no legal rights to impose or collect such taxes on corporations as it came under the jurisdiction of the federal government.

Contrasting the judgement with *National Inland Waterways Authority v SPDC*, the court rejected the argument by SPDC that the plaintiff lacked the authority to impose taxes on them as the imposition of taxes on its profits came under the jurisdiction of the FIRS. The court in finding for the parastatal considered the provisions of sections in its ACT²³⁰, which it held to be valid. The flaw in this judgement can be attributed to a misunderstanding and inconsistencies in the legislation and taxing powers. The TLA in its schedule vested power on a state government to collect taxes and levies of which the federal authority NIWA imposed taxes on SPDC. Cases of wrong judgement can cause corporations to seek avenues to minimise their profit to avert a drain on their profits. Consequently, Sanni states that multiplicity of taxes makes investment climate chaotic, as investors are not sure of the extent to which their incomes would be taxed.²³¹ There are cases of large corporate entities that have moved their operations out of some States or from Nigeria to neighbouring countries because of the multiplicity of taxes and the rising cost of doing business in Nigeria.²³² It is accepted that resolving the issue of multiple taxation will be difficult given the federal nature of Nigeria. An overlap of the laws is inevitable; however, a significant portion could be resolved with reform of the tax system especially for corporations. A structure similar to the unitary formulary apportionment between the three tiers of governments and their parastatals will be discussed as a potential recommendation.

B. Complexity in Commencement Rules

²³⁰ National Inland Waterways Authority ACT s. 28 The Authority may, with the approval of the Minister, make regulations for dues, rates and charges for the following purposes- (b) sale of sand, (g)- sand search, (h) dredging permit and (r) property rents.

²³¹ Abiola Sanni, 'Multiplicity of Taxes in Nigeria: Issues, Problems and Solutions' (2012) 3(17) International Journal of Business and Social Science 229.

²³² Ibid.

The CITA sets out rules for the taxation of companies during commencement of business.²³³ Ideally, companies are taxed on their profits based on the preceding year. In Nigeria, under the CITA, this is not the case as new companies are taxed in the year it commenced business. The tax for the second year is assessable on the profits of the company for the first twelve months from the date of commencement of business. For the third year, the tax is assessed on the preceding year basis.²³⁴ These rules are unnecessarily complicated and result in double taxation of affected companies during their start-up phase. Therefore, if either a domestic company or MNC commences business in Nigeria it will be assessed for tax, twice within the first months of its commencement hence being subjected to double taxation. Hence, this creates an unfavourable environment for business especially for a developing economy as Nigeria facing a drastic need for diversification of its revenue source. Despite this being criticized,²³⁵ nothing has been done to change this.

C. Complexity in excess dividend charge

The CITA in section 19 imposes ‘excess dividends tax’ where dividends are paid out as profits on which no tax is payable.²³⁶ While section 80, imposes a charge of 10 percent, withholding

²³³ See section 29(3) of CITA 1990 - The assessable profits of any company from any trade or business for the year of assessment in which it commenced to carry on such trade or business; (or in the case of a company other than a Nigerian company for the year of assessment in which it commenced to carry on such trade or business in Nigeria) and for the two following years of assessment ; (which years are in this section respectively referred to as “the first year”, “the second year” and “the third year”) shall be ascertained in accordance with the following provisions-

for the first year the assessable profits shall be the profits of that year

for the second year the assessable profits shall unless such notice as hereinafter mentioned is given, be the amount of the profits of one year from the date of the commencement of the trade or business as determined for the purpose of paragraph (a) of this subsection

for the third year the assessable profit shall unless such notice as

hereinafter mentioned is given, be computed in accordance with subsection (1) of this section

A company shall be entitled on giving notice in writing to the (board within two years after the end of the second year to require that the assessable profits both for the second year and the third year; but not for one or other only of those years shall be the profits of the respective year of assessment.

²³⁴ Ibid.

²³⁵ Olumide K Obayemi, ‘Tax Litigation in Nigeria and a Review of recent Nigerian Court Decisions on Taxation’ (2014) Research Journal of Finance and Accounting 5 24.

²³⁶ Section 19 CITA- Where a dividend is paid out as profit on which no tax 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 is paid by a Nigerian company paying the dividend shall be charged to tax at

tax on dividends before it is distributed to the shareholders.²³⁷ This is regardless of whether the profit being distributed may have already been taxed or legally exempted from tax.²³⁸ Furthermore, both domestic (resident) corporations, and non-resident MNCs are required to pay a further 30 percent of the dividends declared as tax if the dividend is the total profit for the year of assessment. This is applicable where the company is not ordinarily liable for tax for that year of assessment due either to no taxable profit or less profit. All these in essence lead to a double taxation of the profits of the corporations. The case of *Oando PLC v FIRS II*²³⁹ highlights the problem not only with the section, but also with the application of the section by the tax authority and the interpretation of the legislation by the court. Between 2005 and 2007, Oando declared and paid dividends to its shareholders. The FIRS invoked the provisions of section 19 and assessed the dividends to 30 percent corporate income tax. This assessment was made on the basis that the dividends exceeded the company's taxable profits for the relevant years of assessment. In objection to the assessment, Oando lodged an appeal with the Tax Appeal Tribunal (TAT) and the following points were considered:

A. Whether the sums paid as dividends were taxable under Section 19 of CITA

B. Whether the provisions of Section 19 of CITA are ambiguous and should be interpreted in favour of the taxpayer.

the rate prescribed in subsection 1 of section 40 of this Act 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.

²³⁷ See section 80 of CITA in Appendix B.

²³⁸ Taiwo Oyedele, 'How Nigeria's tax system discourages investments' (2015) <<http://www.pwc.com/ng/en/publications/tax-watch-february-2015.html>> accessed 18 April 2016. Also see sections 19 and 20 of CITA in Appendix B.

²³⁹[2013]11 TLRN 169.

Oando argued that the dividends were paid from already taxed earnings from past years and therefore, FIRS should have considered and applied section 80 (3) CITA²⁴⁰ which exempts dividend income that had already been subjected to withholding tax. Finally, Oando argued that if section 19 is considered ambiguous, it should then be interpreted in line with the *contra fiscum* rule.

The TAT held that regardless of whether earnings have been previously taxed, where there is no current year taxable profit or where the taxable profits are less than the amount of dividends declared, such dividends would be taxed at 30 percent in terms of section 19.²⁴¹ Furthermore, it held that section 19 is clear and unambiguous and therefore its literal interpretation will be given. Additionally, it found that Section 80 (3) was not to be considered, as the source of the profits from which the dividend has been declared was not received from its subsidiaries. Thereby, the TAT found in favour of FIRS regardless of the ruling of the Federal High Court in *Oando v FIRS I*²⁴² which held that dividends paid from retained earnings are not subject to tax.²⁴³ Consequently, the judgement by the TAT imposes a double taxation on companies and in certain cases; the companies may be subjected to paying tax on legally exempt profit.²⁴⁴ This calls for a review of this section and its application and interpretation by the FIRS.

D. General complexities

²⁴⁰ Section 80 (3) (3) Dividend received after the deduction of tax shall be regarded as franked investment income of the company receiving the dividend and shall not be charged to further tax as part of the profits of the recipient company. However, where such income is redistributed and tax is to be accounted for on the gross amount of distribution in accordance with subsection (1) of this section, the company may off-set the withholding tax which it has itself suffered on the same income.

²⁴¹ Ibid note 232.

²⁴² [2009] ITLRN 61.

²⁴³ Ibid.

²⁴⁴ Supra 230.

In Nigeria, CIT is imposed on the profit or gain of any company: accruing in, derived from, brought into, earned in or received in Nigeria.²⁴⁵ The tax rate of 30 percent is applied on the total profit or chargeable profit of the corporation. The PPTA imposes tax at the tax rate of 67.5 percent for the first five years of operations for corporations that fall under its scope and an increased rate of 85percent thereafter.²⁴⁶ The exact meaning of chargeable or total profit is debatable or ambiguous. The CITA and the PPTA specifically refer to ‘chargeable profit’,²⁴⁷ as what tax should be imposed on. However, CITA permits the FIRS to assess and charge tax turnover of trade or business of a company if it appears to that the trade or business of the company produces no assessable profits or the assessable profit is less than expectation, or it cannot be ascertained.²⁴⁸ This means that affected companies would have to pay taxes out of their capital, which invariably increases the risk of failure for such companies. This could be why a number of domestic companies in Nigeria tend to fold up due to the burden placed on them. John posits that it is inequitable and destructive to business enterprise in Nigeria.²⁴⁹ There is no clarity in the imposition of corporate tax on smaller companies. CITA imposes a smaller company’s rate of 20 percent on small companies in the manufacturing industry and wholly export-oriented companies with turnover not exceeding 1 million for the first five years of operation.²⁵⁰ This raises the question of what either would happen after the five-year period if the company were on the threshold or did not make a turnover of 1 million. Further, as previously mentioned, there is an imposition of a further tax in the guise of Education tax, which is charged at 2 percent of assessable profit. CITA imposes a rate 20 percent on chargeable profits of Oil Marketing Corporations and Oil Servicing Corporations respectively

²⁴⁵ See section 9 CITA in Appendix B.

²⁴⁶ Onaolapo A Abdul-Rahamoh, Fasina H Taiwo, Adegbite T Adejare, ‘The Analysis of the Effect of Petroleum Profit Tax on Nigerian Economy’ (2013)1(1) Asian Journal of Humanities and Social Sciences 26.

²⁴⁷ See section 40 CITA in Appendix B and section 9 of the PPTA in Appendix C respectively.

²⁴⁸ See section 30 CITA

²⁴⁹ DC John, ‘Corporate Taxation Laws in Nigeria: A Review’, (2011) 2(1) International Journal of Advanced Legal Studies and Governance, 239.

²⁵⁰ Section 40 CITA in Appendix B.

while also providing them with incentives.²⁵¹ It is unclear why this is not placed in PPTA as it creates confusion on what actually falls under a particular legislation.

Recognising the implications of these issues, the government through the National Tax Policy (NTP) has tried to address these problems by attempting to restructure the tax system to make it fairer. The TLA has been amended to clearly define which tier of government is allowed to collect a particular tax. Although this is commendable, it is still not enough. Since its launch in 2012, the NTP has not been implemented. Recently, the Nigerian government has decided to review the NTP in order to make it conform with global best practices as well as align with the nation's socio-economic realities.²⁵² The government aims at entrenching an improved tax policy to effectively harness the much-needed resources necessary for the nation's sustainable economic growth and development.²⁵³ Part of the reviewing committee's agenda will be to review the existing DTTs and work towards negotiating new treaties with states. Although this is welcomed, a major problem will lie on its implementation.

One of the foremost problems with the actualisation of policies and the compliance with legislation in Nigeria lies in their implementation; and in general, it is observed that policy implementation is one of the major problems confronting developing nations.²⁵⁴ It is perceived that the implementation issues in developing countries, the problem of implementation could be because of certain factors, which could either be the demography of the environment, the policy makers and the policy itself. When policy makers do not take in cognisance of the social,

²⁵¹ See section 39 CITA in Appendix B.

²⁵² Taiwo Oyedele, 'Nigeria reviews its National Tax Policy' PWC Tax Matters <<http://pwc-nigeria.typepad.com/>> accessed 17 August 2016.

²⁵³ Ibid.

²⁵⁴ Taiwo Makinde, 'Problems of Policy Implementation in Developing Nations: The Nigerian Experience' (2005) 11 (1) Journal of Social Sciences.

political, economic and administrative characteristics of a particular society or state while creating policies, the result will be a lack of implementation.²⁵⁵

This then creates a void in the society instead of addressing the particular needs for which the policy or legislation was enacted. Accordingly, Honadle likens the problems of lack of implementation as that of social carpenters and masons who fail to build to specifications and thus distort the building print.²⁵⁶ This is the situation in Nigeria. The government's bid to reform and review existing policies and legislation in order to stimulate the economy suffers from the problem of implementation as in the case of the NTP mentioned above. It is expected that even without being implemented, this policy is currently being reviewed in order for it to be implemented.²⁵⁷ This thesis, argues that the social and economic factors in Nigeria such as high levels of illiteracy, lack of adequate infrastructure, and lack of trained tax personnel to enact the policy requirements impedes implementation. It is expected that a policy like the NTP that advocates for self-assessment should have taken into consideration factors such as illiteracy and electricity.

4.3.1.3 Rationale and Mechanisms of imposing CIT in Nigeria

Following the trends of international law, the jurisdiction to impose CIT in Nigeria is based on the 'place of incorporation test' otherwise known as 'residence test'.²⁵⁸ As previously stated, the CAMA does not recognise a corporation for business and tax purposes. Thus, to accept this for tax purposes in order to apply the residency test on foreign MNCs which derive profit from Nigeria will be problematic. For this reason, this thesis will concentrate on the definition set out in CITA. While CITA does not define the term residence for tax purposes, Abdulrazaq

²⁵⁵ Ibid.

²⁵⁶ George Honadle and Rud Klauss (eds.), *International Development Administration: Implementation Analysis for Development* (Praeger 1979).

²⁵⁷ Ibid note 245.

²⁵⁸ Adam Wahab, 'Legal Issues in the Taxation of Companies in Nigeria' <http://www.academia.edu/15765952/Legal_Issues_in_the_Taxation_of_Companies_Income_in_Nigeria> accessed on 18 April 2016.

surmises that it is a question of fact and not law.²⁵⁹ This is unlike the UK where the term has been defined and accepted by the case law as discussed further. Certain factors that can be used to determine or establish residence for tax purposes include, but are not limited to – the period of physical presence in a country in the year under question, past residence history, frequency and regularity and duration of visits. Further, the purpose of such visits and conversely the purpose of the absence abroad and whether there is a place available for the taxpayer's domestic use during the year in question are included.²⁶⁰ The author argues that this is potentially an avenue for tax evasion and avoidance by MNCs located in Nigeria. By effectively structuring their Corporations and the business carried out by them, they can and do manipulate this flaw in the legislation as will be depicted further on.

A corporation is deemed to be resident in Nigeria if it is incorporated in Nigeria while a non-resident company is one that is not incorporated in Nigeria but derives income or profits from Nigeria.²⁶¹ Although corporations can be exempt from incorporation under CAMA, they are not exempt from payment of tax under the provisions of CITA.²⁶² This was affirmed in the case of *Shell Petroleum Internationale Mattschappig (SPIM) B.V v Federal Board of Inland Revenue*.²⁶³ The appellant argued that it was not liable to pay income tax in Nigeria on the basis that the services rendered by it to Shell Petroleum Development Company of Nigeria (SPDC) were performed outside the country. In addition, the payments received in return contained no profit element. The Supreme Court held that by virtue of section 26 CITA:

²⁵⁹ MT Abdulrazaq, *Nigerian Revenue Law*, (Matthouse Lagos, 2005) 169.

²⁶⁰ Ibid.

²⁶¹ JM Elegido, Liability of Non-residents to Nigerian Tax (1987) 15 International Business Law 411.

²⁶² Federal Inland Revenue Service Information Circular No 9302 of March 1993, Available at http://www.firs.gov.ng/CMSTemplates/FIRS_SITE/downloads/Tax_for_non_resident_in_nigeria.pdf > paragraph 2.3.1.

²⁶³ [1999] 1 N.R.L.R

Tax authorities are empowered to assess and charge a company...of its trade attributable to the operations carried on in Nigeria where the trade or business produces either no assessable profits or less...²⁶⁴

The Supreme Court also found the act of putting together the payments made in Nigeria and around the world to the Groups companies account as a scheme to avoid payment of tax in Nigeria.²⁶⁵ The appellant (SPIM) is a foreign company incorporated in the Netherlands, with its shares held by Shell Petroleum N.V also incorporated in the Netherlands. Its activities consist of rendering technical and managerial services to over 40 companies in the Royal Shell Group operating in the oil and gas industry throughout the world. The offices and laboratories from which it worked were located in the Netherlands. When its staff came to work in Nigeria, such staff usually use any office provided by SPDC. SPDC has been making payments to the appellant for the services provided under a special sharing arrangement whereby all the appellants services and expenditures are charged to the Groups companies account on basis and in such a way that the appellant is left with no profit.

While a Nigerian company is charged tax on its worldwide income, a non-resident company is liable to pay tax only on the profits of its income attributable to the business or trade carried on in Nigeria.²⁶⁶ The definition of a foreign company in the Nigerian legislation has made it possible for non-resident companies to derive income on investments, royalty, interest and rent. These are classified as passive income and are subject to a 10 percent withholding tax as the final tax.²⁶⁷ Where the non-resident company, earns income other than this, for tax purposes, the company is by law required to register and file a full tax returns. This creates a challenge for an already overburdened tax authority, as it will be difficult to verify and establish the exact

²⁶⁴ See section 26 CITA in Appendix B.

²⁶⁵ Ibid, paragraph (i) pg. 80.

²⁶⁶ Section 13 CITA in Appendix B.

²⁶⁷ Ibid note 255.

amount of expenses and the capital allowance attributable to the Nigerian operations of the non-resident company in respect of profits to be assessed to tax.

To counter this, section 30 CITA empowers the FIRS to assess companies to income tax based on a reasonable percentage of turnovers. FIRS, sees this to be the deemed profit basis, best of judgement assessment or presumptive taxation. As mentioned earlier, there is a problem with the interpretation of the sections of CITA and how the FIRS assess tax liabilities on corporations. Assessing and imposing tax on MNCs has been an area where not only CITA but also the FIRS have faced a call for reforms. The decision in the case of *Saipem Contracting Nigeria Ltd vs FIRS*,²⁶⁸ portrays an example of the need for a review of the legislation, and training for tax authorities especially in terms of tax assessment. Essentially, Saipem Nigeria and its sister subsidiaries, entered into contract arrangements with Shell Nigeria Exploration and Production Company Limited to perform different services. The non-resident companies carried out their responsibilities under these contracts outside Nigeria. Afterwards, FIRS issued tax assessments to the French and Portuguese subsidiaries on the profits from their services carried outside Nigeria subject to sections 9, 11, 13 26 and 30 of CITA.²⁶⁹ Saipem Nigeria rejected and claimed *inter alia*, that subject to sections 13(2)(c)(c) and 9(1) of CITA income of a non-resident corporation was not subject to tax in Nigeria, since Saipem Portugal and Saipem Parent Company neither had a fixed base nor a permanent establishment in Nigeria. Saipem further argued that under article 7 of the Double Tax Treaty between Nigeria and France (DTT), income of Saipem Parent Company was exempted. Therefore, if the DTT does not apply, a non-resident company (NRC) will only be taxable if the income is derived from Nigerian business activities.²⁷⁰ The court dismissed their claim and held that where a single

²⁶⁸ (2014) 15 TLRN 76.

²⁶⁹ Ibid.

²⁷⁰ Ibid also Article 7 paragraph 1 of the Double Tax Treaty Nigeria-France Income Tax Treaty (**Business Profits**) -The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless

Consortium Contract containing offshore and onshore elements was performed by two separate local (Saipem Contracting Nigeria Limited NigCo); and foreign subsidiaries (Saipem Portugal PortCo) of a global conglomerate (Saipem International in France) it may have its onshore part taxable.

The court decision in this case highlights clearly the flaw in the legislation concerning the clarity of definitions. Basing the imposition of CIT on fact and not law as held by the court shows a clearly flawed structure. This allows for mixed and conflicting judgements by the courts and TAT. Additionally, this creates an avenue for MNCs to arrange and plan their corporate structure while executing transactions in such a way that they can minimize their tax liability. Furthermore, as the Nigerian government seeks to draw FDI, it is imperative that the business environment is founded on certainty, credibility and consistency. To achieve this, the regime, especially FIRS has to be reviewed and restructured. A clear and succinct definition of residency and permanent establishment as set out in Article 7 of the OECD MTC is necessary especially in light of the OECD BEPS project. The BEPS Action 7 looks at closing the loopholes in the definitions of PE and resident and non-resident corporations.²⁷¹ MNCs are said to use these loopholes to create structures which enable them avoid tax. In Nigeria, how this will pan out is yet to be seen. As the Nigerian tax treaty network is about to undergo a review, it is expected that this will be taken on board. Furthermore, a review of the tax legislation should reflect this.

Recently, the position for the taxation of foreign companies in Nigeria was reaffirmed and clarified by the Federal High Court of Nigeria in the case of *JGC Corporation v. Federal Inland*

the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

²⁷¹ See OECD 'Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report' <<http://www.oecd.org/ctp/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm>> accessed 15 September 2016.

*Revenue Service.*²⁷² The appellant, JGC Corporation, a foreign company, entered into a contract with a Nigerian company, Mobil Producing Nigeria Unlimited (MPN), to provide engineering and procurement services in an offshore contract. Concurrently, JGC's Nigerian subsidiary and a third party also entered into a construction contract with MPN in an onshore contract. Both contracts related to the same project. The offshore contract, if none of the activities pursuant to the contract would be carried out in Nigeria. The FIRS assessed tax on JGC that was a party to the onshore contract and had a fixed base in Nigeria through its Nigerian subsidiary. JGC appealed the assessment at the TAT in Lagos, which dismissed the appeal and upheld the assessments. JGC appealed to the Federal High Court and the following the issues were set out for the courts to determine,

- whether the TAT's judgement should be disregarded since the TAT did not consider and evaluate material pieces of evidence
- whether the TAT correctly concluded that JGC had a fixed base in Nigeria and would be liable to tax based on the evidence presented to the TAT and;
- whether the TAT correctly accepted the FIRS's tax assessment based on the entire profit from the offshore

The court ruled in favour of JGC on all issues and concluded that the TAT breached JGC's right to a fair hearing by not considering all material facts and evidence. It held that the existence of a fixed base is an issue of fact and based on such facts, JGC did not have a fixed base in Nigeria. An interesting development was the court's position in recognising a taxpayer's right to plan its activities in the most tax efficient manner, provided the taxpayer's activities remain within the scope of the law. In essence, the Nigerian court determined that payments sourced from Nigeria without a tax presence in the country are not subject to Nigerian

²⁷² (2014) 15 TLRN 105.

income tax that nullified the earlier decision in *Sapiem's* case. To be taxable, said the court, the foreign company must have a fixed base in Nigeria, and the profits to be taxed should be attributable to the fixed base.

To administer the corporation tax, the Federal Inland Revenue Service (Establishment) Act No. 13 of 2007 formally established the Federal Inland Revenue Service in Nigeria.²⁷³ The FIRS has control and administers the different taxes and laws specified in the First Schedule or other laws made occasionally by the National Assembly. It also includes control of other regulations made thereunder by the Government of the Federation and seeks to account for all taxes collected. The FIRS not only controls and administers the taxes, but it also enforces the compliance of tax payments. Its tax enforcement mechanisms will be discussed in the forthcoming chapter.

4.3.2 United Kingdom

4.3.2.1 Overview of Corporate tax laws in the United Kingdom

In the United Kingdom, there is no single source of tax laws.²⁷⁴ Its basic rules are enshrined in Acts of Parliament, and then left to the decision of Her Majesty's Revenue and Customs (HMRC), which is the final authority on taxation to interpret or explain the provisions of the law. It is important to state here that such interpretations have no legal backing; nevertheless, they are binding on all corporations except in instances of successful legal challenges in court of law. In the event of issues arising from the compliance with the interpretation of such laws, the court would normally intervene to ensure the proper application of the law.

