

DIGITAL ECONOMY AND TAX COMPLIANCE IN NIGERIA: A LITERATURE REVIEW

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Abstract

This paper critically reviewed the extant literature that is related to digital economy and tax compliance in Nigeria with a view to identifying gaps for further extensive empirical consideration. Taxpayers, especially in the digital economy are always looking for means to reduce or avoid their tax liability, and this has led to some high-level of tax non-compliance in both advanced and emerging countries. The paper is centered on fairness theory and economic deterrence theory. This paper, therefore, present a review of extent of extant literature on Digital Economy and tax compliance in Nigeria. The methodology employed in the study was purely exploratory library and desktop study that is based on an in-depth review of existing literature on the topical issues. The paper identified gaps that require hardcore empirical investigation to reduce mixed result observed in the results of literature reviewed. Furthermore, logical conclusions were reached and recommendations were made

Keywords: Digital Economy, Effective Tax Rate, Tax Compliance, Significant Economic Presence, Base Erosion and Profit Shifting.

Introduction

The rapid development of digital economy occasioned by technological advancement has led to change in business landscape and the economy. This exponential and technological advancement has also provided business, in the word over an opportunity to access global markets, opportunities for business growth and pose a challenge to taxation. Digital economy refers to as an economy that encompasses all economic activity reliant on, or significantly enhanced by the use of digital inputs, including technologies, digital infrastructure, digital service and data (OECD, 2023).

According to Modibbbo and Buba (2022), digital economy operators can be categorized into: (i) companies that provide online platforms and allow users to interact are considered digital economy operators (ii) companies that provide digital content to users are considered digital economy operators, and (iii) Companies provide the basic infrastructure that powers the digital economy. According to estimates, the worldwide value of the digital economy in 2025 is projected to be \$24 trillion, representing 21% of global GDP (UNCTAD, 2025).

According to the UNCTAD (2025), majority of the total market capitalization value is represented by the six global technology companies of Apple, Microsoft, Amazon, Google, Facebook, ten cents, and Alibaba, with three of them being based in the United States and the other three in China. In same vein, the digital economy in Africa is expanding with 4.5% to GDP with some projections of 5.2% in 2025 (World Bank, 2020). Estimates for 2020 showed a contribution of 4.5%, or \$105 billion USD. According to a 2020 research conducted by Google and the International Finance Corporation (IFC), the digital economy may unlock the continent's GDP by US\$712 (8.5%) billion by 2050 and US\$180 billion (5.2%) by the end of 2025" (Naira metric, 2025).

In Nigeria, digital payment is experiencing exponential growth, with the total transactions value

soared to N1.08 quadrillion, in 2024 compared with N600 trillions reported in 2023 (Naira metrics 2025). With Nigeria's population predominantly youths, has subscribed to digital economy, which has occasioned increase in FinTech solutions and other digital services. This growth dynamics, also present challenges especially tax compliance. These developments have presented significant challenges for traditional tax frameworks and tax authorities in terms of developing appropriate taxation strategies for the digital economy, as the latter makes it difficult to monitor transactions and enforce tax compliance (Adeosun, 2023).

World over, government are face with challenges of developing the regulatory framework to tax the digital economy and Nigeria is not an exception. The Nigerian Government are faced with the task of ensuring that the digital economy contributes a fair share of taxes, while avoiding multiple taxation which could discourage investment and economy growth. In response to this, tax administrators and policy makers, through an amendment of the substantive legislation, sort to encourage tax compliance by such corporations. Thus, the birth of the finance Act 2019, which took effect from January 13th 2020. The Finance Act, 2019 amended seven key tax legislations, including the Companies Income Tax Act. The Act amended section 13(2) CITA, which was the premise for imposing taxes on non-resident companies. By introducing the concept of "Significant Economic Presence". The law expands the incidence of taxation for non-resident companies in Nigeria, which could not be prior captured in the tax net, thus deviating from the hitherto inadequate traditional basis of taxation. Flowing from the above submission, this paper is therefore set out to assess taxation of digital economy in Nigeria by exploring its compliance.

Theoretical framework

Fairness and Equity Theory

Fairness and equity theory also known as Smith's Theory of Taxation. This theory draws its relevance from the "canon of taxation" propounded by Adam Smith in 1776. The fairness and equity theory asserts that it is more likely for individual to obey rules if they consider the system that produces the rules to be fair and equitable. That when individual perceives inequality in any system, it will result to disobedience to the rules from such system. As per Smith's (1776) assertion, a tax system designed to accomplish certain goals must conform to a set of principles known as its features. Smith was curious in how an economy might increase its revenue in order to maintain itself or fulfill its obligations to the general population. He believed that since the private sector was more effective than the public sector, it should bear the main burden of fostering economic expansion (Bhatia, 2002).