²⁷³ Ifueku Omoigui Okauru, '*Federal Inland Revenue Service and Taxation Reforms in Democratic Nigeria*' (2012 Safari books).

²⁷⁴ Malcolm James, *The UK Tax System: An Introduction* (2ed. Spiramus Press 2009).

In a discussion of taxes on businesses in the UK, it is essential to state exactly what is regarded as Corporation Tax. For some,²⁷⁵ such taxes range from taxation on profits to business rates from the use of property and net sales from the value added tax (VAT)²⁷⁶ down to the labour inputs from employees. At this stage, it is essential to go back to the roots of corporate taxation in order to understand the reason why corporation taxes rest solely on profits. This occurred in the nineteenth century when the court made a distinction between the owner and shareholders of a company²⁷⁷ creating a separate legal entity. Economists over the years have tended to extend the separation to taxation. Additionally, with that ruling came the distinction in the taxation of individuals and corporations. The distinction was then widened to include incorporated and non-incorporated companies such as sole traders and partnerships;²⁷⁸ because of the fact that business partners and sole traders normally merge their profits with other incomes and subsequently taxed as single earning.²⁷⁹

World War II saw an increasingly heavy financial burden on the exchequer;²⁸⁰ and the effects of the war led to significant initiatives being introduced in order to raise more revenue to bear the costs of war.²⁸¹ Initially in the UK, the incomes of individuals and corporations were a means of funding World War effort. After the war, differences arose between unincorporated traders and the incorporated companies whose identity was separate from other entrepreneurs.

²⁸² Thus at the end of the war, this was substituted by the Corporate Profits Tax (CPT) of 1920 through the Finance Act of 1920 which was highly controversial and not well received as it

70 Stuart A. Johnson P. and Miller H., 'Response to the House of Lords Select Committee on Economic Affairs' Call for Evidence: Taxing corporations in a global economy: is a new approach needed?' (2013) <http://www.ifs.org.uk/docs/response_lordsct.pdf> accessed on 30 November 2014.

²⁷⁶ Ibid.

²⁷⁷ *Salomon v Salomon & Co Ltd* [1896] UKHL.

²⁷⁸ Simon James and Christopher Nobes, *Economics of Taxation* (14th ed. Fiscal Publications 2014/15).

²⁷⁹ Ibid.

²⁸⁰ Ibid.

²⁸¹ See generally, *Economics of taxation* at note 271, The Munitions Levy and the Excess Profits Duty in the Munitions of war ACT 1915 and the Finance ACT of 1915 are examples of taxes which were imposed on businesses in order to generate revenue for the government.

²⁸² Indicator, *United Kingdom Corporation Tax memorandum 2013-2014* (F L Memo London 2013).

was perceived to bear heavily on industry and enterprises.²⁸³ Despite corporations being subject to this tax, they were also subject to the income tax and this more or less acted as surtax for corporations.²⁸⁴ This is likely to be one of the reasons for its unpopularity as it was considered that it placed a significant financial burden on corporations. Notwithstanding the criticisms of this act, it is considered to have introduced an element of a classical tax system as against the imputation tax system that was prevalent at that time.²⁸⁵

4.3.2.2 Rationale and Mechanisms of CIT in United Kingdom

The success of corporation tax laws also rests on its administration and having a sustainable body to administer and monitor the regime is vital to its success. As with all other taxes in the UK, corporation tax is a combination of statute, case law and the practices of the HMRC. To understand how corporation tax laws, affect the UK economy, it is necessary first to have an understanding of the rationale and mechanisms of corporation tax laws. Additionally, in determining what is taxable in a corporation, it is necessary to first consider, whether or not the corporation is undertaking a business or investment activities or if it is dormant. Since it is usually clear when an activity is being carried out, what is hard to determine is whether a trade or business exists at all? The courts tend to examine the facts and look for the presence or absence of the common features of the business. This leaves a wide scope for defining business or trade. In *CIR v Fraser*,²⁸⁶ the courts defined business/trade as an isolated transaction while in *Wisdom v Chamberlin*,²⁸⁷ the definition was given as a speculative adventure, which yields a profit.²⁸⁸ Incorporated firms of lawyers, accountant's architects are all liable to pay

²⁸³ Dominic de Cogan, 'The Wartime Origins of the Irish Corporation Tax' (2013) 3(2) Irish Journal of Legal Studies 25-26 where he discussed the unpopularity and subsequent repeal of this act in Britain.

²⁸⁴ Ibid 24.

²⁸⁵ Ernst and Young 'The Historical development and International context of Irish Corporate tax system' 2014 <http://www.budget.gov.ie/Budgets/2015/Documents/EY_Historical_Dev_International_Context_Irish_%20Corporation_Tax.pdf> accessed on 25 November 2014.

²⁸⁶ [1942] 24TC498

²⁸⁷ [1969] 45 TC 103

²⁸⁸ Ibid.

corporation tax as 'profession' is deemed to a trade according to the HMRC although statute does not give a definition for profession.²⁸⁹ Other means of identifying whether or not there is an investment are by identifying profit-yielding assets.

As the HMRC states that part of a corporation's occupation is to make investments,²⁹⁰ where either a corporation's main occupation is investments exclusively or as a hybrid,²⁹¹ they will be subject to corporation tax and entitled to deductions and expense reliefs. In *Medway Housing Society Ltd v Cook*,²⁹² the courts held that as the society was formed for the provision of affordable housing in return for below market value rent, nevertheless at a level which produced a profit. It was held that the society was an investment company and was therefore subject to corporation tax.

In addition to determining whether there is a trade, business or investment to be taxed, corporate residency and taxable profits must be clearly set out. Two methods are used to determine a corporation's residence status. If either method places the corporation's residence as the UK, it follows that all the corporations' profits will be subject to taxation.²⁹³ In order to be considered as a resident in the UK, a corporation should be incorporated either in the UK or in its central management and control takes place in the UK. Although this is not laid down in statute, it has been well established through case law examples of which include in *De Beer Consolidated Mines Ltd v Howe*²⁹⁴ and *LAERSTATE BV*.²⁹⁵ In such cases, the courts tend to examine the situation in order to locate where the highest form of control is situated against its

²⁸⁹ Ibid note 275.

²⁹⁰ Ibid.

²⁹¹ Ibid.

²⁹² (1996) 69TC319

²⁹³ See generally, the works of MP Devereux, R Griffith and A Klemm, 'Corporate Income Tax Reforms and International Tax Completion' (2002) 17 (35) Economic Policy 451; MP Devereux and PB Sorensen, 'The Corporate Income Tax: International Trends and Options for Fundamental Reform' (2005) EPRU-Analysis no 4.

²⁹⁴ 1906 5 TC 198

²⁹⁵ [2009] UKFTT 209 (TC)

daily activities.²⁹⁶ However, in certain situations, the HMRC could argue that the central management and control of a subsidiary lies with the parent company.²⁹⁷ In effect, this could only happen where the parent company assumes control of the board of the subsidiary company.²⁹⁸

Determining the residency of a corporation is of enormous importance regarding the taxation of its profits. If a corporation is resident in the UK, all of its UK profits, gains and overseas profits and gains are taxed. However, in cases where a company is not resident in the UK, but has a Permanent Establishment in the UK, only profits arising from the PE and its UK gains on assets used in the PE will be taxed.²⁹⁹ Taxable profits consist of the profits that arise from either a resident or a permanent establishment trade, although not all of them can be taxed.³⁰⁰ The starting point for assessing the profits of a company is the statutory accounts, which are generally prepared according to the terms of the Companies ACT.³⁰¹ Taxable profits consist of income from all sources (trading, letting property and investment income) plus capital gains from sales of certain fixed assets and investments. Dividends received from other companies (both UK and overseas) are not taxable.

Corporation tax is charged on the taxable profits of an accounting period. An accounting period cannot be more than 12 months. The profits in company accounts prepared for a period of more than 12 months are apportioned between the first 12 months.

²⁹⁶ Ibid note 275,49.

²⁹⁷ Ibid

²⁹⁸ American Thread Co v Joyce 1913 6 TC 163.

²⁹⁹ Ibid note 275.

³⁰⁰ Dividend income is taxed separately.

³⁰¹ Not all companies are subject to the Companies ACT and not all corporations are subject to corporation's tax examples include limited liability partnerships, sole traders.

4.4 Conclusion

With an understanding of the use of tax and especially the use of corporation tax, it is necessary to have a sustainable and clearly set out corporation tax structure, which will serve the tax system fully. As part of the tax system, this will create a suitable business environment for countries especially in attracting MNCs. As Steinmo indicates, state governments need money. How they get this money and whom they take it from are two of the most difficult political issues faced in any modern political economy.³⁰² In Nigeria, there is a need for a reform of these laws in order to achieve optimal revenue. A number of factors also exacerbate the situation.³⁰³ They include issues such as inconsistent government policies, lack of adequate data to monitor the tax revenue, ambiguous and overlapping legislation and poor taxpayer education. These tend to lead to tax evasion, avoidance and profit flight. In the UK, it can be seen that corporation tax affects a wide range of choices and decisions made by foreign owned corporations.³⁰⁴ This ranges from the choice of legal form of business to incorporate, and the level of investment to commit to, to the choice of assets to acquire.³⁰⁵ There is clarity of definition and separation in the UK tax legislation that is not found in the Nigerian system. When the UK was faced with an overlap between the objectives of the Inland Revenue and the Customs Service, the government merged the two and continually reformed the system. This is not to say that the UK corporate system is perfect; as discussed in forthcoming chapters, the corporation tax system is still besieged with issues.

As the previous discussion indicates, there is therefore a need to revisit the legislation that administers corporation tax in Nigeria. This is necessary at this time because of the loss of

³⁰² Ibid note 144.

³⁰³ Ehigiamusoe Uyi Kizito, 'The Nexus between Tax Structure and Economic Growth in Nigeria: A Prognosis', (2013) *Journal of Economic and Social Studies* 126.

³⁰⁴ Stuart AP Johnson and H Miller, 'Taxing corporations in a global economy: is a new approach needed?' Response to the House of Lords Select Committee on Economic Affairs call for evidence (2013).

<http://www.ifs.org.uk/docs/response_lordsct.pdf> accessed on 30 November 2014.

³⁰⁵ Ibid.

revenue due to the crash in oil price. As such, the country needs and is looking for, avenues for the diversification of its revenue source. The FIRS has been identifying strategies to increase revenue – some of which may be clearly set out, but some that may not be. An example is the newly announced enforcement of advance corporate income tax on interim dividends.³⁰⁶ The FIRS will seek to collect an advance corporation tax at the rate of 30percent on interim dividends as prescribed by CITA; however, its implementation remains to be seen.³⁰⁷ Although CITA states that an advanced corporation tax is to be paid, it has not been enforced and corporations were allowed to pay at their convenience; with the pressure to generate revenue this has now changed.

In view of the complexities in the Nigerian corporation tax system, there is dire need for changes in the corporation tax system. This is necessary in order to make Nigeria conducive for both foreign and local investments. The most paramount of these is the simplification of the tax system with better clarity in the taxes that are payable and removal of excess dividend tax, minimum tax and commencement rule.

These and more will be extensively discussed and analysed in the next chapter where an analysis of the influence of corporation tax as an FDI variable will be made using the same countries for illustration.

The next chapter will analyse the economic effects of corporation tax in developed and developing countries, once again using the same countries for illustrative purposes to achieve the name of recommending a framework of a sustainable corporate tax system for both countries.

³⁰⁶ PWC Tax Matters Nigeria < http://pwc nigeria.typepad.com/files/tax-alert_firs-issues-public-notice-and-enforces-cit-on-interim-dividends.pdf> accessed 15 October 2015.

³⁰⁷ Section 43(6) CITA in Appendix B.

CHAPTER 5: Interplay of Tax Compliance, Enforcement Strategies and National Economies

5.0 Introduction

From the previous chapter, it was deduced that complexities in the corporate tax system, hinders investment and this subsequently negatively affects national economic growth and development. Further, previous chapters have highlighted that revenue from taxation, in this instance corporation tax, is essential for national economic growth and development; which in addition, it is the source of the high volumes of revenue needed to fund government ambitions in developed economies¹ and more recently, in many of the developing economies. It follows therefore that state governments would rigorously and jealously guard this much-needed revenue by insisting on compliance with the policies and laws enacted by the tax authorities² especially in the long-standing effort to reduce the tax gap.³ With a lack of compliance by the majority of taxpayers, the burden of funding the nation's commitment falls heavily on the few compliant taxpayers. It is stated that a considerable amount of money is lost due to non-compliance of taxpayers globally.⁴ This makes it increasingly difficult for governments to deliver services to their citizens. In order to combat this, governments of developing and developed nations adopt measures to deter and enforce compliance.

This chapter therefore aims to consider how compliance, together with enforcement and deterrence measures on CIT, affects the economic growth and development in national economies. This is accomplished by illustrating and analysing the tax enforcement and

¹ Elaine Doyle, Kieran Gallery and Mary Coyle 'Procedural Justice Principles and Tax Compliance in Ireland' (2009) (8) 1 Journal of Finance and Management in Public Services.

² Kamal Ahmed, 'Let's recognise how much tax firms already pay' *The Telegraph* (9 March 2013).

³ The tax gap is the difference between the actual tax revenue which is meant to be collected from what is actually collected.

⁴ John Obi Anyaduba, Emmanuel Eragbhe, Prince Kennedy Modugu, 'Deterrent Tax Measures and Tax Compliance in Nigeria' (2012) (4) 11 European Journal of Business and Management 37.

deterrence measures for non-compliance in Nigeria and the United Kingdom. It is supposed that the effect of ineffective compliance and enforcement measures leads to tax evasion and avoidance. Both of these are seen as having a negative impact on national economies. The author argues that the tax reforms and existing enforcement measures in the Nigerian tax system are grossly inadequate and that there is a need for much stronger and tighter enforcement measures to be set in place in order to curb tax evasion and avoidance.

This chapter is divided into two parts. Part I discusses tax compliance and enforcement, highlighting the tax compliance determinants on corporations and briefly highlighting those for individuals. The detrimental effects of tax non-compliance, which are tax avoidance and tax evasion, will also be analysed as they negatively impact on the national economy if there are not strictly addressed. Part II will discuss and analyse the various enforcement measures utilized to combat tax evasion and avoidance by the aforementioned countries. The success and challenges of these will be analysed with the view to present recommendations for future best practises.

PART I

5.1 Compliance and Deterrence

In medieval times, it was perceived that people were more inclined to pay tax as they believed they had a moral responsibility, if not a civic duty to do so.⁵ Since that time, despite the attempts to monitor and enforce tax payment, studies conclude that there seems to be an unquantified amount lost in exchequer revenue worldwide.⁶ This could be attributable to non-compliance and ineffective enforcement of tax laws and as such, the impact of this is felt and borne by society. To overcome this, governments continuously seek to erect or create structures

⁵ Frecknall-Hughes J, *The Theory, Principles and Management of Taxation: An introduction* (Routledge 2015)

⁶ Ibid.

to detect and punish legal persons⁷ who try to deprive them of these much-needed funds.⁸ According to Selmond, this is necessary as he posits that government cannot create a tax system and then rely on the taxpayer's sense of duty to remit what they owe.⁹ Selmond further states that governments should not just set out laws; rather they should also monitor the compliance of these laws, and not leave it to the citizens to decide whether to comply with the law. No matter how much expectation is placed on taxpayers to voluntarily comply with their tax payments, a good number will willingly comply while a good number will not. Hence, the need for enforcement by the government arises.

As discussed below, there are different reasons for compliance motivations for taxpayers. Instances are seen in recent widely reported cases in the United Kingdom (UK) of tax avoidance and evasion by both individuals and corporations alike.¹⁰ Likewise in Nigeria, it has been widely reported that the 'elite' and some multinationals do not comply with tax payments or pay the right amount of tax.¹¹ This, in essence, can be attributed to some form of favouritism towards certain corporations and classes of individuals in the society by the respective governments.¹² As a result, there is a mirroring effect from the traditionally 'dutiful' taxpayers to resort to finding avenues, legal or otherwise, to circumvent tax payment.¹³ Consequently, governments have made tax payments a legal responsibility, to both their citizens and residents, with penalties for non-compliance attached to them. Despite the threat of penalties, individuals and corporations still go to great lengths to avoid and evade payment of tax. Literature seems

⁷ Legal persons in this context refer to both individuals and artificial persons in the form of corporations and businesses.

⁸ Timothy Besley T, Anders Jensen, Torsten Persson, 'Norms, Enforcement, and Tax Evasion' 2014 <<http://pareto.uab.cat/research/sempdf/applied/2014/Persson.pdf>> accessed 16 April 2014.

⁹ Joel Slemrod, 'Cheating Ourselves: The Economics of Tax Evasion', (2007) 21(1) The Journal of Economic Perspectives 25.

¹⁰ Starbucks, Amazon, Google are examples of MNCs which have been accused of tax evasion and avoidance in the UK.

¹¹ Ventures Nigeria, 'If Nigeria wants to avoid economic collapse it should tax its elite' <<http://venturesafrica.com/if-nigeria-wants-to-avoid-economic-collapse-it-should-tax-its-wealthy/>> accessed 25 July 2015.

¹² Vodafone in the UK has been accused of going into a 'sweetheart deal' with the HMRC.

¹³ Ibid note 9.

to demand that through deterrence, tax compliance will be achieved, and government revenue be assured. However, subsequent literature has debunked this school of thought, and rather argued that sociological and psychological factors, amongst others, affect tax compliance.

These competing responses raise questions about the nature and purpose of current enforcement measures and the extent to which these have succeeded. Further, the rationale behind tax compliance and enforcement measures is questioned. Additionally, the question of defining tax avoidance and evasion also becomes central to understanding issues associated with the way corporations structure their affairs through tax planning. This last question stems from the fact that lack of compliance and enforcement is equated to with tax evasion and avoidance. To better answer and discuss these questions in this thesis in relation to Nigeria and the United Kingdom, tax enforcement and compliance measures of businesses¹⁴ will be analysed. Although studies tend to research separately and discuss tax compliance and enforcement issues of individuals and businesses, in this chapter it has been chosen to bring them together. This is mainly because decisions are made for businesses by individuals and as such, studies have shown that while businesses are clearly different from individuals, both are subject to the cultural norms that may affect their decision or motivation to pay tax.¹⁵ Furthermore, individual ownership and control also filter down to the actions of corporations in paying or avoiding tax.

5.1.1 Tax Enforcement and Compliance

The importance of tax revenue and its impact on national economies has been constantly emphasised in the previous chapters. The underlying features of the good tax system; for the

¹⁴ For the purposes of this chapter, businesses will include corporations, firms, small businesses and partnerships.

¹⁵ James Alm and Chandler McClellan, 'Tax Morale and Tax Compliance from Firms Perspectives' (2012) (65) 1 *Kyklos International review for Social Sciences* 1.

purposes of providing for the sustainable wellbeing of the country should be equality, certainty, convenience of payment and economy in collection, as reflected by Adam Smith.¹⁶ With an understanding of the importance of tax revenue to economies, it is recognised that no system can function effectively without the co-operation of the majority of taxpayers, showing the extent to which compliance is important.¹⁷ In order to fully understand the impact of a tax system on a national economy, it is important to understand the ‘why’ and ‘who’ of tax compliance.¹⁸ Lack of compliance by taxpayers leads to governments losing revenue and to circumvent this, tax systems are designed with enforcement measures that are intended to enhance compliance. Thus, maximum revenue is ensured¹⁹ and at the same time, the tax system becomes sustainable.

Compliance and enforcement of tax laws have been widely researched in developed countries and currently the widely reported incidences of corporate and individual tax avoidance and evasion has highlighted the need to tighten loopholes that corporations and individuals use to either evade or avoid tax payment. Both enforcement and compliance are intertwined and often overlap, and this may be because traditional approaches to tax enforcement assume that taxpayers are generally non-compliant and therefore pay taxes only to avoid legal sanctions that may apply.²⁰ This recognises tax enforcement as laws that deal with penalties and the probability of detection if there is no compliance.²¹ Although unlike other law agents, tax agents do not start from a crime and work forward, rather they tend to start from the back,

¹⁶ R Heilbronger, *The Essential Adam Smith* (Oxford University Press 1986), in Jeff Pope and Margaret McKercher, ‘Understanding Tax Morale and its Effect on Individual Taxpayer Compliance’ (2011) *British Tax Review*.

¹⁷ Simon James and Christopher Nobes *The Economics of Taxation* (13th Edition 2013)

¹⁸ Benno Torgler, *Tax Compliance and Tax Morale: A theoretical and Empirical Analysis*, (Cheltenham Edward Elgar 2007).

¹⁹ A Miller, *Principles of International Taxation* (4ed. Bloomsbury Professional 2014).

²⁰ *Ibid* note 9.

²¹ James Andreoni, Brian Erard and Jonathan Feinstein ‘Tax Compliance’ (1998) XXVI *Journal of Economic Literature*.

²¹ *Ibid*.

perusing documents looking for evidence of crime.²² Further to this, tax enforcement also raises challenging issues about organizations and institutions and the extent to which the government can make laws that will be adhered to by its citizens.²³ In this sense, the extent to which there is enforcement will invariably depend on the extent to which there is compliance.

The decision on whether or not to declare one's full income to the tax authorities does not automatically provoke an enforcement reaction from the tax authorities.²⁴ To accept the above line of thought will mean that tax compliance depends solely on the risk that non-compliance will be detected and on the severity of the penalty that is imposed if this is detected. Ultimately, taxpayers have the choice between fully declaring, not fully declaring or not declaring any, of the income they have earned. If the taxpayer chooses either of the latter two, it is still at the discretion of the tax authorities whether to enforce penalties. This is usually the case with the HMRC as it has been reported to select whom to enforce and impose penalties on.²⁵ This system of selection is not necessarily random but due to high administrative costs involved in enforcement and because the HMRC would rather pursue defaulters, from whom they are certain to get back money.²⁶

Tax compliance has been cast in terms of the degree to which taxpayers comply with tax laws,²⁷ and this could be measured by the tax gap between revenue collected and revenue lost. James and Nobes, see compliance with tax law and administration as the degree to which this is implemented without the need for enforcement.²⁸ This is therefore debateable as not all individuals or corporations tend to adhere to the law or choose to comply with government

²² Ibid

²³ Ibid

²⁴ Michael G Allingham and Anger Sandmo, 'Income Tax Evasion: A theoretical Analysis' (1972) (1) Journal of Public Economics in Rethinking Tax Enforcement and Compliance.

²⁵ Ibid.

²⁶ Ibid note 9.

²⁷ Ibid note 24

²⁸ Ibid.

laws that are not always transparent. Some individuals may simply choose not to comply because they dislike or disagree with the government in power while in the case of businesses, some may feel cheated due to some more favourable conditions given with other businesses.

The OECD suggests that legislation plays a major role in achieving optimal compliance.²⁹ It advises that it is necessary to have clear-cut laws that are easy to understand and interpret, providing a solid backdrop on which tax administration can be built.³⁰ A good law increases trust and underpins the tax authorities' ability to deliver procedural fairness in the conduct of its administration. A lack of trust by the citizens increases the risk of tax non-compliance.³¹ For example in the 1990s in the United Kingdom, many of the people who refused to comply with the poll tax did not believe that the tax was fair as it did not treat people of similar income similarly.³² Consequently, if this view is to be accepted, it means that there must be a driving force behind the taxpayers needs to comply with these laws. This driving force may be transparency and fairness. In any event, the need for enforcement is still certain. Pope and McKercher propose that compliance occurs when the taxpayer fulfils all of their legal obligations, including filing of the required returns on time and reporting the relevant tax liability accurately and in accordance with the prevailing condition.³³ In trying to understand their definition for compliance, what comes to mind is the question of the taxpayers that do fill their required returns but do not return them by the stipulated time.³⁴ One could argue that as

²⁹ OECD Forum on Tax Administration and Compliance Sub-Group Compliance Risk Management: Managing and Improving Tax Compliance 2004 <<http://www.oecd.org/tax/administration/33818656.pdf>> accessed 17 July 2015.

³⁰ Ibid.

³¹ Ibid.

³² Cullis JP Jones and Morrissey, G 'The Charge of the Tax Brigade: A Case Study of Government Failure and Tax Reforms', (1993) European Journal of Political Economy 9, Managing and Improving Tax Compliance

³³ Jeff Pope and Margaret McKercher, 'Understanding Tax Morale and its Effect on Individual Taxpayer Compliance' (2011) British Tax Review.

³⁴ Recently in the UK, the HMRC has decided not to impose the £100 fine on people who have reasonable grounds for filing their returns late. This most probably has been done in the bid to be proportionate and fair but perhaps truly as their penalty and enforcement measures do not reflect their objectives in line with the taxpayer behaviour. No £100 fine for late tax returns, says HMRC <<http://www.bbc.co.uk/news/uk-32941425>> accessed on 12 July 2015.

long as the taxpayer still declares and completes the required returns even if late, compliance will still be deemed as being effected. Different factors contribute to the extent to which compliance is executed, and in essence, determines the nature and the extent of enforcement measures. It has been argued that tax morale and ethics play a significant factor in tax compliance.³⁵ These and other theories will be discussed to understand better how these affect both tax compliance and enforcement.

5.1.2 Determinants of Tax Compliance - *to pay or not to pay*

5.1.2.1 Deterrence

One of the earliest theories of compliance was developed by Allingham and Sandmo,³⁶ who proposed this theory based on Becker's theory and model of economic crime.³⁷ With the aim of understanding why individuals committed economic crimes, Becker, through his reasoning found what essentially became the first theory of economic crime. He theorised that criminals were rational, purposive actors who maximised utilities subject to constraints.³⁸ In a simple way, he stated that the underpinning or underlying motivation for committing a crime is determined by the penalty a criminal expects to face which is the probability of being punished if caught. Relating to this study, if the taxpayer, assumes or believes that the severity of his being non-compliant is not high, there may be the overall tendency to be non-compliant. The deterrence theory advocates that taxpayers are economically rational, and therefore are motivated entirely by maximising personal gain.³⁹ In other words, taxpayers weigh and decide whether and the extent to which they will either evade or avoid taxes in the same way they will

³⁵ James Allen and Benno Torgler, 'Do Ethics Matter? Tax Compliance and Morality' (2011) 101 (4) Journal of Business Ethics 635.

³⁶ Ibid 24.

³⁷ Ibid.

³⁸ Gary S Becker, 'Crime and Punishment: An Economic Approach' (1974) National Bureau of Economic Research, < <http://www.nber.org/chapters/c3625.pdf> > accessed on 8 May 2016.

³⁹ Ibid note 1.

approach risky decisions.⁴⁰ Whatever decisions they arrive at are greatly influenced by the possible legal penalties imposed by law.⁴¹

Proponents of deterrence theory believe that the only way to encourage compliance is for regulators to increase audit probabilities and impose sanctions and penalties for tax evaders. They may have assumed that the fear or threats of penalties and audits will motivate taxpayers to desist from tax evasion and rather comply. This notwithstanding, both individuals and firms have been seen to strive to dodge tax payments either legally or illegally. Although this theory has garnered support over the years;⁴² more recently due to a number of factors, studies have discovered that there are social and behavioural factors that could motivate tax compliance. In other words, penalties and audits alone do not essentially motivate tax compliance. Recently, Her Majesty's Revenue and Customs (HMRC) has added its voice to this by acknowledging that despite their penalty regime being intended to influence customer behaviour, the current way of managing penalties does not meet their objective of being clear, cost-effective, fair and proportionate.⁴³ The main objection to deterrence is that it significantly over-predicts non-compliance especially if the probability of audits and penalties are low or inconclusive.⁴⁴

5.1.2.2 Tax Morale

The negligible impact of the deterrence theory during the 1990s fuelled further studies in order to understand how social, behavioural and psychological variables impacted on tax compliance.⁴⁵ Torgler is certain that there is a necessity to analyse tax morale, as studies in the

⁴⁰ Ibid note 9 at 35.

⁴¹ Ibid.

⁴² CM Fischer, M Wartick and MM Mark, 'Detection probability and Taxpayer Compliance: A review of the Literature' (1992) 11(1) *Journal of Accounting Literature*, Beck P, Jon D and Jung WO, 'Experimental Evidence on Taxpayer Reporting under Uncertainty' (1991) 66(3) *The Accounting Review*.

⁴³ HMRC, 'No £100 fine for late tax returns, says HMRC' < <http://www.bbc.co.uk/news/uk-32941425> > accessed on 12/06/2015.

⁴⁴ Michael Hallsworth, 'The Use of Field Experiments to Increase Tax Compliance' (2014) 30(4) *Oxford Review of Economic Policy*.

⁴⁵ Ibid at note 7.

1990s concentrated on displaying tax compliance as “why so many individuals pay their taxes” and not “why people evade taxes”.⁴⁶ Likewise, Alm proposes that governments should focus on why taxpayers pay the tax rather than why they do not pay tax.⁴⁷ This way, tax authorities will be better equipped in assisting and encouraging tax compliance.⁴⁸ Furthermore, Elffers also noted that compliance could not be explained entirely by the level of enforcement.⁴⁹ Countries set the levels of audit and penalty so low that most individuals would evade taxes if they were rational because it is unlikely that cheaters will be caught and penalized.⁵⁰ Nevertheless, a high degree of compliance is observed. These variables are comprised of factors such as norms, religion, economic factors, justice and fairness and trust in the government (tax system) amongst others.

Following this school of thought, Torgler argues that to understand tax morale, there must be moral rules and sentiments.⁵¹ Morale rules stems from a belief in religion and if Torgler’s view is to be accepted, it then means that taxpayers could be perceived to be religious or have some belief in something that will enforce the moral obligation to comply with taxation. The extent to which this is true is subjective in the sense that a good number of people could say that they do not subscribe to any religion nor believe in anything. In addition to moral rules and sentiments, he also maintains that there must be fairness and trust between the taxpayer and the government. He argues that where there is a lack of trust between the government and

⁴⁶ Benno Torgler, ‘The Importance of Faith: Tax morale and religiosity’ (2006) 61(1) Journal of Economic Behaviour and Organization 81.

⁴⁷ James Alm, ‘Measuring, Explaining, and Controlling Tax Evasion: Lessons from Theory, Experiments, and Field Studies’ (2012) 19 International Tax and Public Finance.

⁴⁸ Ibid.

⁴⁹ H Elffers *Income Tax Evasion: Theory and Measurement* (Amsterdam Kluwer 1991) in Benno Torgler, ‘The Importance of Faith: Tax morale and religiosity’ (2006) 61(1) Journal of Economic Behaviour and Organization 81.

⁵⁰ J Andreoni, B Erard and J Feinstein, ‘Tax Compliance’ (1998) Journal of Economic Literature in Benno Torgler, ‘The Importance of Faith: Tax morale and religiosity’ (2006) 61(1) Journal of Economic Behaviour and Organization 81.

⁵¹ Ibid note 46.

taxpayers, there usually is a lack of compliance.⁵² Feld and Frey seem to support this school of thought as they maintain that where there is a respectful and trusting relationship between the government and the citizens, tax authorities will merely act as a customer service institution providing help and support to taxpayers in fulfilling their duties.⁵³ They suggest that treating citizens respectfully can be expected to be more pronounced in polities with constitutional provisions for direct voter participation, for example referenda and initiatives. This is because both taxpayers and tax authorities know that voters support public policies that clearly sustain the public good.⁵⁴

Kornhauser has a broader view and argues that tax morale includes procedural justice.⁵⁵ In recent times, more studies have been done to include the impact of religiosity as tax morale on tax compliance. Torgler, found through research using world values survey data for 1995-1997, that there is a high impact on tax compliance based on religiosity.⁵⁶ Empirical findings from his research support the school of thought that promotes the incorporation of non-economic factors into the analysis of tax compliance.⁵⁷ He summarizes that tax morale and tax compliance are only functions of opportunity to evade taxes, tax rates, and are a probability of detection.⁵⁸ Equally, Richardson, also found that tax evasion is reduced where taxpayers have high religious faith.⁵⁹

⁵² Benno Torgler and K Murphy, 'Tax morale in Australia: What shapes it and has it changed over time?' (2005) 58 Australian National University Working Paper.

⁵³ Lars P Feld and Bruno S Frey, 'Trust breeds trust: How taxpayers are treated' (2002) 3(2) Economics of Governance 10.

⁵⁴ Ibid at page 11. Looking at countries such as Nigeria and Greece where there is a high rate of non-compliance, it has been suggested that this is due to a lack of trust between the citizens and the government in that the government allows for unfairness in taxation and the tendency of allowing rich individuals and corporations to get away with non-payment of tax.

⁵⁵ Marjorie E Kornhauser, 'A Tax Morale Approach to Compliance' Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers <http://taxprof.typepad.com/taxprof_blog/files/Kornhauser.pdf> accessed 12 June 2012.

⁵⁶ Ibid note 50.

⁵⁷ Ibid note 38.

⁵⁸ Ibid.

⁵⁹ Ibid note 40.

Similarly, Erikume suggests that in Nigeria, religion plays a role in sensitizing citizens of their moral obligation to pay tax.⁶⁰ He suggests that religion is pivotal in achieving tax compliance in Nigeria as it shapes the principles of what people consider right or wrong.⁶¹ Interestingly, this religious phenomenon has not deterred corrupt practices from the citizens. A question that comes to mind is whether the tax advisers, lawyers and directors of the MNCs and corporations in Nigeria share the same ideology concerning having a morale for paying tax. Digressing a bit from MNCs an interesting concept in Nigeria is noted: despite an apparent biblical mandate for tax compliance,⁶² certain Nigerian religious leaders have been accused of not being compliant with tax payments.⁶³ Furthermore, the business activities of some of these religious institutions are said to amount to trade⁶⁴ while channelling their funds into avenues that will generate more revenue. Despite this business structure, they still reject paying tax as they state that their business still falls under Sec.23(c) CITA and are therefore exempted. If this is correct then it clearly is tax evasion and avoidance. This then vetoes Erikume's notion of a religious incentive and highlights an imminent need for a review of this section to address this issue.

⁶⁰ Kenneth Erikume, 'Taxation and Governance -part 2 (Religious leadership)' <<http://www.pwc.com/ng/en/assets/pdf/tax-bites-june-2016-part-2.pdf>> accessed 14 September 2016.

⁶¹ Ibid.

⁶² The Holy Bible, Good News Translation, Mark 12:13-17 **The Question about Paying Taxes** ¹³ Some Pharisees and some members of Herod's party were sent to Jesus to trap him with questions. ¹⁴ They came to him and said, "Teacher, we know that you tell the truth, without worrying about what people think. You pay no attention to anyone's status, but teach the truth about God's will for people. Tell us, is it against our Law to pay taxes to the Roman Emperor? Should we pay them or not?" ¹⁵ But Jesus saw through their trick and answered, "Why are you trying to trap me? Bring a silver coin, and let me see it." ¹⁶ They brought him one, and he asked, "Whose face and name are these?" "The Emperor's," they answered. ¹⁷ So Jesus said, "Well, then, pay to the Emperor what belongs to the Emperor, and pay to God what belongs to God." And they were amazed at Jesus.

⁶³ Certain pastors such as David Oyedepo and Chris Oyakhilome have been reported to avoid tax. See Reuters, 'Insight - Nigeria's 'megachurches': a hidden pillar of Africa's top economy' <<http://uk.reuters.com/article/uk-nigeria-megachurches-insight-idUKKCN01104B20141012>> accessed 15 September 2016.

⁶⁴ Section 23 (c) CITA allows for the exemption of religious and educational institutions of a public character as long as the profit does not arise from a trade. See Appendix B.

5.1.2.3 Ethics

Another factor to be considered in line with tax morale is ethical code. In recent years, various incidents have demonstrated that businesses and individuals are constantly confronted with various moral problems especially in taxation matters.⁶⁵ Hogan, defined ethics as normative systems of rules of conduct developed to provide guidance in social or interpersonal settings.⁶⁶ This guidance has long since surpassed social and interpersonal settings and has overlapped onto business settings. While it is expected that ethics may help regulate the relationships of humans with one another and individual human affairs, in business settings it is expected to act as a form of conscience in activities undertaken by businesses especially in taxation matters.

In their argument that individual and business compliance extends far beyond deterrence, Alm and Torgler, argue that the taxpayer is not an intrinsic selfish and self-interested individual as portrayed in the standard neoclassical paradigm of tax evasion.⁶⁷ Rather, they are often motivated by many other factors that have as their main foundation some aspects of morality, social norms, altruism, fairness, or the like, all of which can be classified ethics.⁶⁸ A study that investigated tax ethics as a possible explanatory variable of tax compliance arrived at results that indicated that individual moral beliefs are highly significant in tax compliance decisions.⁶⁹ They found amongst their sample that if tax evasion is seen as a moral issue, individuals are less likely to evade taxes regardless of the tax situation.⁷⁰

Recent avoidance and evasion scandals have helped raise both public and business awareness of the importance of corporate compliance. Emphasis on compliance, business ethics and

⁶⁵ These incidents are generally tax evasion and avoidance

⁶⁶ Hogan Robert. 'Moral Conduct and Moral Character: A Psychological Perspective' Psychological Bulletin 79 (April, 1973) in Philip MJ Reckers, Debra L Sanders and Stephen J Roark in 'The Influence of Ethical Attitudes on Taxpayer Compliance' (1994) 47 National Tax Journal 826.

⁶⁷ James Alm and Benno Torgler, 'Do Ethics matter? Tax compliance and Morality' (2011) 101(4) Journal of Business Ethics.

⁶⁸ Ibid.

⁶⁹ Philip MJ Reckers, Debra L Sanders and Stephen J Roark in 'The Influence of Ethical Attitudes on Taxpayer Compliance', (1994) 47 (4) National Tax Journal 833.

⁷⁰ Ibid

corporate responsibility forces business owners to question how their business can serve the common good.⁷¹ Studies show that ethical values and common moral conceptions not only strengthen the effectiveness of compliance programmes but also help to promote positive behaviour. Moral values have a greater influence on behaviour than control or sanction mechanisms and the effects are shown in areas where there are no legal provisions or regulations.

An example of a country that has strong ethical codes that have become embedded in businesses is Germany. German law requires the monitoring of ethical misconduct risks. An example can be found in the ‘Gesetz zur Kontrolle und Transparenz im Unternehmensbereich’ (KonTraG) which is the Control and Transparency in Business Act. For corporations, values provide long-term security, orientation and a sense of identification with a company’s resident country, which can help strengthen confidence in the event of a critical situation. The introduction of value based compliance management encourages employees to be lawful, rational and moral.

To successfully achieve sustainable and quality administrative compliance, using strategies based on enforcement measures alone may well be a reasonable starting point. However, they are not a good ending point for closing the tax gap. Instead, what is needed is a multi-faceted policy approach that emphasises enforcement, at the same time emphasising morale and ethics.

5.1.3 Breakdown of Factors Determining Compliance

According to Frey,⁷² the motivation for individual compliance lies in their intrinsic motivation known as tax morale.⁷³ He maintains that tax morale includes variables such as cultural,

⁷¹ Norton Rose Fulbright LLP Business ethics and anti-corruption in Germany<<http://www.lexology.com/library/detail.aspx?g=cd5bf279-44e2-4843-b35c-75c04fb42652>> accessed 03 August 2015.

⁷² Bruno Frey ‘Pricing, regulation and Intrinsic’ in James Alm and Chandler McClellan, Tax Morale and Tax Compliance from firms’ perspectives (2012) (65) 1 *Kyklos International review for Social Sciences* 1.

⁷³ Ibid.

societal and individual norms.⁷⁴ From this, it can be inferred that if taxpayer values are influenced by cultural norms and values, and this at the same time affects a taxpayer's inclination to either pay or not pay taxes through their respective tax morale, then tax morale is classified as an important determinant of taxpayer compliance.⁷⁵

The issue of non-compliance of individuals and corporations has been worrisome for the Nigerian government especially in the wake of an economic recession. A recent survey by PwC Nigeria, found that the low level of compliance is attributed the incoherent fiscal policies, cumbersome and inefficient tax administration, ambiguities in the tax laws and lack of transparency and corruption in the tax system which has led to tax evasion and avoidance.⁷⁶

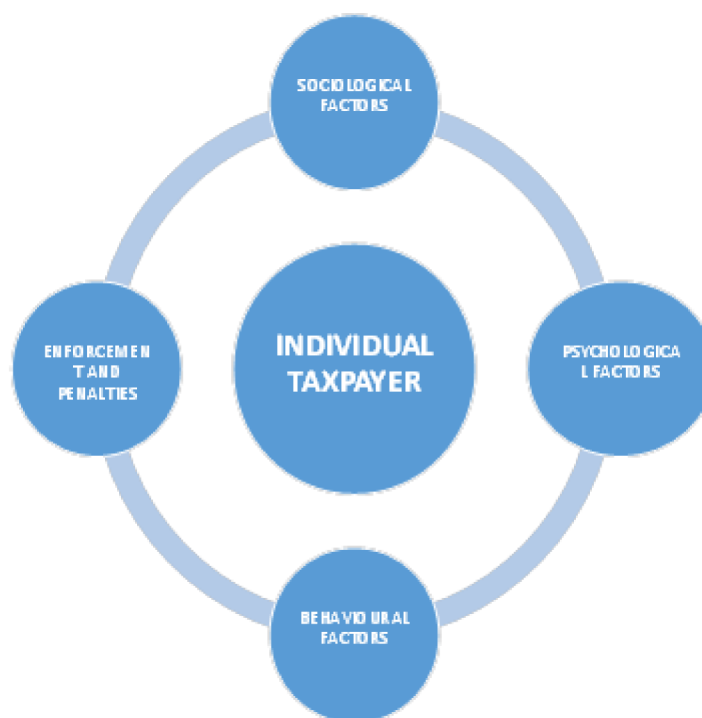


Figure 4: These factors represent different motivations of individual taxpayers.

⁷⁴ Ibid.

⁷⁵ Ibid note 72.

⁷⁶ Tawio Oyedele, 'Guess how many Nigerians pay tax and how our government spends the money' PwC Nigeria < <http://www.pwc.com/ng/en/assets/pdf/tax-watch-june-2016.pdf> > accessed 14 September 2016.

Source: ⁷⁷ Author compiled.

As seen in figure 4, when brought together, these factors or variables help explain and create understanding for the influences on individual taxpayer behaviour in the bid to create a successful framework of compliance treatment strategies. Thus, it is expected that tax authorities should consider these factors while dealing with their taxpayers. However, where compliance is based strictly on the deterrence approach, and is predicated on the idea that compliance depends upon enforcement, it means that the government can encourage greater tax compliance by increasing the audit and the penalty rates, which will not create a friendly atmosphere for taxpayers.⁷⁸ Therefore, it implies that this strict view does not induce adequate compliance; rather it seems to encourage taxpayers to seek for avenues not to comply with taxes, as far as they can get away with it. The best way of ensuring compliance, as proposed by Freedman is to create a relationship based on trust between the tax authority and taxpayers. By introducing trust, the taxpayer will have greater motivation to comply. In a country like Nigeria, which has a history of adversarial litigation, touting and corruption in its collection and enforcement of tax payments,⁷⁹ entrenching the idea of trust in its tax policies will be achieved in adding compliance.

Although some individual perspectives of deterrence and tax morale compliance behaviour can be attributed to that of businesses, corporate decision makers' views may or may not reflect that of individual taxpayers. This is mostly due to their artificial nature. In terms of religiosity, businesses could be said not to have religious beliefs; although it can be appreciated that some businesses do have religious affiliations as well as having their cultures influenced by their

⁷⁷ Judith Freedman, 'We should create a tax system that reassures the public', (Financial Times 9 February 2016) <<http://www.ft.com/cms/s/0/12e5ea38-cf10-11e5-831d-09f7778e7377.html#axzz4FX9MSNBL>> 22 July 2016.

⁷⁸ Ibid note 67.

⁷⁹ Ade Ipaye, 'Multiple Taxation: Lagos State Government Assessment and Response', an address to European Union (EU) Business Meeting (2010) in Olumide K Obayemi, 'Tax Litigation in Nigeria and A Review of Nigerian Court Decisions on Taxation' (2014) Research Journal of Finance and Accounting 5.

founders and owners.⁸⁰ Furthermore, Ariel suggests that individuals and business taxpayers are different actors.⁸¹ Some businesses operate in groups for instance, multinational corporations (MNCs) whilst some may be partnerships or individually owned businesses. Most MNCs and some partnerships, usually hide behind the veil of limited liability while holding varying degrees of corporate responsibility.⁸² Ariel further contends that certain issues, which include, stock values and market fluctuations, are unique to businesses and not individual taxpayers.⁸³ For most SMEs, the aforementioned issues directly affect a good number of them, as the owners cannot hide behind the veil of incorporation. An example that will be discussed later in this work is the Arctic Systems case where the HMRC, took the owners of Arctic Systems to court for tax purposes.

Given the negative effect of tax evasion and avoidance, there is continued research to focus on understanding the tax compliance activities of businesses – and identifying factors that would induce compliance and reduce avoidance. As discussed previously, a significantly higher amount of research has focused on the tax compliance behaviours of individual taxpayers than that of business taxpayers,⁸⁴ despite their importance as a revenue source for the government. Joulfaian⁸⁵ contends that business of tax compliance is critical to the fiscal viability of governments, especially as a greater part of the government's tax revenues are collected and paid for by businesses.

⁸⁰ These businesses have been influenced by the religious beliefs and culture of their owners, Chick-a-lee in the US, Asher's Bakery in Northern Ireland.

⁸¹ Barak Ariel, 'Deterrence and Moral Persuasion Effects On Corporate Tax Compliance: Findings from a Randomized Controlled Trial' (2012) 50 (2) *Criminology* 27.