Economic of Crime Theory

Economic of crime theory or deterrence theory views taxpayers as a rational being, thus maximizes benefits irrespective of the moral consequences. This theory was first propounded by Becker (1968). He asserts that if the probability of criminal being caught in a crime and possibility of punishment is high, it will discourage such crime. Allingham and Sadmo (1972) introduced this theory to explain tax compliance behavior. They opined that taxpayers are rational being, hence compare the benefits of non-compliance with the cost of penalty when caught. That if the benefits outweigh the cost, then the taxpayer sees tax non-compliance as a worthy venture. However, tax non-compliance increases if taxpayers know he will not be identified by the tax authorities. More so, that the corporations in the digital economy requires more sophisticated technology by the tax authorities to unlock their tax liabilities.

Literature Review

Digital Economy

Digital economy is an economy built on digital computer technology (Pratt, 2023). The Organization for Economic Co-operation and Development (OECD, 2019) describes the digital

economy as an economy that incorporates all economic activity reliant on, or significantly enhanced by the use of digital inputs, including digital technologies, digital infrastructure, digital services and data. It is simply an economy that is dominated by companies without physical presence but carry on transactions with the aid of the internet. The OECD (2014), identified few essential traits and unique qualities of the digital economy as follows: Dependence on intellectual property: Intangible assets, such as intellectual property, are heavily relied upon. User involvement and data value: A lot of developing business models use data, user involvement, network effects, and user generated content. The capacity to have an economic presence without a significant physical presence is known as "scale without mass. In addition, according to the OECD, there are three main models into which digital businesses can be divided: a) The Subscription Model: On websites like Amazon or Netflix, consumers pay a subscription fee to access certain services or content. b) The advertisement model, in which people earn money by seeing advertisements on websites run by businesses like Facebook or YouTube. c) The access model, in which Internet service providers, data brokers, and data analysts pay content and app creators to access end users' data, including App Store.

Taxation of Digital Economy in Nigeria

According to Eiya (2012), Tax is a compulsory levy imposed by the government on the income, profit, or capital gains of individuals and organizations to generate revenue. Simply put, taxation is the process or system of raising revenue through the levying of different taxes. Nigeria taxes the revenues of companies that carry out digital transaction to the degree that such gains are substantially connected to the business's economic presence in Nigeria when comparing the digital taxes of various nations. In an attempt to address the issues relating to digital taxation in Nigeria, Section 13(2) of Finance Act 2019 was amended in 2020. However, because it was designed or established using the conventional taxation framework, it is hard to adequately regulate or oversee entities that operate in the digital sphere.

The approach adopted by Nigeria in developing taxation rules for the digital economy saw the emergence of the concept of "Significant Economic Presence" (SEP) (Akhatior, et al., 2024). Based on the SEP Order 2020, a non-resident entity will be deemed to have a SEP in Nigeria if it:

1. Receives gross revenue or income from any of the following sources in Nigeria each year, amounting to more than NGN 25 million or its equivalent in other currencies: Downloading or streaming media such as games, apps, movies, music, or books. Transfer of information gathered from user activity concerning Nigerian users. Delivery of products and services to Nigeria using an online platform. Offering intermediation services in Nigeria between suppliers and customers via a digital platform, website, or online application. Connected people's activities will be added together to establish the NGN 25 million threshold.
2. Uses a Nigerian domain name (.ng) or registers a website address in Nigeria, or
3. Maintains intentional and ongoing relationships with Nigerians by tailoring its digital platform to their needs (e.g., by listing the cost of its products or services in naira) (Akhatior, Ezike & Erhuen, 2024).

Tax Compliance of Digital Economy

Tax compliance level in most countries has been a major obstacle to tax revenue sustainability as it creates "tax gap" (Eyitayo-Oyesode, 2004). Brown and Mazur (2005) opined that tax compliance concept has three basic standard perspectives such as compliance to payment, compliance to filling and compliance to reporting. Tax compliance is seen as the "willingness to pay taxes" as at when due (Eiya & Soyinka, 2018). Tax compliance is the extent to which the behavior of taxpayers complies (or fails to comply with tax laws of their country (OECD, 2014). Eiya, Alade and Adu (2016), defined tax compliance as the process undertaken by taxpayers to obey tax laws and regulations. Tax compliance

can be measure in terms of “tax gap” – the difference between budgeted tax revenue and actual revenue collected.