⁸² *Ibid.*

⁸³ *Ibid.*

⁸⁴ See generally the works of Jackson BR, and Milliron VC 'Tax Compliance Research: Findings, Problems, and Prospects' [1986] *Journal of Accounting Literature* 5, M McKercher, 'The Study of Income Tax Complexity and Unintentional Noncompliance: Research Method and Preliminary Findings (2001) ATAX, Natrah Saad, 'Tax Knowledge, Tax Complexity and Tax Compliance: Taxpayers View' (2014) 109 *Social and Behavioural Sciences* 1091.

⁸⁵ David Joulfaian, 'Bribes and Business Tax Evasion' (2009) 6(2) *European Journal of Comparative Economics*, Cattaneo University (LIUC) 227.

As argued above, deterrence plays a significant role on tax compliance and it is suggested that for businesses, this could play a major role as part of their compliance motivations. Braithwaite and Geis have suggested that, the threat of sanctions may be stronger for corporate offenders because they have a higher stake in conventional conformity, and therefore, they have more to lose if they are investigated or prosecuted for noncompliance.⁸⁶ It is argued that compliance is not only shaped by formal law enforcement, but also by informal institutions, like social norms.⁸⁷ Certain thoughts or questions come to mind whether individual and business taxpayers are to be measured in the length, which is, all of them having the same motivating influence to comply with tax. The extent to which adequate compliance by businesses could be achieved by tax authorities depends on the understanding of the factors that influence their compliance. Other than deterrence, other factors affect compliance.

Table 2: Factors influencing the compliance behaviour of businesses

General Characteristics	Factors Influencing Business Compliance Behaviour
Business Profile and Industry	Size and age of the business: this will include the human resource, capital investment etc. Industry issues such as levels of competition, seasonal factors and Infrastructure issues. Structure: sole trader, partnership, multinational corporations etc. This determines the type of tax planning and corporate structuring that businesses enter into especially to alleviate the financial burden on them.
Economic	Financial burden: If the financial burden is large and the business cannot afford it, there will be an unwillingness to comply in tax payment. This triggers the thought of where and how the business can cut down on its liability. Compliance costs: This defers between SMEs and MNCs. Despite the fact that both bear common costs in complying with tax obligations, SMEs especially in the UK have been said to bear most of the compliance costs. ⁸⁸ Compliance costs for SMEs are increased by the use of external advisors to provide advice in areas where small firm owners lack knowledge or confidence. ⁸⁹
Sociological	Attitude to government: some business taxpayers who believe that the system is unfair to them either through personal experience or the tax system itself, is more likely to exhibit an unwillingness to comply with tax payments.

⁸⁶ J Braithwaite and G Geis, 'On Theory and Action for Corporate Crime Control', in G Geis (ed.), *On White-Collar Crime*, (Lexington Books, 1982).

⁸⁷ Ibid note 24.

⁸⁸ OECD Compliance Risk Management: Managing and Improving Tax Compliance (October 2004) < <https://www.oecd.org/tax/administration/33818656.pdf> > accessed 23 November 2015.

⁸⁹ Ibid.

General Characteristics	Factors Influencing Business Compliance Behaviour
Psychological	Greed, risk, fear, opportunity to evade: some people (businesses) view noncompliance as a game and are willing to try and get away from complying with their tax payments.

Source: Adapted from Table 4.1 of the OECD Compliance Risk Management: Managing and Improving Tax Compliance.

5.2 Enforcement Measures

Governments work towards finding the best method to combat tax avoidance schemes by both large and small business and individuals. In the UK, there have been various measures designed. These include Disclosure of Tax Avoidance Schemes (DOTAS), Specific legislation, Targeted Anti-Avoidance Rules (TAAR), Retrospective legislation and litigation (in the form of judiciary) and most recently the adoption of the General Anti-avoidance Rule (GAAR) and the Foreign Account (FACTA). Unlike the UK, Ireland concentrated their efforts in making their country a more attractive environment for business. Despite their implementation of GAAR in 1989, they have implemented various legislations to combat tax avoidance, including FACTA, which they signed with the United States (US). This was perhaps a strategic move to continue the good relationship they have based on FDI.⁹⁰

Likewise, in Nigeria, various enforcement measures have been adopted to help counteract tax evasion and avoidance while fostering compliance. Unlike the two aforementioned developed countries, Nigeria still has many improvements to be made both with its enforcement measures and in terms of creating an environment that is attractive for business. These country specific avoidance measures will be discussed below.

⁹⁰A number of US corporations created subsidiaries in Ireland because of its lucrative corporation tax regime. Although the EU has recently frowned on some of the exemptions granted to these corporations and declaring them to be tax avoidance schemes.

5.2.1 Corporate Tax Enforcement Measures in the United Kingdom

Tax avoidance deprives the UK of the money it needs to fund public services and undermines public confidence in the fairness of the tax system – HMRC.⁹¹ The degree to which tax avoidance is a problem in UK tax law can be considered neither a moral nor an ethical one; as it depends on the definitions adopted by the particular scheme. As far back as 1936, the courts held sway in defining and portraying what falls under tax avoidance. This is exhibited in a range of cases from the Duke of Westminster's case⁹² through *Burmah Oil*,⁹³ *Furniss v Dawson*⁹⁴ and *Ramsay's case*.⁹⁵

In the case of the Duke of Westminster, the courts ruled in favour of the taxpayer and using Lord Tomlin's quote above, gave the illusion that the taxpayer can arrange his affairs in a way that suits him best whether or not he was against the law. This standard, coupled with rising tax rates most probably encouraged the creation of complex avoidance schemes. This probably will account for the turnabout by the courts in *Ramsay's case* where they held that the three separate steps taken by the taxpayer through tax planning was a ready-made tax avoidance scheme. Despite accepting that individually, none of the steps used by the taxpayer amounted to a sham, overall the scheme was deemed illegal because it was created to avoid the payment of tax.⁹⁶ The evolving principle from the case, known as the Ramsay principle, set a benchmark with which the courts defined what amounted to avoidance schemes that have been used over the years in tax avoidance cases to a degree of inconsistency. This inconsistency has over the

⁹¹ HMRC Tackling Tax evasion and avoidance March 2015 < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413943/Tax_evasion_FINAL_web_with_covers_and_right_sig.pdf> accessed 12 January 2015.

⁹² Ibid at note 562.

⁹³ *Burmah Oil Company Ltd v Lord Advocate* [1965] AC 75

⁹⁴ *Furniss v Dawson* [1984] A.C. 474

⁹⁵ *W. T. Ramsay Ltd. v. Inland Revenue Commissioners* [1982] A. C. 300.

⁹⁶ What forms the core of the Ramsay Principle can be found in the *Burmah Oil* case which was decided just after *Ramsay's*, this shows that *Ramsay's* case did not mark a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transaction (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax that, in the absence of those particular steps, would have been payable.

years, led the UK government to introduce specific legislations to counter tax avoidance and while some have proved successful, others have not.

The lack of success of some of this legislation could be because of the complexity of the law increasing to the point where the burden for customers in complying with the law has become a real issue.⁹⁷ It has also been suggested that the legislation does not achieve the purpose of stopping avoidance because the more detailed the rules are, the more likely it is that there will be loopholes which will be utilized by tax advisers. Invariably, this leads to more complexity. This then results in a tax system that is complex and unstable and this in turn affects the competitiveness of the UK as a prime location for business.⁹⁸ Although the HMRC will argue that once legislation has been enacted, its role is to give effect to the intention of Parliament, this can usually, only be discerned from the words of the law.⁹⁹ Lord Nolan's statement in *IRC v Willoughby*¹⁰⁰ supports this as he states,

The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability.

With the recent enactment of GAAR in the UK, the treasury is of the mind that it will offer clarity, to both taxpayers and tax authorities that currently do not exist in the Ramsay principle.¹⁰¹ The HMRC indicated that with its crackdown on avoidance schemes, the government has realised considerable revenue. In 2014, HMRC stated that of the total amount

⁹⁷ Tracey Bowler Tackling Tax Avoidance in the UK in J Freedman (ed), *Beyond Boundaries - Developing Approaches to Tax Avoidance and Tax Risk Management*. (Oxford University Centre for Business Taxation 2008) 65.

⁹⁸ Ibid. See also the Mirrlees Review 2011, which portrays the UK tax system as ... 'a jumble of tax rates, a lack of coherent vision of the tax base, and arbitrary discriminations across different types of economic activities and is regarded as one of the most complex in the world.'

⁹⁹ *ibid*

¹⁰⁰ [1995] S.T.C. 143

¹⁰¹ *WT Ramsay Ltd v IRC* [1982] AC 300 'Ramsay principle' which involves a tax avoidance scheme transaction effected via a series of steps. For it to apply, the effect of the entire series of transactions is taken into consideration and not just the tax position of each individual step.

it had raised, more than £8bn came from large businesses, £1bn from criminals and £2.7bn from tackling avoidance schemes in courts.¹⁰²

5.3 Specific Anti-Avoidance Legislation

5.3.1 *Disclosure of Tax Avoidance Schemes (DOTAS) or Disclosure Rules*

DOTAS rules form an integral part of the UK's anti-avoidance strategy. It obliges promoters and users of tax avoidance schemes to provide early information to HMRC in order to detect avoidance at an early stage and advises the taxpayer on legal steps to take.¹⁰³ In 2013, more than 2035 schemes were identified under DOTAS. This amounted to 60 changes to the law, whilst closing around £12.5 billion in avoidance opportunities. In order for a scheme to be disclosed, its main object, or one of its main objects, has to be a tax advantage.¹⁰⁴ Defining what amounts to a tax advantage is in legislation and can be objective; however the issue is whether the 'main purpose' of the scheme can be said to be created for a tax advantage and this is far more subjective. For instance, in Ramsay's case, each step of the scheme created did not amount to an avoidance scheme but when put together as a whole, it was deemed a scheme for a tax advantage. Tax advisers suspect that until there is a set definition of tax avoidance from the courts, there will always be room for interpretation.¹⁰⁵ Furthermore, tax advisers, believe that DOTAS has become the "kiss of death" for tax avoidance schemes and has pushed some promoters into providing non-DOTAS structures instead of a string of contrived structures shut down because of subsequent investigations and tribunals.¹⁰⁶

¹⁰² BBC NEWS, HMRC crackdown yields record £23.9bn in additional tax <<http://www.bbc.co.uk/news/business-27576626>> accessed 24 June 2015.

¹⁰³ William Craig, *Revenue Law* (3rd ed. Edinburgh University Press 2013).

¹⁰⁴ Ibid note at 24.

¹⁰⁵ Callum Fuller, HMRC crackdown could result in spike in non-DOTAS schemes 11 August 2014. <<http://www.accountancyage.com/aa/analysis/2359132/non-dotas-tax-avoidance-schemes-could-warp-market-for-hmrc>> accessed 24 June 2015.

¹⁰⁶ Ibid.

Despite the initial success of DOTAS resulting in a fall in notified schemes, loopholes were discovered by tax advisers who advised their clients around these rules.¹⁰⁷ The HMRC has recognised that the rules were being interpreted in such a way as to prevent registration.¹⁰⁸ Hence, the government introduced improvements to the DOTAS rules. These proposals include more detailed reporting obligations by the promoters and users of avoidance schemes, and additional obligations on promoters who have incurred a penalty for a serious failure to comply with DOTAS in the past. Most recently, the Government legislated changes to the DOTAS rules to identify users of certain Stamp Duty Land Tax avoidance schemes more effectively.¹⁰⁹

5.3.2 Foreign Account Tax Compliance Act (FATCA)

As part of the US worldwide initiative covering all trading nations, the US and the UK in 2013 entered into an intergovernmental agreement known as FATCA, which sets out the obligations of UK, based financial institutions. This has been introduced as an anti-avoidance and evasion measure by the US to prevent the avoidance of tax by US taxpayers holding assets through overseas entities.¹¹⁰ Both countries entered into an intergovernmental agreement (IGA) which sets out the due diligence and reporting requirements for financial institutions based in the UK.¹¹¹ In carrying out this due diligence, financial institutions are required to determine if an account is a US based reportable account.¹¹² As this is a relatively new Act, the first registration by financial institutions at the HMRC started mid-October 2014 and the first returns was filed by May 2015.¹¹³ So far, tax advisers have been monitoring the implementation of FATCA and

¹⁰⁷ Ibid

¹⁰⁸ Ibid.

¹⁰⁹ HMRC, 'Tackling tax avoidance' Issue Briefing September 2012 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/89029/briefing-avoidance.pdf> accessed 06 February 2014; Tackling Tax Avoidance' issue briefing March 2015<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413943/Tax_evasion_FINAL_web_with_covers_and_right_sig.pdf> accessed 20 September 2016.

¹¹⁰ Ibid at 25.

¹¹¹ Ibid.

¹¹² Ibid.

¹¹³ Pat Sweet, Accountancy Live, HMRC launches online FATCA reporting service <<https://www.accountancylive.com/hmrc-launches-online-fatca-reporting-service>> accessed 24 June 2015.

waits to see how the courts will interpret this. At the time of concluding this thesis, the HMRC has withdrawn its detailed guidance on registering for FATCA and replaced it with an automatic Exchange of Information registering and exchange guidance.¹¹⁴

The UK is not the only developed country that has signed on to FATCA. Similarly, Ireland signed their FATCA with the US in 2010. as with the other countries who signed with FATCA, its main purpose is to ensure the US Inland Revenue Service (IRS) can identify and collect tax from US citizens and residents holding financial assets outside the US.¹¹⁵

5.3.3 General Anti-Avoidance Rules (GAAR)

The GAAR was introduced in July 2013 with the Finance Act for tax purposes; in March 2014, it was introduced for National Insurance Contributions (NICs).¹¹⁶ GAAR is intended as an additional deterrent to taxpayers entering into specific arrangements as it provides an additional weapon in HMRC's armoury to counter what it considers abusive tax avoidance.¹¹⁷ It is specifically designed to counteract and deter the use of abusive tax arrangements. Existing tax penalty rules can already apply to tax arrangements that come within the GAAR.¹¹⁸ These rules are set out in Schedule 24 of the Finance Act 2007, and can apply where a taxpayer has failed to take reasonable care in completing their tax return or has deliberately submitted an incorrect tax return. The GAAR will act as a deterrent to those engaging in artificial and abusive avoidance schemes by improving HMRC's ability to tackle schemes successfully.¹¹⁹ These

¹¹⁴ HM Revenue & Customs, 'Automatic Exchange of Information, Tax compliance and Tax agent and adviser guidance' < <https://www.gov.uk/government/publications/foreign-account-tax-compliance-act-registration-guidance-fatca> > accessed 25 September 2016.

¹¹⁵ Revenue, Irish Tax and Customs, Automatic exchange of Information < <http://www.revenue.ie/en/business/aeoi/index.html> > accessed 24 June 2015.

¹¹⁶ Her Majesty's Revenue and Custom, Tax avoidance: General Anti-Abuse Rule < <https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules> > accessed 24 June 2015.

¹¹⁷ Dixon Wilson chartered accountants The UK's New General Anti-Abuse Rule < <http://www.dixonwilson.co.uk/wp-content/uploads/2013/07/The-UKs-new-General-Anti-Abuse-Rule-GAAR-V2.pdf> > accessed 24 June 2015.

¹¹⁸ Ibid.

¹¹⁹ Ibid.

tests apply equally to tax returns submitted by taxpayers who have used an abusive tax avoidance scheme, which is counteracted under the GAAR.¹²⁰

The success of GAAR is an issue that has been debated especially as the body tasked with enforcing the rule has been distinctly quiet; despite claims that companies and their accountants are perpetrating tax avoidance on an 'industrial scale'.¹²¹ According to Patrick Mears who chairs the GAAR panel, neither the panel nor the HMRC is currently reviewing any cases; and have not been alerted of any in progress. If the accusations towards Price Waterhouse Cooper and HSBC are valid, one will wonder why the panel and HSBC have not persecuted either or both of them.¹²² While there has been a distinct absence of public activity by the GAAR panel, Mears feels the rule is having an effect, but that the threat to avoiders is functioning on a conceptual, Damoclean level, ahead of the more active deterrents to come.¹²³

According to Trades Union Congress (TUC), the GAAR is inundated with deficiencies, one of which is that it only tackles tax abuse that is so narrowly defined that the number of occasions on which the Rule will be used will be rare. In addition, the test for deciding when the Rule can be used is awkward that it is considered GAAR will be hard to use.¹²⁴ It is worthwhile to consider the extent to which Ireland has fared with the GAAR and if it has served its purpose since its adoption. Ireland adopted its GAAR in 1989 and it is now incorporated into the Taxes Consolidation Act 1997.¹²⁵ The Irish GAAR seeks to target transactions that give rise to a tax

¹²⁰ Ibid When the GAAR was being developed, having GAAR-specific penalties was raised, but the Government concluded that it was not the right time to introduce such a penalty. With GAAR now being in place for 18 months and taxpayers and advisers having had time to consider the published guidance and absorb a range of published material, the government now wants to consider the adoption of GAAR-specific penalties.

¹²¹ Callum Fuller, Interview: GAAR is ready for action, panel chairman Mears says, Accountancy Age < <http://www.accountancyage.com/aa/interview/2395748/interview-gaar-is-ready-for-action-panel-chairman-mears-says> > PWC has been accused by the Public Accounts Committee in the Commons of promoting corporate tax avoidance on an "industrial scale" while HSBC helped thousands of wealthy clients cheat HM Revenue & Customs of millions in tax.

¹²² Ibid.

¹²³ Ibid.

¹²⁴ For a comprehensive brief of the GAAR deficiencies, see TUC, The Deficiencies in the General Anti- Abuse Rule, <https://www.tuc.org.uk/sites/default/files/GAAR.pdf> accessed 24 June 2015.

¹²⁵ Taxes Consolidation Act 1997.

advantage and are undertaken primarily to obtain that tax advantage. TCA 1997 s811C (3) states that, “A person shall not be entitled to any tax advantage arising out of or by reason of a tax avoidance transaction to which this section applies”.¹²⁶ Despite having adopted the GAAR since 1989, the Revenue authorities continued to introduce specific legislation to block what it regards as abusive anti-avoidance schemes. This would mean that if the GAAR had been working, introducing further legislation would not be necessary. In addition, it was not until 2011 that the Irish Supreme court delivered its first judgement in the first case brought before it.¹²⁷

The taxpayers in the O’Flynn case sought to avail itself of the export sales relief, now defunct in Ireland, whereby profits earned from qualifying exports would be exempt from corporation tax. Greatly simplified, the taxpayer developed a scheme – which involved over 40 steps – whereby a construction company, lacking a background in export sales, paid a tax-free dividend out of its distributable reserves by benefitting from bought-in export sales relief.¹²⁸ The Supreme Court held that the transactions executed by the taxpayer infringed the GAAR. The court upheld the argument of the Revenue Commissioners that the use of specific relief provisions by the taxpayers amounted to a misuse or abuse of those provisions, having regard to the purpose for which the relief was provided.¹²⁹

The Irish GAAR gives Revenue vast power to overturn a transaction, or a series of transactions while at the same time giving them a considerable work to do.¹³⁰ This work is mostly because legislation does not describe what the Revenue can and cannot consider and thereby making it impossible for Revenue to formulate a substantive opinion that can withstand the inevitable

¹²⁶ Ibid.

¹²⁷ Revenue Commissioners v O’Flynn Construction Ltd and Others [2011] ITR 113.

¹²⁸ Ibid.

¹²⁹ Ibid

¹³⁰ Brian Keegan, ‘Irish Experience of an Anti-Avoidance Rule (GAAR)’, [2011] The Journal of the Global Accounting Alliance.

appeals through the courts.¹³¹ Revenue cannot cast a sceptical eye if the transaction is done with a view to making profit in the course of normal business activities. Nor can the Revenue look askance at schemes to avail of statutory tax reliefs, unless the relief is being misused or abused. It has remained far easier for Revenue to block certain types of transaction that they regard as tax avoidance rather than have recourse to section 811 to challenge their operation in individual cases.¹³²

5.3.4 General avoidance measures by the HMRC

In addition to legislation, the HMRC uses vigorous administration, a refusal to compromise on litigation and ‘propaganda’.¹³³ This is done by naming and shaming serial avoiders in the bid to deter them from avoiding tax further.¹³⁴ Additionally, they still show willingness to accept settlement on a basis that includes full-tax interest and either no penalty or only nominal penalties, on the promise that after a certain date, the offer is withdrawn and full penalties are sought.¹³⁵ Whilst tackling tax avoiders such as MNCs and wealthy individuals who are most likely to engage in tax avoidance, the HMRC seeks to reduce tax avoidance by developing an open and co-operative relationship with these taxpayers, using customer relationship managers.¹³⁶ These customer relationship managers are responsible for knowing the taxpayer’s business and tax affairs thoroughly, understanding the avoidance risks they pose and co-ordinating HMRC’s interventions.¹³⁷

¹³¹ Ibid.

¹³² Ibid.

¹³³ Her Majesty’s Revenue and Custom, Strengthening Sanctions for Tax Avoidance <
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/399823/Strengthening_sanctions_for_tax_avoidance_-_consultation_document.pdf> accessed 24 June 2015.

¹³⁴ Ibid.

¹³⁵ Ibid.

¹³⁶ Ibid.

¹³⁷ Ibid.

5.4 Corporate Tax Enforcement and Deterrence Measures in Nigeria

Due to low compliance in Nigeria, the contribution of the CIT has consistently remained low. At present, Nigeria's revenue from CIT is 7percent of its GDP, which is low compared to other developing and emerging economies like Ghana whose revenue from CIT is 21percent of its GDP.¹³⁸ It has been highlighted that enforcement of corporation tax is inevitable in Nigeria due to the ingenuity of taxpayers in either fully or partially complying with their tax payments.¹³⁹ A study undertaken in Nigeria, which investigated the reason behind tax evasion and avoidance, suggested that the low level of compliance by the corporate taxpayers could be attributed to the lack of accountability, and inadequacies of tax administration procedures and structures.¹⁴⁰ This relates the lack of compliance to a perceived lack of trust in the government and administration. Another study also noted that the low and shrinking tax compliance could be attributed to poor governance, corruption and the poor tax service quality.¹⁴¹ Fagbemi adds that corruption of the government and tax officers has contributed to the high level of tax evasion in Nigeria and that transparency of the government will lead to a scenario to induce compliance.¹⁴² One of the effects of corruption is that taxpayers are not certain that the tax they have paid will be used to finance public goods and services, which then decrease their willingness to comply. Furthermore, with corruption, if the taxpayer believes that the cost of bribing a tax official is lower than the tax, the possibility of them offering the bribe is high. An example of this was seen in the case study of CNL above.

¹³⁸ John Obi Anyaduba, Emmanuel Modugu and Prince Kennedy, 'Deterrent Tax Measures and Tax Compliance in Nigeria' (2012) 4(11) *European Journal of Business and Management* 38.

¹³⁹ Ibid.

¹⁴⁰ TO Fagbemi, SO Ajibolade, SA, Arowomole and MF Ayadi, 'Repositioning the Nigerian Tax System for Sustainable Development: Role of Business Taxpayers' Perception of the Company Income Tax Administration' (2011) 12th Annual International Academy of African Business and Development Edmonton: International Academy of African Business and Development 42.

¹⁴¹ U Akpo, 'The People as Government: The Importance of Tax Payment' (2009) Akwa Ibom State Revenue Summit. Uyo: Akwa Ibom State Internal Revenue Service.

¹⁴² TO Fagbemi, OM Uadiale and AO Noah, 'The Ethics of Tax Evasion: Perceptual Evidence from Nigeria' (2010) 17 (3) *European Journal of Social Sciences* 360.

In addition, where the taxpayers do not get a return for their tax in terms of basic services and public goods, there is a tendency of mistrust and lack of confidence in the government, which is the case in Nigeria according to Gwangdi.¹⁴³ She further maintains that the Nigerian tax laws are replete with punitive momentary measures as well as criminal sanctions but these laws are not strictly enforced.¹⁴⁴ The lack of rule of law reduces transparency of public action, and fosters distrust among citizens. As a result, taxpayers may not be willing to finance the state through taxes.

Enforcement of CIT in Nigeria is entrenched in legislation¹⁴⁵, and this empowers officers of the FIRS to enforce tax payments. The extent to which this has been achieved or served its purpose is highly debateable. Unlike the UK and perhaps other transitioning countries, Nigeria enforcement measures have not yet evolved to the same extent as the UK. Despite reforms made to the tax system especially in the area of compliance and enforcement, the FIRS have reported a sizeable loss of revenue due to lack of compliance and adequate enforcement.¹⁴⁶ It follows that there exists a large scale of tax evasion and avoidance, which is caused, by either inadequate or effective enforcement or a disinterest by the taxpayers to comply. This creates the need for firstly understanding and encouraging compliance, additionally a further reform of existing enforcement measures, and ultimately creating realistic and effective enforcement measures. The literature indicates that MNCs tend to make use of the loopholes in the existing laws to avoid tax payments. However, with events such as the fall in oil prices, the focus of the present Nigerian government is shifting increasingly towards taxation as the veritable source

¹⁴³ Maryam Ishaku Gwangdi and Abubarkar Garba, 'Administration of Companies Income Tax in Nigeria: Issues of Compliance and Enforcement' (2015) 7 (8) *European Journal of Business and Management*.

¹⁴⁴ Ibid.

¹⁴⁵ Sections 85 and 86 the Companies Income Tax Act LFN 2007.

¹⁴⁶ Nigeria Daily Trust Newspaper, 'FIRS: 30 of Firms in Nigeria evading tax' 03/09/2014 < <http://www.dailytrust.com.ng/news/business/firs-30-of-firms-in-nigeria-evading-tax/55486.html>> accessed 22 November 2015.

of revenue.¹⁴⁷ New measures are being introduced by the tax authorities to raise revenue while unprecedented fines are being imposed on corporate entities.¹⁴⁸ Presently in Nigeria, there are no specific enforcement measures against non-compliant corporations. The basic enforcement measures that are in use are analysed.

The first steps to enforcement for noncompliance for corporations in Nigeria are penalties, which are set out in CITA. Section 92 CITA, sets out a penalty of N20, 000.00 for any corporation which fails to comply with any of the provisions of the Act or of any rule made thereunder for which no other penalty is specifically provided.¹⁴⁹ The Act also empowers the FIRS to assess every corporation's chargeable tax after the expiration of the period allowed for self-assessment.¹⁵⁰ This is done by sending reminder letters to taxpayers within two months of expected due dates and the issue letters of demand or call for returns on or before the due date.¹⁵¹

As part of the reforms of the tax system, and in the bid to bring about tax compliance, self-assessment was introduced in 1991. At that time, it was optional and came with incentives to elicit compliance.¹⁵² However, in 2011, with further tax reforms, self-assessment became mandatory for all corporations. The extent to which this has achieved its means is questionable. When corporations conduct business in an environment that is not wholly conducive, in the bid to protect its profits, the company will assess itself in a manner that will be profitable for it. This clearly leaves room for tax avoidance, as it cannot be expected that corporations will always put in the right amount of tax due.

¹⁴⁷ Tawio Oyedele, 'Preparing for taxing times ahead as tax becomes the new oil' PwC Tax matters Nigeria, 17 November 2015 < http://pwc-nigeria.typepad.com/tax_matters_nigeria/2015/11/preparing-for-taxing-times-ahead-as-tax-becomes-the-new-oil.html > accessed 17 November 2015.

¹⁴⁸ Ibid.

¹⁴⁹ See section 92 CITA in Appendix B.

¹⁵⁰ See section 65 CITA in Appendix B.

¹⁵¹ Ibid.

¹⁵² Finance Miscellaneous Taxation Decree No. 2 of 1991 Laws of the Federal republic of Nigeria.

Similarly, in the UK, the Act provides tax officials with the power of distrain on any corporation that fails to comply with its payments after it has been assessed and the appropriate notice has been sent to it.¹⁵³ It further empowers the tax officials with right to call law enforcement officers to assist in this carrying out this distrain.¹⁵⁴

5.4.1 The application of FATCA as a deterrence measure in Nigeria

Nigerian financial institutions have been mandated to comply with the requirements of FATCA.¹⁵⁵ It is envisaged that this Act will help in curbing tax evasion and avoidance in the country as it serves as a means of exchange of information and as a means of collecting information about taxpayers in Nigeria and the US.¹⁵⁶ This information will be used to determine the extent of profits and illicit financial flows being transferred out the country. At present, most of the financial institutions in Nigeria that are seen as Foreign Financial Institutions (FFIs) for the purposes of FATCA, have been registered with the IRS in the US.¹⁵⁷ The difference between the FATCA in the UK and the one in Nigeria is that it falls under the Inter-Government Agreement (IGA) into which the UK and the US have entered. IGAs help reduce legal barriers to compliance and thereby lower the cost of implementing FATCA on the affected parties.¹⁵⁸ Furthermore, the US willingly exchanges information with countries with which it has entered into IGAs.

¹⁵³ Mohammed Bashir Tanko, 'Tax Law Enforcement: Practice and Procedure' (2015) 6 (7) Research Journal of Finance and Accounting.

¹⁵⁴ See section 86(3) CITA LFN 2007 in Appendix B.

¹⁵⁵ Taiwo Oyedele, 'FATCA implementation and lessons for Nigeria' PwC Tax Matters Nigeria, June 24 2014 <<http://pwc-nigeria.typepad.com/files/fatca---curbing-tax-evasion.pdf>> accessed 23 November 2014.

¹⁵⁶ Ibid.

¹⁵⁷ Ibid.

¹⁵⁸ Ibid.

5.5 International Co-operation in Tackling Tax Avoidance

5.5.1 Tax treaties as a means of enforcement

Irrespective of their traditional use for eliminating double taxation, tax treaties have been lauded for their use in the tackling tax evasion and avoidance. This thesis proposes that tax treaties are forms of effective enforcement measures through which abusive tax practices can be countered. Modern treaties that follow the OECD Model, state in their title and preamble the use of the treaty as a means of eliminating tax evasion and avoidance.¹⁵⁹ Most treaties for example in the United States (US) include limitation of benefits clauses (LOB) which contains a set of objective tests to determine when treaty benefits will be denied to taxpayers who otherwise would qualify as residents in the treaties.¹⁶⁰ In other words, the LOB provisions narrow the definition of a treaty “resident” to exclude taxpayers who lack sufficient connection with the contracting states.¹⁶¹ The LOB article singles out conduits, such as corporations and trusts, for special scrutiny and directs the countries applying the treaty to look through a conduit to determine whether its ultimate owners are themselves entitled to treaty benefits.

In the UK, the HMRC uses exchange of information arrangements (EOI) which are found in their tax treaties as a means of better assessing where there are risks to collecting the tax that is due, and where to focus on countering tax avoidance.¹⁶² Having the second largest treaty network in the world helps the HMRC in exchanging information about MNCs in so many countries.¹⁶³ By using the EOI clause in tax treaties a sense of transparency on MNC tax dealings, ownership of assets and most importantly the location and source of their profits are

¹⁵⁹ See generally, the Model treaties of the United Kingdom, United States, republic of Ireland etc.

¹⁶⁰ R Mason, ‘U.S. Tax Treaty Policy and European Court of Justice’. (2005) 58 Tax Law Review.

¹⁶¹ Ibid.

¹⁶² HM Revenue and Customs, ‘Taxing multinationals: tackling aggressive tax planning’ <<https://www.gov.uk/government/publications/issue-briefing-taxing-multinationals-tackling-aggressive-tax-planning/issue-briefing-taxing-multinationals-tackling-aggressive-tax-planning>> accessed 22 November 2015.

¹⁶³ Ibid.

projected. This will help governments counter loss of tax revenue through abusive transfer pricing arrangements.

Notwithstanding the benefits of tax treaties as a means of combatting tax evasion and avoidance, Baker stresses the danger of the improper use or abuse of tax treaties that can invariably be used for tax avoidance and evasion purposes.¹⁶⁴ These could be through treaty shopping or the use of conduit companies.¹⁶⁵

5.5.2 The Base Erosion and Profit Shifting (BEPS) Project

Within the past few years and for the first time, in the bid to tackle tax avoidance through the shift of profits from MNCs to tax haven, the G20 and OECD have collaborated on a project called BEPS. The final reports of this project were published last year and all tax administrators are due to start implementing this. The overall purpose of the BEPS project is to ‘ensure that profits are taxed where economic activities take place and value is created’.¹⁶⁶ This arose from the concern that the international tax rules that were designed more than a century ago may no longer be adequate to address the current business environment especially in the wake of tax avoidance issues by MNCs such as Google, Starbucks and Apple. The BEPS approach focuses on three broad measures; firstly, achieving a coherence in tax systems globally, secondly, providing economic substance in cross border dealings, and thirdly, introducing transparency with respect to relevant taxpayers’ data to assist revenue administrations’ tax investigation efforts¹⁶⁷

¹⁶⁴ Philp Baker, ‘Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion’ United Nations Papers on Selected Topics in Administration of Tax Treaties for Developing Countries < http://www.un.org/esa/ffd/wp-content/uploads/2013/05/20130530_Paper9A_Baker.pdf > accessed 22 November 2015 17.

¹⁶⁵ Ibid at 10.

¹⁶⁶ OECD, ‘Action Plan on Base Erosion and Profit Shifting’, (OECD Publishing 2013) <<http://dx.doi.org/10.1787/9789264202719-en> > accessed 9 May 2016; OECD, ‘BEPS 2015 Final Reports’, <<http://www.oecd.org/ctp/beps-2015-final-reports.htm> > accessed 20 September 2016.

¹⁶⁷ Ibid.

The BEPS project aims at reforming the existing international tax system. The substance of these reforms, inter alia, includes¹⁶⁸ developing and introducing model provisions to the OECD MTC through a new multilateral instrument, which is presumed to prevent treaty abuse through treaty shopping. It is expected that this will hinder the use of conduit companies in countries with favourable tax treaties to channel investments and obtain reduced rates of taxation.¹⁶⁹ Tax administrators, through standardised country-by-country reporting and other documentation requirements, will have a clearer and a more global picture of where MNCs profits, tax and economic activities are reported.¹⁷⁰ MNCs are expected to report a range of information including their revenues, pre-tax profits, income tax paid and accrued, number of employees, stated capital, retained earnings and tangible assets in each jurisdiction where they operate.¹⁷¹ This will enable tax administrators to assess transfer pricing and other risks. The project report reviews the definition of a PE in treaties to prevent the use of certain tax avoidance strategies. This review will ensure that profits are taxed where economic activities take place and value is created.¹⁷²

While the OECD lauds its achievement in producing the BEPS, the BEPS in effect does not aim to change the fundamental system of taxing MNCs. Rather, it aims at reducing the abusive form of tax planning which has led to worldwide tax avoidance and evasion.¹⁷³ With reference to the problems of the international tax system as laid out by Devereux and Vella, the issue of allocating taxing rights was not addressed. BEPS from the onset had clear limitations and this suggests that it lacks a serious analysis of the fundamental aims and the rationale for the

¹⁶⁸ For a full discussion on the on the please see the above cited note 234.

¹⁶⁹ OECD Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD (2015) <www.oecd.org/tax/beps-explanatory-statement-2015.pdf> accessed 9 May 2015.

¹⁷⁰ Ibid.

¹⁷¹ Ibid.

¹⁷² Ibid.

¹⁷³ Michael Devereux, 'Can BEPS reforms solve problems of International Tax?' <http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/summer_conference/2013/michael-devereux.pdf> accessed 9 May 2016.

taxation of multinationals' profit.¹⁷⁴ Most particular, BEPS does not address the fundamental issue of determining where MNC profit should be taxed.¹⁷⁵ The BEPS proposals address specific issues, or loopholes, but the fundamental structural weaknesses in the system will remain. For this reason, it is unlikely that such an approach can generate a stable international tax system. Hence, once again developing economies and lower income countries seem to be at the same disadvantage. Similarly, the problem of country competition, which has amounted to a race-to-the bottom in cutting rates and granting tax incentives, was not addressed. If there is to be a successful reform of the global tax system, these need to be addressed as the former set the foundation of the existing international tax system. Furthermore, as these rules are 'soft' law and therefore not legally binding until implemented by the countries, the extent to which some of the countries will do is debatable. It could be considered if this will be like the FATCA where countries are more or less wrangled into implementing the rules. Therefore, it can be concluded that BEPS does not solve the problem of tax avoidance. Although it could to an extent if heavily implemented increase compliance.

5.6 Detrimental Effects of Lack of Compliance and Enforcement

Different schemes have been used by MNCs and individuals to avoid and evade tax payments in the bid to boost profits and capital.¹⁷⁶ These schemes result in a loss of tax revenues, which undermines government legitimacy and prevents economic and social development, and invariably affects the poorest of the society.¹⁷⁷

¹⁷⁴ Ibid.

¹⁷⁵ Ibid.

¹⁷⁶ Ibid.

¹⁷⁷ Ibid.

5.6.1 Tax Evasion

Tax evasion is a violation of the law when the taxpayer refrains from reporting income from labour or capital that is in principle taxable, the taxpayer engages in an illegal activity that makes him liable to administrative or legal action from the authorities.¹⁷⁸ In evading taxes, the taxpayer may worry about the possibility of his actions being detected. Tax evasion occurs when a taxpayer's transactions result in a certain amount of taxable income, but the taxpayer declares a lower income on their return, or fails to make a return at all.

5.6.2 Tax Avoidance

According to the HMRC, tax avoidance, is the bending of the rules of the tax system to gain a tax advantage that Parliament never intended. It often involves contrived or artificial transactions that serve little or no purpose other than to produce a tax advantage. It also involves operating within the letter – but not the spirit – of the law. Similarly, Murphy defines it as seeking to minimise a tax bill without deliberate deception (which would be tax evasion) but contrary to the spirit of the law. It therefore involves the exploitation of loopholes and gaps in tax and other legislation in ways not anticipated by the law. Those loopholes may be in domestic tax law alone, but they may also be between domestic tax law and company law or between domestic tax law and accounting regulations. For example, the process can also seek to exploit gaps that exist between domestic tax law and the law of other countries when undertaking international transactions.¹⁷⁹

¹⁷⁸ Agnar Sandmo, 'The Theory of Tax Evasion: A Retrospective View', (2004) Discussion paper Norwegian School of Economics and Business Administration available at <<file:///H:/Legal%20Enforcement%20and%20Tax%20Evasion%20Chapter/The%20theory%20of%20tax%20ev%20A%20retrospective%20view..pdf>> accessed 25 November 2015.

¹⁷⁹ Richard Murphy, 'Tax Avoidance, Tax compliance and tax cheats.' Tax Research UK <<http://www.taxresearch.org.uk/Blog/2010/12/20/tax-avoidance-tax-compliance-and-tax-cheats/#sthash.2BHLT1c1.dpuf>> accessed 25 November 2015.

It is necessary that the thin line between avoidance and evasion is clear. The theoretical distinction between tax evasion and tax avoidance is assumed to centre on the legality of the taxpayer's actions that is founded on its definition.

Tax avoidance, is supposed to be within the legal framework of the tax law. It consists in exploiting loopholes in the tax law in order to reduce one's tax liability.¹⁸⁰ It is generally expected that while engaging in tax avoidance, the taxpayer has little reason to worry about possible detection however; this is quite to the contrary. It is often imperative that a detailed statement is made about transactions in order to ensure that the desired tax reduction is received.¹⁸¹ The different concepts and definitions have made it unclear as to what exactly amounts to tax avoidance and whether or not it is legal. To tackle avoidance successfully, there needs to be a distinction between evasion, avoidance, mitigation and planning. As Vella attests, by adding terms and adjectives such as "aggressive" and "abusive" does not clarify the meaning of avoidance¹⁸² rather, these words add to the complication of definition.

It is suggested that tax evasion and avoidance practices have international connections through globalisation and the mobility of capital through MNCs. MNCs in the bid to maximise their profits in their cross border transactions, tend to search for low tax regimes where they can either locate subsidiaries or head offices. Oil and gas related activities, which contribute to cross border activities, play a role in tax avoidance and evasion. To better maximise profits and escape from heavy tax burdens placed on them, such MNCs will work towards taking advantage of loopholes in laws of the host country where they are situated. Consequently, MNCs are termed to be the greatest culprits of using tax avoidance schemes as they account

¹⁸⁰ Ibid

¹⁸¹ Ibid.

¹⁸² Michael Devereux, Judith Freedman and John Vella, 'Tax Avoidance' [Report commissioned by the UK National Audit Office] (2012) 3
<http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/TA_3_12_12.pdf>
accessed 25 November 2015.

for a large part of the world's GDP, with intra-firm trade a growing proportion.¹⁸³ Additionally, they have global operating models with integrated supply chains and functions centralised at regional or world levels. Developing and developed countries globally compete to attract funds to their economies, and thereby create and offer environments either through tax incentives or various other incentives that are not tax related for FDI. These environments in turn create opportunities for MNCs to devise corporate tax structures through which they take advantage of legal loopholes to maximise profits, thereby evading and avoiding tax.

The European Union (EU) projects that the scale of its Member States losses through the increasingly aggressive use of tax-avoidance schemes by MNCs is difficult to estimate, but is considered serious.¹⁸⁴ Various methods include transfer pricing, the use of lower-tax jurisdictions, over-charging entities in higher tax countries to reduce taxable profit and (legally) completing a transaction in a lower tax country, different to the country to which the business which the business is related.¹⁸⁵ The EU Commission advised its Member States to counteract aggressive tax planning practices by MNCs that fall outside the scope of their specific anti-avoidance rules.¹⁸⁶

Countries worldwide have also been affected by tax avoidance perpetuated by MNCs and they continuously seek individually or collectively, to create different measures to combat this as tax avoidance has now become an international dilemma. It has been reported that in 2012, Amazon paid just £2.4million of UK corporation tax on UK sales of £4.2bn, which is less than the £2.5m it received in government grants.¹⁸⁷ Likewise, Thames Water paid no corporation

¹⁸³ Library of the European Parliament, Corporate tax avoidance by multinational firms [http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2013/130574/LDM_BRI\(2013\)130574_REV1_EN.pdf](http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2013/130574/LDM_BRI(2013)130574_REV1_EN.pdf) accessed 25 November 2015.

¹⁸⁴ Ibid.

¹⁸⁵ Ibid.

¹⁸⁶ Ibid.

¹⁸⁷ Margaret Hodge, 'To combat tax avoidance, tough talk is not enough', *Guardian Newspaper* (11 June 2013) < <http://www.theguardian.com/commentisfree/2013/jun/11/tax-avoidance-sickness-g8-cameron> > accessed 05 February 2016.

tax and pocketed a £5m credit from the Treasury. In an age of austerity, maximising government income is essential.¹⁸⁸ According to Action Aid, developing countries are being deprived of billions of dollars of tax revenue by wealthy corporations and investors using secretive tax havens.¹⁸⁹ There is no question that these wealthy corporations are MNCs involved in cross border transactions and investment. Otusanya argues that MNCs in Nigeria are the key actors that engage in tax evasion and avoidance and thereby facilitate in antisocial tax practices.¹⁹⁰ He argues that due to the blurred lines in the terminology of tax avoidance and evasion, MNCs have been able to evade and avoid tax payments in Nigeria.¹⁹¹ This is very acceptable as there is no definition of tax avoidance or evasion in the Nigerian legislation. This could mean that the tax planning strategies used by some MNCs in Nigeria may appear to be lawful, but if challenged will amount to tax avoidance and evasion carried out through transfer pricing.

In Africa, tax avoidance and evasion, in addition to illicit financial flows, has seen the developing and emerging economies of the continent lose more than \$50bn every year.¹⁹² This is due to illicit financial outflows as governments and MNCs engage in fraudulent schemes aimed at avoiding tax payments.¹⁹³ This causes a significant drain on government resources across the continent.¹⁹⁴

¹⁸⁸ Ibid.

¹⁸⁹ Action Aid, 'How Tax Havens Plunder the Poor', < <http://www.actionaid.org.uk/latest-news/almost-half-of-all-investment-into-developing-countries-goes-through-tax-havens>> accessed 05 February 2016.

¹⁹⁰ OJ Otusanya, *The Role of Multinational Companies in Tax Evasion and Tax Avoidance*, (University of Lagos Press 2011).

¹⁹¹ Ibid.

¹⁹² *Illicit Financial Flows*, Report of the High Level Panel on Illicit Financial Flows from Africa < http://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf> accessed 21 November 2015.

¹⁹³ Ibid.

¹⁹⁴ Ibid.

5.7 Case Study of Tax Compliance behaviour of businesses against government enforcement measures

The next section analyses through case studies, the tax compliance of businesses against enforcement measures by governments. Businesses in this context are subdivided into SMEs and MNCs, using particular case studies from Nigeria and the UK.

5.7.1 SMEs

Small firms are profoundly different from large corporations and consequently face different concerns particularly as they have limited resources in comparison with their larger counterparts specifically in terms of human and monetary capital.¹⁹⁵ With the smaller amount of human capital, SMEs are highly dependent on their key individuals' time and skills, and these are often required to multitask in order to save costs. Part of the owners' responsibility in some instances consists of handling the financial management issues of the firm. As seen from Table 2 above, the financial burden on SMEs in the form of tax liabilities and rising costs of services often leads to them restructuring their business and arranging their tax liabilities in the best way that will suit them. This has been an issue of contention between tax authorities and SME taxpayers. In the UK, several SMEs have been taken to court by the HMRC on issues regarding arrangements made in their tax structures.¹⁹⁶ The position of the courts in two different case studies will be considered.

5.7.1.1 *Jones v Garnett (Arctic Systems)*¹⁹⁷

In this case, Mr and Mrs Jones each owned one share in Arctic Systems Ltd, their family-owned company. Mr Jones was the fee-earner, as an IT consultant, and Mrs Jones dealt with the admin

¹⁹⁵Matthew Ward and Chris Rhodes, 'Small businesses and the UK economy' (2014) House of Commons Library Standard Notes SN/EP/6078 < www.parliament.uk/briefing-papers/SN06078.pdf > accessed 05 February 2016.

¹⁹⁶ Buck v HMRC [2008] SpC 716, Patmore v HMRC [2010] SFTD 1124, Jones v Garnett [2007] 1 W.L.R.2030.