Adebisi and Gbegi (2013) show that tax is a major source of government revenue, and any act against the payment of tax will lead to non-compliance which is as a result of delinquent behavior among the taxpayer. It is against this backdrop, we defined tax compliance as taxpayers’ willingness to obey tax laws and offset tax liability promptly. The discourse on determinant of tax compliance in literature has been centered on one of the four school of thoughts: economic motives, social, institutional and demographic (Brooks, 2001; Devos, 2008; Kirhler, 2008; Palil, 2010). These factors or motive account for taxpayer’s willingness to comply with tax laws or fails to comply. Companies operating in the digital economy are not in any way different from other companies operating in the traditional economy, except not having physical presence. Thus, exhibit same taxpayer’s behavior often occasioned by economic motives (when a taxpayer perceived that the probability of being caught in tax non-compliance and attendance penalty is high). In order to address tax non-compliance by non-resident corporations in the digital economy, Nigeria has showed commitment for Pillar Two of the OECD/G20 agreement, which seeks to establish a global minimum tax rate to prevent profit shifting and tax avoidance by multinational corporations. These reforms may engender tax compliance by non-resident digital enterprises, enhance fiscal capacity and sovereignty of Nigeria to tax the income derived from its digital economy (Ogidan, 2021; Oyedele & Oyedele, 2021). Specifically, section 57 Nigerian Tax Act (NTA), 2025 says that if foreign subsidiary of a Nigerian company pays less than the minimum effective rate (ETR) of 15%, the parent company must pay the shortfall. This clearly positioned Nigerian to align with the OCED and global best practice on Base Erosion and Profit Shifting (BEPS).

Gabriel Aliu (2021) elaborately addresses the digital economy and the evolutionary trends of law and policy in Nigeria. He began by pointing out the inadequacy of international tax rules in taxing the new business models. The author recognizes reactionary policies by international and local lawmakers and tax administrators. He highlights and analyses the adequacy of the provisions of existing legislation on the taxation of non-resident companies in Nigeria before the Finance Act 2019. This exercise is relevant as the Finance Act signaled the adoption of a unilateral approach to the taxation of the digital economy in Nigeria. He examines the introductions provided in the Finance Act, as well as the Significant Economic Presence Order. The author highlights the challenges of enforcing the key provisions and concludes that the Nigerian tax administrators may have allegedly jumped the gun to tap the digital economy's spoils.

Oyedele and Oyedele (2021) argued that on taxing the digital economy in sub-Saharan Africa, explores the implications of taxing the digital economy in sub-Saharan Africa, with a focus on Nigeria as a case study. The paper examines the domestic efforts on taxing the digital economy in Nigeria under the Finance Act 2019 and 2020 and assesses their impact and effectiveness. They conclude with some recommendations for sub-Saharan African countries to adopt a balanced and pragmatic approach to taxing the digital economy that considers their specific needs and circumstances. In addition, Ogidan (2021), carried out an investigation on Taxation of the Digital Economy in Nigeria – Analysis of the Policy, Legal & Administrative Dimensions, provides a comprehensive analysis of the policy, legal and administrative dimensions of taxing the digital economy in Nigeria, with reference to the international developments and best practices. The paper also identifies some implementation and enforcement issues, such as defining and measuring the significant economic presence, allocating profits among different jurisdictions, collecting and verifying data, and resolving disputes with taxpayers and other countries which results to tax non-compliance.

In the same vein, Aduloju (2022) carried out a study on Taxation of the Nigerian Digital Economy in View of the 2019 and 2020 Finance Act, the study critically evaluates the taxation of the Nigerian digital economy in view of the 2019 and 2020 Finance Acts. The paper employs a doctrinal approach to analyze the relevant provisions of the Finance Acts, which adopted the significant

economic presence approach to tax non-resident digital corporations that have a substantial connection with Nigeria. He founds among other that tax compliance by non-resident digital corporations can be enhanced by harmonizing domestic tax laws with international standards, adopting a coordinated and cooperative approach with other countries, providing clear guidance and certainty for taxpayers, and promoting digital development and innovation.

Furthermore, Olbert and Spenge (2017), recognized the challenges created by the digital economy for the international community. They emphasize the increasing mobility and importance of intangibles and the concomitant decreasing relevance of a physical presence as primary tax challenges in the digital economy. They begin by addressing the slow-paced nature of international tax law and principles compared to the constantly evolving nature of global business practices. They highlight the scarcity of scientific evidence on tax challenges and make critical recommendations premised primarily on the reliance on interdisciplinary knowledge. Additionally, they recommend developing specific guidance on transfer pricing of digital business models as a pragmatic policy option to address the digital economy's tax challenges effectively.