¹⁹⁷ Jones v Garnett [2007] 1 W.L.R.2030.

work. Mr Jones was the sole director and chair of Arctic Systems, which enabled him to control both the day-to-day and the strategic management of the company.¹⁹⁸ However, the Jones' took very little out of the company in the way of salaries, and instead paid out the profits as dividends. Basic tax planning advises that this is the most tax-efficient way to extract cash from such a company.

However, HMRC took the view that this strategy was unacceptable tax avoidance. HMRC indicated allowing Mrs Jones to have one of the shares in a company for which Mr Jones earned all the income, and by taking a low salary so that there were more profits to distribute as dividends, Mr Jones had made a "settlement" with his wife. Consequently, Mrs Jones' income should have been taxed as if it were her husband's. This would have meant a significantly higher tax bill because Mr Jones paid income tax at 40percent, whereas his wife paid at the basic rate. Essentially, Mr Jones would have paid an extra 25percent in addition to the 40percent he was paying.

The Jones' on the other hand argued that the exemption from the "settlements" rules for "outright gifts" between spouses applied in their case. HMRC on their part argued against this on the basis that the exemption does not extend to gifts that are "wholly or substantially a right to income". Their basis for this argument was that Arctic Systems had no fixed assets and thus a share in the company was "substantially a right to income". Therefore, the right of the HMRC to overturn the payment of dividends to a spouse and treat them as her husband's income for tax purposes; thus negating the tax savings, was brought into question. The House of Lords agreed with HMRC that there was indeed a settlement but at the same time that the couple had arranged their company in such a way in order to save tax. This notwithstanding, they did not

¹⁹⁸ Ibid.

overturn the payment of Mrs. Jones despite part of the income she received being gifted by her husband.¹⁹⁹

The circumstances of this case raised a number of questions about small business taxation and compliance. Following the ruling, the government went on to introduce legislation to ensure that income splitting or shifting as the Jones' and many other SMEs often do would not continue. From the case, it is understood that HMRC argued and maintained that the arrangement carried out in Arctic Systems amounted to tax avoidance and that the SME was not tax compliant as the arrangement allowed for the right amount of tax not to be paid. Considering that the arrangement of shifting income was legally made possible by the introduction of independent taxation, it will be difficult to understand how the right amount of tax was not paid and how noncompliant the Joneses were. MNCs and SMEs alike both enter into arrangements or structures that will save them tax. The extent to which this is considered noncompliance or avoidance and evasion is a question of what HMRC and the courts deems.

5.7.1.2 Furniss v Dawson and Thames Water Utilities

In *Furniss v Dawson*²⁰⁰, the House of Lords charged that the effect of the arrangement amounted to tax avoidance and not a deferral, despite the existence of the specific tax rule on which they depended, The Dawsons owned two successful clothing companies called Fordham and Burton Ltd., and Kirkby Garments Ltd. A company called Wood Bastow Holdings Ltd. offered to buy the operating companies from the Dawsons, and a price was agreed. If the Dawsons were to sell both companies directly to Wood Bastow Holdings, they would have had to pay substantial capital gains tax (CGT).

¹⁹⁹ Ibid.

²⁰⁰ [1984] AC 474.

There was a rule in place at that time that if a person sold his shares in one company to another company and instead of receiving cash, he received shares in the latter company, then there was no CGT payable immediately. Instead, CGT would become payable when or if ever the person later sold his shares in the company. In order to fully benefit from this rule, the Dawsons formed another company called Green Jacket Investments Ltd and then sold the two other companies to it in exchange for shares and Green Jacket Investments then sold the companies to Wood Bastow Holdings. The tax authorities argued that the subsequent company was formed for the purposes of saving and evading tax and as such, the Ramsay principle was extended to find in favour of the tax authorities.²⁰¹

Contrasting their case is that of Thames Water, who had allegedly not paid corporation tax for almost 10 years because of tax deferral, who with the reduction in corporation tax rates from 23percent to 20percent in April 2015, they had benefitted by a reduction of tax payments to the tune £131.0m.²⁰² At the same time, all their taxable profits in a year were offset by tax losses claimed from companies in the Kemble Group of which Thames Water Utilities Cayman Finance Limited were a part. An objective consideration of both businesses, bearing in mind the ruling of the House of Lords in *Furniss* which is small private owned firm, brings to bear the argument that there is unfairness in the way that SMEs and MNCs are treated by the tax authorities in the UK. Thames Water seems to project that the tax system grants businesses the opportunity to structure or plan their tax payments as can be seen from their quote, "...the government's tax system allows us to delay, not avoid, payment of tax based on how much we invest."²⁰³ This suggests either an irregularity with the way taxpayers understand the law or that the law is not clearly set out.

²⁰¹ Ibid per Lord Brightman.

²⁰² BBC News, Thames Water paid no UK Corporation Tax for the Year (10 June 2013)

<<http://www.bbc.co.uk/news/business-22844952>> accessed on 29 July 2015.

²⁰³ Ibid.

5.7.2. MNCs

Corporate compliance is becoming an important part of transparent and responsible corporate management. The issue of corporate noncompliance has led to some recent indignities of MNCs, which have been accused of tax evasion and avoidance. Amongst these are Starbucks, Amazon and Google, Chevron, Shell, MTN amongst others. For the purposes of this thesis, case studies of Starbucks, Chevron and MTN will be analysed. A study of how Starbucks have managed to be perceived as being noncompliant in the UK despite claiming that it has not done any wrong. The Chevron and MTN case studies on tax evasion and avoidance revolve around manipulating legal loopholes through corporate structuring and transfer pricing.

5.7.2.1 *Starbucks and Google*

In 2012, it was reported by Reuters that Starbucks had not paid any corporation tax on its profits for the preceding 3 years.²⁰⁴ Reuters also found Starbucks had made over £3bn in UK sales since 1998 but had paid less than 1 percent in corporation tax. Starbucks achieved this by reporting losses in each of the preceding five years and therefore did not have to pay any corporation tax.²⁰⁵

Reuters reports two strategies that have been used by Starbucks to avoid paying taxes in the UK. Firstly, Starbucks UK subsidiaries were made to pay royalties to its own property units located in other locations for the use of its ‘intellectual properties’ such as its brand and business processes. The report demonstrates that such payments do reduce taxable income in the UK.²⁰⁶ Secondly, the practice of allocating financial resources generated in the UK to external subsidiaries within Starbucks’ supply-chain, allows the company to report losses in

²⁰⁴ Tom Bergin ‘How Starbucks avoids UK taxes’ - Reuters conducted an investigation on Tax payment by Starbucks in the UK (Reuters Special Report 2012) < <http://uk.reuters.com/article/2012/10/15/uk-britain-starbucks-tax-idUKBRE89E0EW20121015> > accessed 25 November 2015.

²⁰⁵ Ibid.

²⁰⁶ Shannon A Bowen and Diana C Sisson, ‘Starbucks, Reputation Management, and Authenticity: A Case Study of Starbucks’ United Kingdom Tax Crisis & “SpreadTheCheer” Campaign’ 2013 < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2335582#page=110 > accessed 03 August 2015.

UK, despite generating substantial revenues. Starbucks buys coffee beans for the UK through a Switzerland-based subsidiary and the beans are then roasted at another subsidiary based in Amsterdam.²⁰⁷ A contentious issue raised is that Starbucks had continuously told investors that the company was doing well in terms of profits in the UK while posting losses.²⁰⁸

It is argued that even if Starbucks' actions were legal, they were still not appropriate; further economists hold that the actions of Starbucks may also be destroying local small businesses.²⁰⁹

In response to this, Starbucks insists that it abides with the entire UK 'arm's length' principle in all its transactions with its subsidiaries. The company insists that it has paid and will continue to pay their fair share of taxes in full compliance with all UK tax laws. It further states that they are good and compliant taxpayers with consistent values that balance their need to operate a profitable business with a social conscience.²¹⁰

Google too has been accused of perpetuating tax avoidance schemes in the UK. With the UK being one of its largest markets, in 2013 it paid £20.4m in taxes out of £3.8bn profits it made in sales from online advertising.²¹¹ Google has been criticised for its legal but complex international tax structures. Its European headquarters are in Ireland, which has a lower corporation tax rate than the UK, it has also used company structures in Bermuda.²¹² Following an internal audit by the HMRC, Google has agreed a deal with British tax authorities to pay £130m in back taxes and bear a greater tax burden in future. The deal will cover a decade of underpayment of UK taxes by the company, which has been criticised in the past for its tax

²⁰⁷ Ibid.

²⁰⁸ BBC News Starbucks 'paid just £8.6m UK tax in 14 years' < <http://www.bbc.co.uk/news/business-19967397> > accessed 03 August 2015.

²⁰⁹ Ibid.

²¹⁰ Howard Schultz, Setting the Record Straight on Starbucks UK Taxes and Profitability 2012 < <http://www.starbucks.co.uk/blog/setting-the-record-straight-on-starbucks-uk-taxes-and-profitability/1241> > accessed 03 August 2015.

²¹¹ Kamal Ahmed, 'Google tax: David Cameron defends £130m UK tax deal' *BBC News* (27 January 2016) (<<http://www.bbc.co.uk/news/business-35416812> > accessed 9 May 2016).

²¹² Ibid.

avoidance policies.²¹³ The MNC, in defending its record, attributes the amount of tax it has paid to not only the domestic tax laws in the countries it trades in, but particularly the international system of taxing MNCs.

Realising that MNCs such as Starbucks and Google discussed above have made use of loopholes in the tax system in order to legally avoid tax, the government has sought to address some of these issues. A significant introduction to corporation tax laws is the diverted profit tax. The diverted profits tax is a new tax enacted as part of the Finance Act (FA) 2015, which seeks to target profits, which have been diverted from the UK tax net.²¹⁴ This is done either by the involvement of entities in transactions lacking economic substance, or through a permanent establishment (PE) taxable diverted profits being assessed by HMRC issuing a charging notice and are subject to tax at 25percent (or 55percent in the case of ring fence profits).²¹⁵ This is aimed at MNCs with business activities in the UK who enter into contrived arrangements to divert profits from the UK by avoiding a UK taxable presence or by other contrived arrangements between connected entities.²¹⁶ This aims to reduce and block loopholes in the tax system. It is worthy of note that this new tax does not apply to SMEs as this is likely to cause a considerable financial burden on them. It has been suggested that the expansive language of the current draft will give rise to significantly more double taxation than it will tax.²¹⁷ Consequently, it will not be possible to escape the tax through a tax treaty.²¹⁸ This alone will lead to problems for the economy, as MNCs tend to look for an encouraging location where

²¹³ Coincidentally, the French authorities are now pursuing Google for €1.6bn (£1.3bn) in tax payments.

²¹⁴ Her Majesty's Revenue and Customs, Diverted profits tax <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385741/Diverted_Profits_Tax.pdf> accessed 03 August 2015.

²¹⁵ Ibid.

²¹⁶ Ibid.

²¹⁷ Mark Bevington, 'Diverted Profits Tax', (2015) Tax Journal <<http://www.taxjournal.com/tj/articles/diverted-profits-tax-05022015>> accessed 03 August 2015; Ben Jones and Cathryn Vanderspar, '20 questions on the Diverted Profits Tax' 2015 Tax Journal <<http://www.taxjournal.com/articles/20-questions-diverted-profits-tax-24092015>> accessed 23 December 2015.

²¹⁸ Alan Cinnamon, 'Tax Treaty briefing for January 2015', Tax Journal <<http://www.taxjournal.com/tj/articles/tax-treaty-briefing-january-2015-15012015>> accessed on 03 October 2015.

the tax system will benefit them. If MNCs were to be double taxed without recourse to tax treaty relief, they would likely lead to the option of MNCs moving their business out of the UK.

5.7.2.2 Chevron Nigeria Limited

Chevron Nigeria Limited (CNL) is a subsidiary company of Chevron International, one of the world's leading energy companies with subsidiaries in more than 180 countries globally. Chevron has been facing challenges in its tax filing practices and it has been reported that Chevron has not filed a tax return in Nigeria since 2000.²¹⁹ In Nigeria, CNL is the third largest oil producing MNC and operates under a joint venture agreement (JVA) with the Nigerian National Petroleum Corporation (NNPC) with each having 60percent and 40percent respectively.²²⁰ Apart from its main Nigerian subsidiary, Chevron operates two other associated companies, Chevron Oil Co. Nigeria Ltd (CNL) and Texaco Overseas (Nigeria) Petroleum Company Unlimited (TOPCON).²²¹ In July 2005, CNL was accused of perpetrating a \$10.8 billion USD tax evasion and fraud in Nigeria and an investigation ensued. The reports of the House Committee on Petroleum Resources (HCPR) found that CNL over inflated its operations' cost and thereby evaded the payment of petroleum profit tax by paying its associated companies unmerited cash to the value of \$52.815 million. This unmerited cash was claims made for Reserve Additional Bonus (RAB).²²² The MNC was also accused of diverting \$75 million corporate tax revenue through dividends and a further \$190 million to unmerited

²¹⁹ International Trade Union Confederation, 'Chevron tax filings challenged by US tax authorities' < <http://www.smh.com.au/business/energy/chevron-tax-filings-challenged-by-us-tax-authorities-report-says-20150917-gjot8i.html>> accessed 21 November 2015.

²²⁰ Chevron Nigeria Fact sheet 2015 < <http://www.chevron.com/documents/pdf/nigeriafactsheet.pdf>> accessed 21 November 2015.

²²¹ OJ Otusanya, *The Role of Multinational Companies in Tax Evasion and Tax Avoidance*, (University of Lagos Press 2011)

²²² The House of Representatives committee on Petroleum Resources Report of the investigative hearing on the alleged \$10.8 billion tax evasion, fraud and corruption by Chevron Nigeria and it associated companies. The Nigerian National Assembly Abuja 2006.

capital allowance based on fictitious qualifying capital.²²³ It was also alleged that CNL conspired with tax officials in order to be assessed to a lower amount in terms of corporation tax by \$95 million.²²⁴ CNL also allegedly had overstated its pension costs by \$139,341,690 in order to gain a cost advantage of \$58,282,347 of which it used \$23,312, for tax evasion purposes.²²⁵

The House Committee concluded that CNL had used its (corporate) group structure to transfer corporate profits. It held that the overstatement of costs, while claiming unmerited RAB, amounted to a tax-planning scheme designed to avoid the payment of taxes in Nigeria. The committee stated, “CNL inflated its community project expenditures, PPT cost, claimed unmerited RAB credit, and the rush to pay \$16 million to the Government when the dispute started is an indication of undisclosed unethical practices. It therefore, recommends that CNL and its associates should pay the additional tax liability of \$492 million (N61.5 billion) within 21 days from the date the recommendation was pronounced”.²²⁶ This was based on the figures on the Table 3 below which are a breakdown of the tax liability of CNL to the Nigerian government.

Table 3: Breakdown of CNL and its associated companies tax liability to Nigeria.

S/N	Item	Tax liability in \$ million
1	Community Development Project	14.907
2	Representation to Mr. President	52.815
3	RAB claim by TOPCON	18.541
4	Over inflated Costs by CNL	263.418
5	Over inflated cost by TOPCON	109.807
6	Over inflated cost by COCNL	22.986
7	Duplicated costs (Licenses and Miscellaneous Taxes)	9.838
Total		492.312

²²³ Ibid 135.

²²⁴ Ibid.

²²⁵ Ibid.

²²⁶ Ibid.

Source: Otusanya (2011) ²²⁷

CNL contended that the use of such tax planning strategies was lawful. Nonetheless, in this instance, it was used to exploit the loopholes in the Nigerian tax structure.

5.7.2.3 MTN Group

MTN is the largest telecommunications MNC in Africa, with about 227.5 million subscribers, and operates in more than 20 countries across Africa and the Middle East. MTN has its largest operation in Nigeria where it is the biggest telecommunication provider. In October 2015, Premium Times Nigeria and a group of journalists across Africa reported the results of their investigation on the MTN Group, MTN Nigeria, MTN Ghana and MTN Uganda.²²⁸ The report alleged that the MNC had been evading corporation tax in these countries through transfer pricing arrangements and aggressive corporate structuring.²²⁹ It was discovered in 2013, that MTN transferred N11.398 Billion from MTN Nigeria to MTN Dubai that was then “on-paid” to Mauritius, a shell company with zero staff and whose physical presence in the capital Port Louis was a post office letterbox.²³⁰ MTN contends that the transfer made to MTN Dubai was made in agreement with MTN Dubai to pay 1.75percent of revenues from Nigeria to the company for management, and royalties for the use of the MTN trademark. The Nigerian government requires that management fees paid by multinationals to other subsidiaries be approved by the National Office for Technology Acquisition and Promotion (NOTAP). However, it was alleged, that this transfer was made without NOTAP's approval. Prior to 2010, the fees had been approved but following a failure to reach an agreement on the amount of

²²⁷ Ibid 135 at 323.

²²⁸ Premium Times Nigeria, ‘INVESTIGATION: How MTN ships billions abroad, paying less tax in Nigeria’ < <http://www.premiumtimesng.com/investigationspecial-reports/192159-investigation-how-mtn-ships-billions-abroad-paying-less-tax-in-nigeria.html>> accessed 21 November 2015.

²²⁹ Ibid.

²³⁰ Ibid.

management fees to be transferred, MTN was instructed to discontinue the payments. Notwithstanding, MTN has continued to make payments to MTN Dubai.

In Ghana, it was alleged that MTN Ghana transferred GH 758 million and this accounts for almost 10percent of its revenue between 2008 and 2013.²³¹ In response, MTN Group and its subsidiaries in Nigeria, Ghana and Uganda, contends that the transfers were legitimate payments for technology transfer and management fees, which were all agreed upon with the appropriate authorities in the respective countries. Furthermore, the MNC states that owing to the evolving nature of its business operations and compliance frameworks in its markets, it continually engages authorities to identify mutually agreeable ways to meet their obligations.

At present, the FIRS have carried out no investigation and NOTAP in Nigeria, and the Civil Society Network against Corruption has petitioned the Economic and Financial Crimes Commission in Nigeria (EFCC) to begin an inquiry into this.²³² Although in another unrelated development, MTN has just been imposed with a fine of \$5.2bn for having committed approximately 28 infractions, one of which is the non-deactivation of 5 million unregistered sim cards attracted the bulk of the fine.²³³ The likelihood of the payment of this fine is uncertain. The amount of money they were fined seems unrealistic and has been identified as the largest fine paid.²³⁴ Furthermore, given that the fine was subsequently reduced, this undermines the initial sum as it suggests that a fine is flexible. This rather projects an unstable and harsh business environment to investors that will not favour the country.

²³¹ Pulse Nigeria, 'Just how much has Nigeria lost from MTN'S Tax evasion?' <<http://pulse.com.gh/telecom/tax-fraud-just-how-much-has-nigeria-lost-from-mtn-s-tax-evasion-id4310352.html>> accessed 22 November 2015.

²³² Sahara Reporters NewYork, 'CSNAC petitions EFCC over non-remittance of tax by MTN'< <http://saharareporters.com/2015/11/19/csnac-petitions-efcc-over-non-remittance-tax-mtn-0>> accessed 21 November 2015.

²³³ ThisDay Nigeria, 'Analysts: MTN Nigeria Fine of \$5.2bn Largest Worldwide, will Scare off Investors < <http://www.thisdaylive.com/articles/analysts-mtn-nigeria-fine-of-5-2bn-largest-worldwide-will-scare-off-investors/226151/>> accessed November 2015.

²³⁴ Ibid.

Considering the two case studies from Nigeria, it could be inferred that MNCs use their corporate structuring and aggressive tax planning to manipulate loopholes in the system to evade and avoid CIT payments. Despite it not being wrong for intercompany or subsidiary transfers within MNCs, there is a need to do so within the principles laid out in the ‘arm’s length’ principle. Not doing so is simply engaging in base erosion and profit shifting (BEPS). Taking advantage of multiple structures to shift profits around as MTN has been accused of is abusive transfer pricing which invariably robs governments of much needed funds. On the other hand, with rampant and in-bred corruption, which seems to have permeated the system, the tax officers themselves aid these MNCs in perpetuating tax avoidance and evasion. There is an imminent need to tackle this problem, as this would deter the effectiveness of any compliance measure put in place by the government.

5.8 The Legality of Tax avoidance

Notwithstanding the impact of penalties or tax morale of taxpayers, it can be argued that as much as this affect tax compliance, the majority of taxpayers, especially businesses accused of tax evasion and avoidance, simply do so in order to make the most of the economic perils that they face. Schemes that may be generally referred to as avoidance or evasion schemes may not necessarily be such. Attributing a legal status to tax avoidance can be traced back to the words of Lord Tomlin in the *Duke of Westminster’s* case, in which he said,

“Everyman is entitled if he can to order his affairs so that the tax attaching under the appropriate acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.”²³⁵

²³⁵ *Duke of Westminster* (1936) AC 1; See also *Ayrshire Pullman Motor Services and Ritchie v Inland Revenue Commissioner* [1929] 14 TC 754.

Depending on the interpretation given to this statement, it can be argued that this is an excuse for aggressive tax avoidance and evasion.²³⁶ Going with this view, this allows taxpayers to structure their financial arrangements to minimise tax liability as long as these structures are within the four corners of the law.²³⁷ Unfortunately, this is now seen as tax avoidance and evasion and as such, the government has exercised its rights by introducing enforcement rules. Despite this, the key issues to be addressed are whether the structuring of business or individual financial affairs amounts to tax evasion and avoidance or when can avoidance be deemed acceptable; further it raises questions of whether this needs enforcement measures. A look at the recent high profile cases of Starbucks, Amazon, Google and Next.co, in which they were alleged to have participated in high levels of tax avoidance and evasion, one may wonder if these MNCs are simply trying to structure their corporations in such a way that they will not be compelled to pay an increased tax. This is in the context that one of the fundamental tenets of the tax advisory profession is that taxpayers have the right to arrange his or her affairs to minimise liabilities.²³⁸ The extent to which they are allowed to do this is therefore debatable, as a distinction must be made between tax planning for corporate structures and tax evasion and avoidance.

Resulting from this, Self reports that there are two elements to acceptable avoidance.²³⁹ She further explains that firstly, any tax planning being orchestrated must relate to a business transaction, an example is the sale of a business or a wish to hedge a financial risk.²⁴⁰ Secondly, the way in which the tax planning is carried out must be commercial. In other words, commercial tax planning, related to business transactions, should be considered acceptable tax

²³⁶ Michael Doran, 'Tax Penalties and Tax Compliance' (2009) 46 Harvard Journal on Legislation 111.

²³⁷ Ibid.

²³⁸ Ibid.

²³⁹ Heather Self, 'Acceptable Avoidance', in J Freedman (ed.), *Beyond Boundaries - Developing Approaches to Tax Avoidance and Tax Risk Management*. (Oxford University Centre for Business Taxation 2008).

²⁴⁰ Ibid.

avoidance. Despite Self's views, she still contends that if there is no business transaction and the taxpayer is simply trying to recognize and manipulate a tax benefit, there is no problem with the tax authorities enforcing whatsoever measures in place and outlawing wholly artificial structures.²⁴¹ In her opinion, UK case law deals with this quite well.²⁴² Equally, if there is a real business transaction, a taxpayer should still be entitled to plan his affairs to pay the minimum amount of tax legally due on that transaction.²⁴³

The question of whether the tax planning is deemed commercial is a harder one to answer, and one that tax authorities have to answer. Given the scenarios above, there is a need to consider the activities of businesses especially in terms of how they structure their corporations to minimise tax payments. These issues need to be considered in the context of evaluating the steps taken by these MNCs within the normal course of their activities and referring to the actions of companies like Starbucks to identify whether their actions can be deemed acceptable avoidance. Further, the extent to which ambiguous legislation creates avenues for tax evasion and avoidance should also be considered. It is suggested that the first two issues cannot be addressed without considering the present international tax regime and solving the problem of uncertainty caused by legislation. According to the HMRC, tax planning is not the same as tax avoidance as the former involves using tax reliefs for the purpose for which they were intended.²⁴⁴ Tax avoidance and evasion, is not defined in any legislation in Nigeria. The

²⁴¹ Examples would include loss-selling (capital or income), or any transaction which is only entered into because there appears to be a tax benefit to be gained.

²⁴² *Burmah Oil case* [1984] STC 153, where it was held that if a transaction has no economic effect, it is unlikely to be effective for tax purposes.

²⁴³ *Ibid* 153-Self gives an example of where a taxpayer chooses to sell shares rather than assets, in order to benefit from the substantial shareholding exemption rather than paying tax on a capital gain on goodwill. There is a business transaction (the sale of a business) and the taxpayer is at liberty to choose between different forms of the transaction, which may have different tax consequences.

²⁴⁴ Her Majesty's Revenue and Custom, Issue briefing Tackling Tax Avoidance September 2012 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/89029/briefing-avoidance.pdf> accessed 24 June 2015. The HMRC gives an example where claiming tax relief on capital investment, saving in a tax-exempt ISA or saving for retirement by making contributions to a pension scheme are all legitimate forms of tax planning. While such actions may reduce the total amount of tax paid, they are not tax avoidance, because they involve using tax reliefs in the way that Parliament intended when it passed the relevant legislation.

legislation and codes do not define nor draw a distinction between tax avoidance and evasion.²⁴⁵ Rather, the tax authorities and the courts rely on definitions given by other jurisdictions or organisations in defining these two terms. This brings in chaos in the fight against tax evasion and avoidance between the tax authorities and tax payers.

The next section will analyse and critique the enforcement measures in both countries while making recommendations of future best practices for effective enforcement measures where necessary.

5.9 Conclusion

From the above analysis and discussion, it can be concluded that tax revenue is vital to governments and as such, every government will protect its tax revenue, as it is vital to its national economy. An understanding of the factors that influence business tax compliance will assist the government in creating a more effective tax system and encouraging a healthy business atmosphere. It is clear that the factors that influence tax compliance as discussed above have not proved successful in both developing and developed countries. This brings to the fore the interesting question of what can be done by the government to induce businesses to co-operate with the compliance regime.

Successfully achieving this requires an understanding of taxpayer motivations in complying with their obligations. This is based on the consideration that compliance is paramount in achieving tax payments, it is therefore important to create a positive relationship between tax authorities and the taxpayer.²⁴⁶ The idea is that the more strongly the political participation rights are developed, the greater the contact is and the higher their tax morale will be. The

²⁴⁵Jacob Obafemi Fatoki, 'An Empirical Study of Tax Evasion and Tax Avoidance: A Critical Issue in Nigeria Economic Development' (2014) 5 (18) Journal of Economics and Sustainable Development 22.

²⁴⁶Lars P. Feld and Bruno S. Frey, 'Trust Breeds Trust: How Taxpayers Are Treated' (2000) 3 Econ.Gov.87.

reasonableness of this can be questioned in the sense that where MNC's have strong political attachments, there could be a tendency of the tax authority being more favourable to the MNC.

Freedman indicates trust as being the bedrock for sustainable tax systems²⁴⁷ particularly for businesses that possibly influence business tax compliance. She argues that transparency alone cannot solve the problems of compliance²⁴⁸, which is now a global problem especially in light of the release of the Panama papers in 2016 that showed widespread evasion and dubious practices on a global scale.²⁴⁹ It can be observed that by introducing trust between the tax authority and the taxpayer, compliance could be increased. This will work as a psychological factor for compliance where the taxpayer believes that the tax authority will deal fairly with his tax assessment using the existing tax laws. Already, in the UK, there is a move towards fostering a relationship between large businesses and the HMRC.²⁵⁰ The government views this as a way of enticing firms into altering their behaviour regarding transparency, governance and tax planning. In the Nigerian context, it could be imagined that there is much work to be done in building an avenue of trust between the tax authorities and the taxpayer. This distrust has been created out of the overarching corruption and perceived lack of interest by the government perceived by the taxpayers. This also comes forms a perception that revenue derived from the tax paid will be used by the tax authorities themselves rather than going into the government's coffers hence, there is no incentive to comply. With a move towards

²⁴⁷ Judith Freedman, 'We should create a tax system that reassures the public', (Financial Times 9 February 2016) <<http://www.ft.com/cms/s/0/12e5ea38-cf10-11e5-831d-09f7778e7377.html#axzz4FX9MSNBL>> 22 July 2016.

²⁴⁸ Ibid.

²⁴⁹ The International Consortium of Investigative Journalists, 'The Panama Papers' (April 2016) <<https://panamapapers.icij.org/>> accessed 22 July 2016.

²⁵⁰ The government's readiness for this relationship is encapsulated in the 2006 review of links with large businesses (the Varney Report). This report endorses a new approach to tax risk management and tax compliance by large businesses which stems from the desire from both sides for a relationship based on mutual trust.

voluntary compliance in Nigeria and a more aggressive approach to fighting corruption, the added benefit of trust will create a more conducive environment for the taxpayers.

CHAPTER 6: Thesis Conclusions and Recommendations

6.0 Introduction

This thesis aimed to investigate the extent to which corporate tax regimes affect national economies. Primarily, this study considered the role of corporate tax regimes particularly its legislations, in promoting sustainable economic growth and development for countries. An underpinning idea for this thesis is that economic development is fundamental for all countries but especially for developing countries. The thesis, legally evaluated the means by which revenue generated by corporate tax may serve in promoting sustainable economic development particularly for developing countries. Through this, it sought to answer the research question as to whether a well-defined corporation tax regime positively affects a nation's economy. The thesis, posited that a sustainable corporation tax regime would positively influence national economies. It found that the ill effects of a badly structured corporate tax regime resulted to tax evasion and avoidance that have detrimental effects on national economies. In trying to answer this, it explored the need for taxation and laws and in so doing, it delved into the debate over the efficacy of corporation tax by highlighting apparent complications that attends its use. Finally, by agreeing with existing empirical literature that until another option is found, tax revenue remains the most sustainable source of revenue, it set the foundation for advocating for a reform of the Nigerian tax system.

6.1 Thesis Conclusions

The main findings of the thesis are chapter specific and were summarised within the chapters. This section will synthesise these findings in order to answer the research questions and aims indicated in the introduction. For the purpose of the conclusion, the synthesis is written as positive statements to show the relationships between the research questions.

In Chapters 2-3, the thesis justified the supposition that economic growth and development is necessary for both developing and developed countries. It found through a literature review that a good tax system could be effective in generating revenue for this needed growth and development.¹ The use of tax, especially corporation tax in addition to creating a sustainable corporation tax structure economic growth and development would ensue.² This can be achieved by having sustainable legislation with a foundation set on fairness, trust and equity.

The first research question sought to determine how the legal structure of corporate tax regimes influence its economic development. The findings indicate that Nigeria needs to evaluate its corporate tax structure, particularly its legislation and policies in order to achieve optimal revenue. Certain factors as identified by the thesis have created uncertainties in the corporate tax legislation and policies in Nigeria; they include inconsistent government policies, lack of implementation of legislation and policies, lack of adequate data to monitor the tax revenue, ambiguous and overlapping legislation, poor taxpayer education and corruption in the system. These factors have not only which hindered the location of FDI to the Nigeria,³ but has also created opportunities for tax avoidance and evasion as in indicated in previous chapters. Thus, the second objective of the thesis was fulfilled.

From the complexities identified in the Nigerian system this thesis advocates and recommends the simplification of the tax system with better clarity in the taxes that are payable. It further

¹Thiess Buettner, and Martin Ruf, 'Tax Incentives and the Location of FDI: Evidence from a Panel of German Multinationals. (2007) 14 International Tax and Public Finance 151; Thiess Buettner and G Wamser, 'The Impact of Non-Profit Taxes on Foreign Direct Investment: Evidence from German Multinationals' (2006 European Tax Policy Forum Conference the Impact of Corporation Taxes Across Borders', London, April 2006) <http://www.ifs.org.uk/conferences/etpf_buettner.pdf> accessed 1 February 2015; Michael P Devereux and Georgia Maffini, 'The Impact of Taxation on the Location of Capital, Firms and Profit: A Survey of Empirical Evidence' (2006) Oxford University Centre for Business Taxation Working Paper WP 07/02 <<http://www.sbs.ox.ac.uk/faculty-research/tax/publications/working-papers/impact-taxation-location-capital-firms-and-profit-survey-empirical-evidence>> accessed 13 September 2015.

² Ibid.

³ Ehigiamusoe Uyi Kizito, 'The Nexus between Tax Structure and Economic Growth in Nigeria: A Prognosis', Journal of Economic and Social Studies (2013) at 126.

advocates a removal of excess dividend tax.⁴ Moreover, overlapping pieces of legislation and regulatory bodies as argued in the thesis, leads to uncertainties and tax evasion and avoidance should be reviewed. A recommendation of the merger of the regulatory bodies is made.⁵ That is to say, that CAC and FIRS are merged into one regulatory body with separate departments created to administer the specific requirements.⁶ This harmonisation will create a ‘one stop shop’ for all incorporation and corporate tax issues with the overall aim of reducing corruption; and ultimately creating a strong and centralised system. Despite the recommendation of merging the CAC and FIRS, the thesis acknowledges the need for separate legislations for the company formation and tax payments. It is necessary and thus recommended that the current legislation for company formation in Nigeria (CAMA), should be reviewed bearing in mind that the end results of companies which could be said to be economic growth and development. Specifically, the review should include a section that introduces tax matters by pointing to the CITA and the FIRS. This will enable businesses whether foreign or indigenous to look towards the FIRS to address their tax liabilities at the onset of business formation.

As discussed in chapter 4, Nigeria is a federalism of 36 states with each state operating a state revenue service, which projects its own laws. This thesis calls for a review of the corporate tax regime to reflect this federalism by recommending thus. The corporate tax should be set in a unitary formulary pattern where each state will impose a federally agreed separate rate on MNCs and domestic corporations but allocate a certain percentage to the federal government. The allocation to the federal government should come directly from the State revenue service

⁴ See section 4.3.1.2- Complexity in excess dividend charge chapter 4

⁵ The regulatory bodies are Corporate Affairs Commission and the Federal Inland Revenue Service.

⁶ Although these two government bodies are not in the same category as the FIRS and CAC, for easier management and reconciliation due to an overlap between the objectives of the Inland Revenue and the Customs Service, the government merged the two regulatory bodies in order to achieve organisational change, which rested on potential improvements in customer service, effectiveness and efficiency. See House of Commons Treasury Committee, ‘The Merger of Customs & Excise and the Inland Revenue Ninth Report of Session 2003–04’ <<http://www.publications.parliament.uk/pa/cm200304/cmselect/cmtreasy/556/556.pdf>> accessed 06 September 2016.

after it has collected the revenue based on the percentage prescribed by the legislation. Rather than remove the education tax which is imposed on the profits of corporations, its imposition should be restructured whereby a certain percentage of the revenue is allocated to education instead of imposing tax on an already taxed profit.

While seeking to answer the second research question and achieving the third objective, it was found that in Nigeria, corporation tax affects a wide range of choices and decisions made by foreign owned corporations.⁷ This ranges from the choice of legal form of business to incorporate, and the level of investment commitment, to the choice of assets to acquire.⁸ This was different from what was found in the UK, which on a surface level, showed clearly defined corporate tax legislation. This is not to say that the UK corporate system is perfect; as discussed in previous chapters, the corporation tax system is still besieged with issues as can be seen with the recent tax evasion and avoidance problems with Starbucks and Google. By relying on empirical data, the thesis found that there is a significant reduction of corporation tax receipts in the UK. Perhaps this could be because the UK has moved from a manufacturing based economy to a more service based economy. The problem of tax avoidance and evasion has suggested the need for a change or move from corporation tax to some other type of taxation was clear. Issues in non-compliance in companies such as Google and Starbucks, and the amount of tax payments they have made for tax liabilities in the past 10 years suggests that until there is a reform of the tax legislation in the UK, CIT receipts will continually reduce. This will not only affect government funding; it will also create a burden on an already overstrained administration.⁹

⁷ Stuart AP Johnson and Helen Miller H, 'Response to the House of Lords Select Committee on Economic Affairs' Call for Evidence: Taxing corporations in a global economy: is a new approach needed?' (2013) <http://www.ifs.org.uk/docs/response_lordsct.pdf> accessed on 30 November 2014.

⁸ Ibid.

⁹ With the HMRC insisting that, the present UK tax laws needs to be changed, as under the present laws, it cannot duly collect optimal revenue from defaulting MNCs. Once again, we are taken back to the efficiency of

The above led to answering the third research question that analysed the extent to which international system for taxing MNCs interacted with the domestic tax system. All these elements are attributable to the international system for tax MNCs. The thesis agreed with Devereux and Vella's position that the international system of taxing MNCs has fundamental issues, which includes the allocation of taxing rights, which is currently entrenched in the OECD MTC.¹⁰ This thesis however contended that the problem with the international taxation of MNCs lies in the hands of developed countries that created a system at a time that solely benefited their needs. As years went by and the emphasis on FDI shifted from developed to developing countries, the system still favoured the developed economies. It is recognised that international institutions and world leading states are addressing the problem of tax evasion and avoidance as it affects both developed and developing economies, but the result will still be the same if the root problem is not tackled. Considering that OECD MTC favours capital, it will be difficult for it to support developing countries. The thesis postulates that as long as developing countries are not made the focus of taxing rights in MTCs, the problem will remain. This should be the focus of the international community and developing countries as a group to spearhead either the reform of the international tax system by going beyond the work of the UN in its treaty.

In light of the discussion and analysis presented in chapter 5 which analysed the effects of tax compliance, together with existing deterrence and enforcement measures on national economies. It was found that for a continuous and sustainable reliance on taxation as a means of government funding, there is a need to achieve a balance between the government (Tax officers) and the taxpayers both individuals and MNCs especially with regard to tax

the legal system that needs to be strengthened in order to avoid tax avoidance and evasion in any form with the aim of achieving economic growth and development.

¹⁰ Michael Devereux and John Vella, 'Are We Heading towards a Corporate Tax System Fit for the 21st century? WP 14/25' (Oxford University Centre for Business Taxation 2014).

compliance. The constant change and introduction of enforcement measures by governments have so far not been effective in deterring tax avoidance.¹¹ As part of this study's contribution to knowledge, the thesis proposes the following recommendations.

6.2 Thesis Recommendations and Contributions

6.2.1 Policy recommendations for a Sustainable Tax Regime

This thesis, reached the position that it is imperative that there should be a policy and legislation realignment in Nigeria. The process for this realignment however has to take cognizance of certain factors. Firstly, the pre-policy consultations should be inclusive and consider the realities of even the rural communities. Secondly, the timeframe between the consultations for policy and the actual reaching of a policy should not be far and dispersed. This will ensure that the policy would not lose its relevance in a rapid and dynamic environment. Said policies should be contextualised to reflect the environment where such policy is meant to be implemented.

6.2.1.1 Tax Compliance Strategy

One of the key recommendations of the research is the need for the review of the current tax compliance strategy not only in Nigeria but internationally as well. This should start with a redefinition of tax avoidance and evasion. The complexities with the definition of tax avoidance, mitigation, planning and evasion have added to the ongoing problems on the side of the government in holding certain multinationals to task. In addition, MNCs use these complexities to successfully circumvent complying with their tax responsibilities. A clearer definition of these terms not only in Nigerian legislation, but also for the international community is also needed. The Nigerian legislation does not in any instance present a clear

¹¹ See section 5.2 - Enforcement Measures Chapter 5

dentition of either tax evasion or avoidance.¹² This helps MNCs and individual taxpayers to facilitate tax evasion and avoidance. In addition, the thesis advocates for an imposition and implementation of sanctions to be set for lawyers, tax advisers and company directors in Nigeria whose advice and actions encourage and achieve successfully tax evasion and avoidance. This will demonstrate to the international community and the MNCs that the Nigerian government is willing and ready to tackle tax avoidance and evasion. Finally, these sanctions will help curb the problem of corruption, which this thesis argues creates an uncertainty for FDI.¹³

It is noteworthy to mention that developed countries such as the UK have initiated steps to strengthen tax avoidance sanctions by imposing financial sanctions on enablers that include advisers, lawyers and accountants.¹⁴ A limitation to this could be that the enablers could be willing to overlook the fines if they believe that the advice will yield results that are more positive for the corporations. The extent to which reforms can be introduced by the UK parliament (especially in the wake of the UK's vote to leave the EU) and the Nigerian Senate will depend on both the political and judicial will of both governments to see this through. Debatably, if taxpayers fund politicians' campaigns, the likelihood introducing such reforms will be hard pressed.

Despite the above, it is necessary that a transparent and equitable tax compliance guide that should help to facilitate trust should be put in place by tax authorities (for instance FIRS) which will amount to equitable tax breaks for MNCs so as not to over burden them. This should be set and controlled in such a manner that will also benefit indigenous corporations as well as

¹² See section 5.1.5 - The Legality of Tax Avoidance Chapter 5.

¹³ See 3.4.3- Uncertainties in locating FDI by MNCs Chapter 3.

¹⁴ HMRC, 'Strengthening Tax Avoidance Sanctions and Deterrents: A discussion document' <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/546589/Strengthening_Tax_Avoidance_Sanctions_and_Deterrents-discussion_document.pdf> accessed 09 September 2016. See also Appendix E for the pertinent section of this document.

small businesses. Such a system will deter tax administrators from striking "sweetheart-deals" with MNCs, which makes the tax balance inequitable. Tax breaks given to MNCs should be made available to other businesses. The idea of creating "sweetheart deals" or showing favouritism towards a certain class of businesses will encourage noncompliance rather than encouraging compliance. Furthermore, with the perception that the Nigerian tax authorities are widely reported to be corrupt, honesty and trust will encourage taxpayers to comply, as there will be a sense of openness and clarity that should motivate compliance.

Finally, it is the intention of the thesis to inform the policies of the Nigerian Government by recommending a reconsideration of the use of tax breaks to stimulate foreign investment, and to ensure that foreign companies pay their fair share of taxes in Nigeria. This in no way suggests that tax breaks are not useful. Tax breaks are ideal as they afford smaller and new companies the opportunity to grow without the burden of tax payments.

6.2.1.2 An Effective Enforcement Regime in Nigeria

The situation in Nigeria does not just call for effective enforcement and deterrence measures; rather it calls for an end to the corruption of tax officials. It is imperative that the gap between taxpayers and tax officials is narrowed. Fostering the creation of additional incentives in addition to salaries and proper training will mean that the need to participate in corrupt practices will be diminished. Furthermore, effective disciplinary measures should be put in place for erring tax officials.

Considering the high number of MNCs investing in Nigeria, it is recommended that Nigeria should have in place specific anti-avoidance rules and furthermore consider the adoption of a GAAR, which could be a good weapon to have in the government's armoury for tackling tax avoidance. Presently, the closest approximation to GAAR is found in Sec. 22 of CITA, which states:

that where the tax authorities are satisfied that (i) any disposition is not in fact given effect, or (ii) any transaction that reduces or would reduce the amount of any tax payable is artificial or fictitious, they may disregard any such disposition or make adjustments as they consider appropriate so as to counteract the reduction of tax liability.¹⁵

Unreported information obtained by the author from tax officers in FIRS shows that tax officers are reluctant to apply this provision to transactions mostly because of the vague and ambiguous language of the legislation. Once again, this brings about uncertainty in the law as reflected earlier in chapter 3, as this hampers effective implantation of legislation and policies. Specific and unambiguous enforcement measures for MNCs and smaller corporations are necessary, as there are currently none designed for such categories of taxpayers in Nigeria. An example worthy of emulating can be found in Europe where the European Commission held the same opinion when it proclaimed that member states should counteract aggressive tax planning practices that fall outside the scope of their specific anti-avoidance rules. To achieve this, it mandated that Member States adopt a general anti-abuse rule, adapted to domestic and cross-border situations confined to the Union and situations involving third countries.¹⁶

Therefore, building upon the discussion in Chapter 5, it is recommended that the Nigerian government should design an anti-avoidance instrument akin to a GAAR, which will reflect a statutory measure that will achieve its set purpose. It is further recommended that this instrument should state anti-avoidance measures in clear and unambiguous language while including accepted international anti-avoidance measures. Bowler suggests that while a GAAR may assist with countering some transactions, it will not always provide the answer for all transactions.¹⁷ It could be more effective to consider using a GAAR while at the same time,

¹⁵Sec 22 CITA (Artificial Transactions, Etc.) in Appendix B.

¹⁶ Library of the European Parliament, Corporate tax avoidance by multinational firms [http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2013/130574/LDM_BRI\(2013\)130574_REV1_EN.pdf](http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2013/130574/LDM_BRI(2013)130574_REV1_EN.pdf) accessed 25 November 2015.

¹⁷ Tracey Bowler 'Tackling Tax Avoidance in the UK' in J Freedman (ed), *Beyond Boundaries - Developing Approaches to Tax Avoidance and Tax Risk Management*. (Oxford University Centre for Business Taxation 2008) 65.

tackling areas in tax law which are structured in such a way as to maximise rather than minimise opportunities for tax avoidance.¹⁸ This could be achieved by having tax authorities and the government collaborate to ascertain whether provisions in the legislation are driven by an underlying structural scheme. The courts have a role to play in the sense that the interpretation of what legislation sets out is done by the courts during litigation.

The ambiguity in the Nigerian tax legislation, especially in terms of the definition of ‘foreign companies’, fixed base and ‘permanent establishment’ can easily lead to tax evasion and avoidance by MNCS.¹⁹ Their approach to interpretation should therefore clearly reflect the intention of the legislation. Two instances in both the UK and Ireland are highlighted. Rowlett J. in *Cape Brandy Syndicate v IRC* stated, "...It is urged ... that in a tax act, clear words are necessary to tax the subject... there is no room for any intendment, nothing to be read in, and nothing is to be implied."²⁰ In the same vein, Kiernan, Henchy J in the Irish case of *McGrath v McDermott* asserted:

A word or expression in a given statute must be given meaning and scope according to its immediate context, in line with the scheme and purpose of the particular statutory pattern as a whole, and to an extent that will truly effectuate the particular legislation or a particular definition therein.²¹

It can be considered that tax advisers would create tax avoidance schemes by using the complex language in the legislation to their favour. Therefore, it is imperative that the corporate tax legislation and policies are simplified in order to create fewer ambiguities while creating loopholes for tax avoidance and evasion.