Falana et al (2024) examined the impact of digital tax administration on tax compliance within Nigeria's informal sector, focusing on South-West States. The researchers conducted a survey involving 547 respondents, including artisans, street vendors, small scale traders, and service providers. The study examined technical know-how to enhance digital literacy among informal sector participants to positively influence tax compliance. The study suggested investing in digital infrastructure and training to enhance tax compliance in the informal sector. All these studies collectively underscore the importance of adapting tax systems to evolving digital landscape, emphasizing the need for improved digital infrastructure, updated legislation, and international collaboration to improve tax compliance in Nigeria's digital economy.

Digital Economy: Lessons from International Organizations

The taxation of the digital economy is a global issue; therefore, there has been different assertions for the establishment of a global platform to harvest opinions and adopt a consensus position to address the non-compliance arising therefrom. While this has not been achieved, the OECD has been at the focal point of championing a new global taxing rules. The major objective of the OECD is to develop a generally accepted regime for taxing the digital economy. This objective would be achieved through a consistent review of recommendations put forward by member states, the Task Force on The Digital Economy, and the Inclusive Framework with the ultimate goal of reaching a consensus.

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) has reached a two-pillar agreement to address tax non-compliance occasioned by the digital economy. Pillar 1 focuses on multinational enterprises (MNEs) with global revenue exceeding 20 billion euros and a profitability rate of 10% or more, which may be reduced to 10 billion euros if certain conditions are met. The framework outlines a special purpose nexus rule allowing for revenue allocation to market jurisdictions when the MNE earns at least 1 million euros, or 250,000 euros for smaller jurisdictions with GDP under 40 billion euros. According to OECD (2021), the framework aims to minimize compliance costs and allocate 25% of residual profits to market jurisdictions based on revenue allocation. The second pillar of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting, known as the Global Anti-Base Erosion Rules (GloBE), makes up of two domestic regulations that work together: The Income Inclusion Rule (IIR), which requires a parent company to pay additional tax on the low-taxed income of a subsidiary, and the Undertaxed Payment Rule (UTPR), which denies tax deductions or requires an adjustment for low-taxed income not taxed under the IIR. Additionally, there is a treaty based rule called the Subject to Tax Rule (STTR) that allows the source country to impose limited source taxation on certain payments to related parties that are taxed below a minimum rate. This tax will be credited as a "covered tax" under the GloBE rules (OECD, 2021).

Nonetheless, the agreement represents the commitment of the overwhelming majority of the Inclusive Framework members to tackle tax compliance surrounding the expansion of the digital economy.

The above presents various policy suggestions that have been proposed by the Organization for Economic Co-operation and Development (OECD) to address the challenges faced by digitalization in taxation. These policy suggestions are part of the broader Base Erosion and Profit Shifting (BEPS) project, which aims to reform international tax rules to ensure that businesses, including digital enterprises, are taxed in a fair and consistent manner. Below is the summary of the key policy suggestions related to digitalization taxation in each year?

The OECD (2015):

- **BEPS Measures Toolkit:** Deliver a final package of BEPS measures that provides a comprehensive toolkit for governments to address tax avoidance by multinational enterprises. This toolkit includes four new minimum standards that cover country-by country reporting, treaty shopping, harmful tax practices, and effective mutual agreement procedures. While not explicitly focused on digitalization, these measures lay the foundation for broader tax reforms, including those addressing digital tax challenges.
- **Tax Challenges of Digitalization:** Recognize the tax challenges arising from the digitalization of the economy as one of the main areas of focus in the BEPS Action Plan. This leads to the BEPS Action 1 Report, which analyses the key features of digital business models, and their tax implications, and explores potential options to address these challenges.

The OECD (2018):

- **Two-Pillar Approach:** Continue the work on the two-pillar approach to address the remaining BEPS issues and the allocation of taxing rights. This approach is essential in addressing the unique tax challenges posed by digital business models that may not have a physical presence but generate significant value in various jurisdictions.
- **Enhance Tax Certainty:** Introduce effective dispute prevention and resolution mechanisms to enhance tax certainty for businesses operating in the digital economy. Given the complexities of digital transactions, providing clarity on tax obligations is crucial for taxpayers and tax authorities alike.
- **Support for Developing Countries:** Support developing countries in implementing the BEPS package and participating in the Inclusive Framework. Digitalization affects both developed and developing economies, and assistance in implementing BEPS measures ensures a more inclusive and coordinated international tax framework.
- **Monitor Implementation and Impact:** Monitor the implementation and impact of the BEPS measures, with particular attention to the tax challenges associated with digitalization. This ongoing evaluation helps identify any shortcomings and adapt tax policies to changing digital business models.