¹⁸ Ibid.

¹⁹ See the case of *JGC Corporation v Federal Inland Revenue Service* section 4.3.1- Overview of Corporate tax legislation in Nigeria Chapter 4.

²⁰ [1921] 1 K.B. 64.

²¹ [1988] IR 258.

A limitation of this recommendation is that tax law simplification can be a double-edged sword. For instance, while trying to simplify the UK tax system, laws that are more complex are enacted. Furthermore, the influence of other institutions such as the EU and OECD further compromises this. This creates a tendency of enacting laws and policies that do not specifically address the business environment in UK but as a member state, will have to comply with policies and legislations.²² This notwithstanding, joining the OECD and having its influence in Nigeria will be beneficial considering that a good number of the MNC investors in Nigeria, particularly those from developed economies, are members of the OECD and will readily abide by the laws set out by them. Furthermore, the Nigerian corporate tax structure needs an urgent revaluation due to the rampant cases of illicit financial flows, abusive transfer pricing tax avoidance and evasion. The OECD will be a good international organisation to help direct and bring about this much-needed change by advocating best practice. Finally, it is recommended that Nigeria should consider signing an IGA with the US considering that some American MNCs conduct business in Nigeria and a good number of Nigerians hold dual citizenship with Nigeria and the US.

6.3 Theoretical Contributions

This thesis has major contributions to the academic literature in the Nigeria. With the present economic problems in Nigeria at the time of writing this thesis, it is imperative that the issue of economic development using taxes is addressed through a legal lens. Law academics, can contribute to the much-needed reforms in Nigeria by producing research that can influence policies. The existing literature on the effects of corporation tax on national economies, and the need for reform of the international tax regime, stem from the perspective of economics and accountancy. In Nigeria, there is a gap in the legal academic literature on the need for the

²² For instance, in the case of Cadbury Schweppes, the UK's CFC rules were deemed to contravene on of the freedoms of the EU which led to the ECJ ruling in favour of Cadbury Schweppes.

reform of the corporate tax legislation, which is beset with complexities. This gap is presented in the body of the thesis considering that tax systems whether international or domestic, hinge on law.

6.4 Future research

6.4.1 Policy and Legislation Consideration

Considering the current economic recession in Nigeria, there is a need to design and structure achievable policies that could assist the government to diversify its income by identifying other perhaps sustainable sources of revenue. This creates an opportunity not only for researchers but also for policy-makers to explore areas through which this could be achieved. The opportunity may involve a comparative analysis of other developed jurisdictions in order to better understand how their implementation strategies and how they can be operationalised in Nigeria. For instance, a comparative study of the US and Nigerian tax system should be further explored given that the US and Nigeria operate a federal system of government. The US Internal Revenue Service (IRS), has through history reorganized itself to closely resemble the private sector model of organizing around customers with similar needs.²³ This has enabled the US government to create an environment for compliance.

6.4.2 A New System of Taxing Corporations

With the recently rolled out BEPS action plan and the recent ruling by the EU on Apple, the scale of the debate on corporation tax has escalated.²⁴ This will bring an opportunity for developing a new system for taxing corporations. Whether it will mean introducing a unitary

²³ Library of the European Parliament, Corporate tax avoidance by multinational firms < http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2013/130574/LDM_BRI%282013%29130574_R_EV1_EN.pdf> accessed 05 June 2015.

²⁴ The Centre for Business Taxation, Said Business School University of Oxford, hosted a conference this summer in which recommendations were made for an international tax reform especially for the Corporation tax. The panellists included but not limited to tax and economics academic and campaigners such as MP Devereux, Wolfgang Schön, John Vella, Michael Graetz, Judith Freedman and Alex Cobham.

formulary system or abolishing the corporation tax totally, an opportunity has arisen for a change to occur especially for developing countries.

On the other hand, if corporation tax cannot be abolished, research into a new system of taxing MNCs in developing and emerging economies should be considered. This will create a system that will hopefully, align with the demographic demands of these countries and at the same time, limit illicit financial flow, tax evasion and avoidance.

6.5 Final Thoughts

With the recommendations for the review of the Nigerian tax system, it is expected that this will set Nigeria on the path to a stronger corporate tax regime and perhaps a more favourable environment for foreign investment and local business set up. Short-term objectives of the government should include reforms and eradication of corruption to project a better international image for business. It is imperative that such objectives are reviewed periodically to strengthen the foundation that has been laid. With a strong tax system that promotes economic development, fosters socio-economic growth whilst meeting the basic needs of its citizens, Nigeria would not only become again the giant of Africa but a world economic power.

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APPENDICES

APPENDIX A: Companies and Allied Matters Act (CAMA) Cap C20 LFN 2004

Section 54 (1) -Subject to Sections 56 - 59 of this Act, every foreign company which, before or after the commencement of this Act, was incorporated outside Nigeria, and having the intention of carrying on business in Nigeria shall take all steps necessary to obtain incorporation as a separate entity in Nigeria for that purpose, but until so incorporated the foreign company shall not carry on business in Nigeria or exercise any of the powers of a registered company and shall not have a place of business or an address for service of documents or processes in Nigeria for any purpose other than the receipt of notices and other documents as matters preliminary to incorporation under this Act.

APPENDIX B: Company Income Tax Act Cap C21 LFN 2004

Section 9

(1) Subject to the provisions of this Act, the tax shall, for each year of assessment, be payable at the rate specified in subsection (1) of section 40 of this Act upon the profits of company accruing in, derived from, brought into, or received in, Nigeria in respect of

(a) any trade or business for whatever period of time such trade or business may have been carried on;

(b) rent or any premium arising from a right granted or any other person for the use or occupation of any property; and where any payment on account of such a rent as is mentioned in this paragraph is made before the expiration of the period to which it relates and is included for the purposes of this paragraph in the profits to company, then, so much of the payment as relates to any period beginning with the date on which the payment is made shall be treated for these purposes as accruing to the company proportioned from day to day over the last-mentioned period or over the five years beginning with that date, whichever is the shorter;

(c) dividends, interest, royalties' discounts, charges or annuities;

(d) any source of annual profits or gains not falling within the preceding categories;

(e) any amount deemed to be income or profits under a provision of this Act or, with respect to any benefit arising from a pension or provident fund, of the Personal Income Tax Act;

(f) fees, dues and allowances (whenever paid) for service rendered.

(g) any amount of profits or gains arising from acquisition and disposal of short term money instruments like Federal Government securities, treasury bills, treasury or savings certificates debenture certificates or treasury bonds.

(2) For the purposes of this section, interest shall be deemed to be derived from Nigeria if (a) there is a liability to payment of the interest by a Nigeria company or a company in Nigeria regardless of where or in what form the payment is made, or (b) the interest accrues to a foreign company or person from a Nigerian company or a company in Nigeria regardless of whichever way the interest may have accrued.

(3) In this section, "dividend" means (a) in relation to company not being in the process of being wound up or liquidated, 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 the shareholders, and (b) in relation to company that in being wound up or liquidated, 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.

Section 10.

Identification of a company. The incorporation number of a company to which the provisions of section 8 apply, shall serve as the identification number of the company and shall be displayed by the company on all business transactions with other companies and individuals and on every document, statement, returns, audited account and correspondence with Revenue Authorities, including the Board of Customs and Excise, Ministries and all Government agencies.

Section 13 Nigerian companies.

(1) 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. (2) The profits of a company other than a Nigeria company from any trade or business shall be deemed to be derived from Nigeria

(a) if that company has a fixed base in Nigeria to the extent that the profit is attributable to the fixed base

(b) if it does not have a fixed base in Nigeria but habitually operate a trade or business through a person in Nigeria authorized to conclude contracts on its behalf or on behalf of some other companies controlled by it or which have controlling interest in it or habitually maintains a stock of goods or merchandise in Nigeria from which deliveries are regularly made by a person on behalf of the company to the extent that the profit is attributable to business or trade or activities carried on through that person

(c) if that trade or business or activities involve a single contract for surveys, deliveries, installations or construction; the profit from that contract

(d) where the trade or business or activities is between the company and another person controlled by it or which has a controlling interest in it and conditions are made or imposed between that company and such persons in their commercial or financial relations which in the opinion of the board is deemed to be artificial or fictitious, so much of the profits adjusted by the board to reflect arm s length transaction

(3) for the purposes of subsection 2 of this section a fixed base shall not include facilities used solely for the

(a) storage or display of goods or merchandise.

(b) facilities used solely for the collection of information.

Section 19 Where a dividend is paid out as profit on which no tax 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 is paid by a Nigerian company paying the dividend shall be charged to tax at the rate prescribed in subsection 1 of section 40 of this Act 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.

Section 20 In the case of a company which is neither a Nigerian company nor engaged in a trade or business in Nigeria at any time during a year of assessment-

(a) no tax shall be charged on it for that year in respect of any dividend received by it from a Nigerian company apart from tax withheld under section 80 of this Act;

(b) where any dividend is paid out of profits on which no tax is payable due to no total profits or total profits which are less than the amount of dividend which is paid whether the recipient of the dividend is a Nigerian company or not, the company paying the dividend shall be charged to tax at the rate prescribed in subsection (1) of section 40 of this Act as if such dividend is the total profits of the company for the year of assessment which relates to accounts out of which the dividend is declared;

(c) nothing in this Act shall confer on such company or on the company paying the dividend, a right to repayment of tax paid by reason of the provisions of this section.

Section 22 Artificial transactions

(1) Where the Board is of opinion that any disposition is not in fact 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 any such disposition or direct that such adjustments shall be made as respects liability to tax as it considers appropriate so as to counteract the reduction of liability

to tax affected, or reduction which would otherwise be affected, by the transaction and any company concerned shall be assessable accordingly.

(2) For the purpose of this section—

(a) “Disposition” includes any trust, grant, covenant, agreement or arrangement;

(b) Transactions between persons one of whom either has control over the other or, in the case of individuals, who are related to each other or between persons both of whom are controlled by some other person, shall be deemed to be artificial or fictitious if in the opinion of the Board those transactions have not been made on terms which might fairly have been expected to have been made by persons engaged in the same or similar activities dealing with one another at arm’s length.

(3) A company in respect of which any direction is made under this section, shall have a right of appeal in like manner as though for the purposes of Part X of this Act such direction were an assessment.

Section 23 Profits exempted

(1) There shall exempt from the tax-

(c) the profits of any company engaged in ecclesiastical, charitable or education activities of a public character in so far such profits are not derived from a trade or business carried on by such company.

Section 29 (3) - The assessable profits of any company from any trade or business for the year of assessment in which it commenced to carry on such trade or business;(or in the case of a company other than a Nigerian company for the year of assessment in which it commenced to carry on such trade or business in Nigeria) and for the two following years of assessment ;

(which years are in this section respectively referred to as “the first year”, “the second year” and “the third year”) shall be ascertained in accordance with the following provisions-

for the first year the assessable profits shall be the profits of that year

for the second year the assessable profits shall unless such notice as hereinafter mentioned is given, be the amount of the profits of one year from the date of the commencement of the trade or business as determined for the purpose of paragraph (a) of this subsection

for the third year the assessable profit shall unless such notice as hereinafter mentioned is given, be computed in accordance with subsection (1) of this section

A company shall be entitled on giving notice in writing to the (board within two years after the end of the second year to require that the assessable profits both for the second year and the third year; but not for one or other only of those years shall be the profits of the respective year of assessment.

CITA PART VI

Incentives to the gas industry

Section 39 Gas utilisation (downstream operations)

(1) A company engaged in gas utilisation (downstream operations) shall be granted the following incentives, that is—

(a) an initial tax-free period of three years which may, subject to the satisfactory performance of the business, be renewed for an additional period of two years;

[1998 No. 18.]

(b) as an alternative to the initial tax free period granted under paragraph (a) of this subsection, an additional investment allowance of 35 per cent which shall not reduce the value of the asset,

so however that a company which claims the incentive provided under this paragraph shall not also claim the incentive provided under paragraph (c) (ii) of this subsection;

[1999 No. 30.]

(c) accelerated capital allowances after the tax-free period, as follows, that is—

(i) an annual allowance of 90 per cent with 10 per cent retention, for investment in plant and machinery;

(ii) an additional investment allowance of 15 per cent which shall not reduce the value of the asset;

[1998 No. 18.]

(d) tax free dividends during the tax free period, where—

(i) the investment for the business was in foreign currency; or

[1998 No. 18.]

(ii) the introduction of imported plant and machinery during the period was not less than 30 per cent of the equity share capital of the company;

[1999 No. 30.]

(e) interest payable on any loan obtained with the prior approval of the Minister for a gas project, shall be tax deductible.

[1998 No. 19.]

(2) The tax-free period of a company shall start on the day the company commences production as certified by the Ministry of Petroleum Resources.

[1998 No. 18.]

(3) In this section—

“gas utilisation” means the marketing and distribution of natural gas for commercial purposes and includes power plant, liquefied natural gas, gas to liquid plant, fertiliser plant, gas transmission and distribution pipelines;

[1998 No. 19.]

“tax-free period” means the tax-free period referred to in subsection (1) (a) of this section.

[1998 No. 18.]

Section 40

(1) There shall be levied and paid for each year of assessment in respect of the total profits of every company tax at the rate of thirty kobo for every naira.

(2) In addition to any levy made pursuant to subsection (1) of this section, there shall, as from the assessment year commencing on 1st January, 1989 be levied and paid a special levy of fifteen per cent on excess profits of every company including banks and for the purpose of this subsection, excess profits means the difference between total profits as computed in accordance with section 27 of this Act and standard profits as calculated in accordance with the provisions of subsection (3) of this section.

Section 65 Board to make assessments.

(1) The Board shall proceed to assess every company chargeable with tax as soon as may be after the expiration of the time allowed to such company for the delivery of the audited accounts and return provided for in section 55 of this Act or otherwise as it appears to the Board practicable so to do.

(2) Where a company has delivered audited accounts and return, the Board may (a) accept the audited accounts and return and make an assessment accordingly; or (b) refuse to accept the return and, to the best of its judgments, determine the amount of the total profits of the company and make an assessment accordingly.

Section 80 Deduction of tax from dividend

(1) Where any dividend or such other distribution becomes due from or payable by a Nigerian company to any other company or to any person to whom the provisions of the Personal Income Tax Act apply, the company paying such dividend or making such distribution shall, at the date when the amount is paid or credited, whichever first occurs, deduct therefrom tax at the rate prescribed under subsection (2) of this section and shall forthwith pay over to the Board the amount so deducted.

[Cap. P8.]

(2) The rate at which tax is to be deducted under this section shall be 10 per cent.

(3) Dividend received after deduction of tax prescribed in this section shall be regarded as franked investment income of the company receiving the dividend and shall not be charged to further tax as part of the profits of the recipient company. However, where such income is re-distributed and tax is to be accounted for on the gross amount of the distribution in accordance with subsection (1) of this section, the company may set-off the withholding tax which it has itself suffered on the same income.

(4) The tax, when paid over to the Board, shall be the final tax due from a non-resident recipient of the payment.

(5) In accounting for the tax so deducted to the Board, the company shall state in writing the following particulars, that is to say—

- (a) The gross amount of the dividend or such other distribution;
- (b) The name and address of the recipient;
- (c) the accounting period or periods of the company in respect of the profits out of which the dividend or distribution is declared to be payable and the date on which payment is due; and
- (d) The amount of tax so deducted.

Section 92 Penalty for offences.

(1) Any person guilty of an offence against this Act or any person who contravenes or fails to comply with any of the provisions of this Act or of any rule made there under for which no other penalty is specifically provided, shall be liable on conviction to a fine of N200, and without prejudice to section 55 (4) or (5), where such offence is the failure to furnish a statement or information or to keep records required, a further sum of N40 for each and every day during which such failure continues, and in default of payment to imprisonment for six months, the liability for such further sum to commence from the day following the conviction, or from such day thereafter as the court may order...

Section 96.

Tax to be payable notwithstanding proceedings for penalties. The institution of proceedings for, or the imposition of a penalty, fine or term of imprisonment under this Act shall not relieve any company from liability to payment of any tax for which it is or may become liable.

Section 105 (1) - In this Act, unless the context otherwise requires-

“Company” means any company or corporation (other than a corporation sole) established by or under any law in force in Nigeria or elsewhere.

“Foreign company” means any company or corporation (other than a corporation sole) established by or under any law in force in any territory or country outside Nigeria.

“Nigerian Company”

APPENDIX C: Petroleum Profits Tax Act

Section 2 Interpretation

In this Act, unless the context otherwise requires-

"company" means any body corporate incorporated under any law in force in Nigeria or elsewhere;

Section 8. Charge of tax

There shall be levied upon the profits of each accounting period of any company engaged in petroleum operations during that period, a tax to be charged, assessed and payable in accordance with the provisions of this Act.

Section 9 Ascertainment of profits, adjusted profit, assessable profits and chargeable profits

APPENDIX D: The Taxes and Levies (Approved List for Collection) Act CAP T2, Laws of the Federation of Nigeria 2004.

1. (1) Notwithstanding anything contained in the Constitution of the Federal Republic of Nigeria 1979, as amended, or in any other enactment or law, the Federal Government, State Government and Local Government shall be responsible for collecting the taxes and levies listed in Part I, Part II and Part III of the Schedule to this Act, respectively.

(2) The Minister of Finance may, on the advice of the Joint Tax Board and by Order published in the Gazette, amend the Schedule to this Act.

1. (1) Notwithstanding anything contained in the Constitution of the Federal Republic of Nigeria 1979, as amended, or in any other enactment or law, no person, other than the appropriate tax authority, shall assess or collect, on behalf of the Government, any tax or levy listed in the Schedule to this Act, and members of the Nigeria Police Force shall only be used in accordance with the provisions of the tax laws.

(2) No person, including a tax authority, shall mount a road block in any part of the Federation for the purpose of collecting any tax or levy.

3. A person who –

(a) collects or levies any tax or levy; or

(b) mounts a road block or causes a road block to be mounted for the purpose of collecting any tax or levy, in contravention of section 2 of this Act, is guilty of an offence and liable on conviction to a fine of N50,000 or imprisonment for 3 years or to both such fine and imprisonment.

APPENDIX E: OECD Model Tax Convention on Income and on Capital (CONDENSED VERSION) 2014

Article 1 Persons Covered- This Convention shall apply to persons who are residents of one or both of the Contracting States

Article 3(1) for the purposes of this Convention, unless the context otherwise requires:

- a) The term “person” includes an individual, a company and any other body of persons;
- b) The term “company” means anybody corporate or any entity that is treated as a body corporate for tax purposes;
- d) The terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

Article 5 Permanent Establishment

1. For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term “permanent establishment” includes especially:

- a) a place of management;
- b) a branch;
- c) an office;
- d) a factory;
- e) a workshop, and
- f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

Article 7 Business Profits

1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

2. For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

Article 12 Royalties

1. Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

Article 13 Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

Article 23 METHODS FOR ELIMINATION OF DOUBLE TAXATION

ARTICLE 23 A

Exemption Method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.
2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10 and 11, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.
3. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.
4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.

ARTICLE 23 B

Credit Method

1. Where a resident of a Contracting State derives income or owns capital, which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:

a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;

b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital, which may be, taxed in that other State.

2. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

APPENDIX F: HM Revenue and Customs: Strengthening Tax Avoidance Sanctions and Deterrents: A discussion document.

2. Penalties for enablers of tax avoidance which is defeated

2.1 The vast majority of tax agents, intermediaries and others who provide services in relation to the taxation consequences of commercial arrangements, or who facilitate their implementation, operate within the spirit of tax law and do not enable tax avoidance. But a minority do enable tax avoidance

2.2 The government has taken effective and innovative steps to tackle avoidance, introducing tougher tools and structural reform. Following the 2015 Budget, the government challenged the regulatory bodies who police professional standards in tax and accountancy to take a greater lead in setting and enforcing professional standards around the facilitation and promotion of tax avoidance.

In response, the professional tax and accountancy bodies have been working on strengthening their current Professional Conduct in Relation to Taxation (PCRT) document by inserting some revised standards on acceptable tax planning as a significant first step in meeting the government's challenge.

2.3 Similarly, the Code of Practice on Taxation for Banks was introduced in 2009

It is designed to change the attitudes and behaviours of banks towards avoidance given their position as potential users, promoters and funders of tax avoidance arrangements. It discourages banks and organisations providing banking services from promoting or knowingly facilitating tax avoidance by others. HMRC publishes an annual report including the names of banks who have and have not adopted the Code, and may include the names of those it determines have not complied with the Code. By 31 March 2015, 303 banks had adopted the Code and HMRC has observed positive changes in how those banks conduct their business.

HMRC believes that the Code has been a significant factor in changing the banks' attitudes to avoidance.

2.4 However, agents and banks are only part of the picture when it comes to enabling or facilitating the use of tax avoidance arrangements. There is a whole supply chain of advice and intermediation between those who develop tax avoidance arrangements or schemes and those who ultimately use them in an attempt to pay less tax than parliament intended.

2.5 The people who introduced users to the avoidance, or facilitated its implementation, bear limited risk or downside when avoidance arrangements are defeated by HMRC. The government wants to deter enablers of tax avoidance and considers that financial sanctions would provide a tangible response by minimising the financial rewards those enablers would otherwise enjoy.

2.6 This chapter focuses on those who enable others to avoid tax. It proposes raising the stakes for those who design, market, or facilitate the use of avoidance by introducing sanctions, in line with HMRC's penalty principles in paragraph 1.5, on them when the avoidance they have enabled is defeated by HMRC.

8 Who is an enabler of tax avoidance?

2.7 The word enabler encompasses more than those who design, promote and market avoidance. It includes anyone in the supply chain who benefits from an end user implementing tax avoidance arrangements and without whom the arrangements as designed could not be implemented.

2.8 To ensure that the sanctions proposed in this chapter operate effectively, the government needs to define an avoidance enabler clearly and to provide safeguards for those who are within that definition but were unaware that the services they provided were connected to wider tax avoidance arrangements. A tax agent who, in the circumstances discussed in paragraph

2.30 does no more than prepare a client's tax return for submission to HMRC is not the focus of this measure.

2.9 The focus of the proposals in this chapter is on those who benefit financially from enabling others to implement tax avoidance arrangements. This includes but isn't limited to:

- those who develop, or advise/assist those developing, such arrangements and schemes;
- Independent Financial Advisers, accountants and others who earn fees and commissions in connection with marketing such arrangements, whether or not their activities amount to the promotion of arrangements; and
- company formation agents, banks, trustees, accountants, lawyers and others who are intrinsic in, and necessary to, the machinery or implementation of, the avoidance.

2.10 Many enablers of tax avoidance do not feel affected by the suite of sanctions and deterrents designed to influence avoider behaviour. Indeed, some judge that the business and reputational risks associated with HMRC defeating avoidance arrangements they have helped enable are outweighed by the financial rewards to them. There can be few downsides to their continued involvement with such arrangements, notwithstanding the hardship, which may be faced by their clients.