The OECD (2019):

- **Pillar One Proposals:**
- **User Participation Proposal:** Allocate more profits to jurisdictions where businesses have a significant user base. This addresses concerns about taxing digital companies with a large user presence in various countries. 20
- **Marketing Intangibles Proposal:** Allocate more profits to jurisdictions where marketing intangibles (e.g., brands, trademarks) are created or have an effect. This recognizes the value generated by marketing activities in the digital space.
- **Significant Economic Presence Proposal:** Create a new nexus for taxation based on factors such as revenue, users, and digital presence, allowing countries to tax businesses with substantial digital economic activities.

- **Pillar Two Proposals:**

- **Income Inclusion Rule:** Tax the income of foreign branches or controlled entities if it is subject to a low effective tax rate in their jurisdiction of establishment or residence. This prevents profit-shifting to low-tax jurisdictions.
- **Tax on Base Eroding Payments:** Deny certain deductions or treaty benefits for payments subject to a low effective tax rate, further preventing profit shifting.

The OECD (2020):

- **Unified Approach under Pillar One:** Propose a unified approach combining elements from the three previous Pillar One proposals to address profit allocation and tax challenges related to digitalization more comprehensively.
- **Three Components under Pillar One:** Introduce three components - Amount A, Amount B, and Amount C - to allocate profits and address disputes related to in-country functions, baseline marketing, and distribution activities.
- **Global Anti-Base Erosion Proposal under Pillar Two:** Implement a global anti-base erosion proposal to ensure that all internationally operating businesses, including digital companies, pay a minimum level of tax.
- **Two Interrelated Rules under Pillar Two:** Include the income inclusion rule and switch-over rule, as well as the undertaxed payments rule and subject to tax rule, to operate as a minimum tax and as backstops to the income inclusion rule, respectively.

Conclusions

The main thrust of this paper is to assess the challenges of taxpayers' compliance in the digital economy through a review of the extant literature. There is a paucity of literature on taxpayer's compliance in the digital economy because the issue seems to be relatively new but attractive and a fast growing one. In the developed countries of Europe and America, some empirical attempts have been made, but the issue is still open for further discussion in undeveloped countries like Nigeria. Another important revelation in our literature review is that to the best of knowledge there is no empirical studies on the dynamics of tax compliance of corporations in the digital economy in Nigeria. Therefore, empirical studies on digital economy and tax compliance in Nigeria will aid fiscal policy and also enhance generality on the subject matter in developing countries with Nigeria as a reference point. Section 57 of the Nigerian Tax Act. (NTA), 2025 aligned with OCED consensus solution for taxation of the non-resident companies in the digital economy. However, there is a concern that the consensus solution may be driven by the interests of individual members rather than sound economic principles. This may prevent underdeveloped countries, notably those in Africa with developing ICT sectors, from successfully using internet data to tax revenue generated by digital business models and Nigeria not an exception.

Recommendations

In the light of the above logical conclusions, the authors recommend that:

1. The Nigeria Revenue Service should endeavor to leverage on domestication of the OECD/G-20 tax model and enforce compliance with the minimum effective tax rate of 15% on non-resident companies in stages, to embrace Nigeria's peculiarities, including limited sector diversification and low tax to GDP ratio and putting the full weight of revenue generation on these entities sends the wrong signal, threatening foreign direct investment and economic growth. There is mass competition for foreign investment, evidenced by the location of Twitter's permanent establishment in Ghana when selecting a regional base.
2. To encourage voluntary tax compliance, Nigeria Revenue service should endeavor to

develop streamlined and effective tax compliance methods for digital companies by collaborating with international organizations such as the OECD/G20 framework on determining appropriate formula because Pillar one stipulates that profit to be reallocated to market jurisdictions will range between 20-30%, and pillar two merely provides for “at least” 15 % with no clarity on precise numbers. This ambiguity must be timely ratified by members to hasten the implementation of the unified consensus.

3. The current SEP order and the Nigerian Tax Act. 2025 are without precise penalties for non-compliance, the Nigerian Revenue Service should impose fines and penalties on any taxpayer who fails to comply with these legislations.
4. The Nigeria Revenue service should endeavor to place a high priority on strengthening the administrative capacities of its staff by spending money to improve the capabilities and resources of its tax officials. In order to properly implement the new tax laws in regard to digital transactions and evolving business models, tax administrators should be given thorough training and the required technologies.

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