



## **Notice on Changes to the Double Tax Treaty Regime on Foreign Listing of Securities**



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## Introduction

In May 2022, the Federal Inland Revenue Service (“**FIRS**”) published a public notice which set out changes to the percentage of withholding tax (“**WHT**”)<sup>1</sup> payable on dividends, interest and royalties paid by Nigerian residents to residents of other countries (the “**Notice**”). The Notice raises the tax burden on persons resident in countries with which Nigeria has entered into double-taxation treaties (“**DTTs**”) (“**DTT Countries**”).

The Notice took effect from July 1, 2022. Filings of WHT now have to reflect the changes in the rates as contained in the Notice. This article (a) summarizes the contents of the Notice, and (b) sets out the implications of the Notice for payment of dividends and interest to holders of Nigerian equity and debt securities who are residents in DTT Countries (“**DTT Residents**”).



## Background

Incorporating Special Purpose Vehicles (“**SPVs**”) in DTT Countries to receive interest and dividends that are payable out of Nigeria is a common tax planning tool used by foreign residents investing in Nigerian issuers and companies. Traditionally, SPVs organized in DTT Countries have been preferred by Nigerian residents (especially for Eurobond offerings) to SPVs organized elsewhere because the WHT rate applicable to DTT Residents was 7.5%.

The WHT rate reason for preferring SPVs incorporated in DTT Countries is now lost. The 7.5% preferential tax rate for some DTT Countries (including the UK, the Netherlands and France) has now been repealed, presumably because the Federal Government of Nigeria (“**FGN**”) is concerned that it was losing too much tax revenue by doing so. To be clear, the FGN has, in changing the rate, acted within the terms of the DTTs. The DTTs *ex facie* only stipulate a maximum rate of 10%, and the FGN in the Notice has not gone beyond 10%.

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<sup>1</sup> Withholding tax is a tax collection mechanism further to which taxes on income are collected in advance. It typically involves an initial deduction at the time income is earned and being paid, and a subsequent re-adjustment of total tax liabilities at the time of filing with the relevant tax authority.

However, DTT Countries have the advantage of having been tried and tested in Nigerian inward foreign-investment-in-securities contexts, which pedigree may well remain an attraction for investors in the future. Going forward, DTT Countries which still enjoy lower WHT rate of 7.5% may become the new preferable locations for incorporating SPVs in foreign countries to receive interest and dividends out of Nigeria.

## The Notice

DTTs are entered into between contracting nations to reduce or eliminate double taxation by the contracting nations. Nigeria has entered into DTTs with Belgium, Canada, China, Czech Republic, France, Italy<sup>2</sup>, the Netherlands, Pakistan, Philippines, Romania, Singapore, Slovakia, South Africa, Spain, Sweden and the United Kingdom. Nigeria has also signed DTTs with some countries, but those DTTs are yet to be domesticated in Nigeria, and by implication not enforceable.

Before the issuance of the Notice, the same WHT rate of 7.5% applied to dividends, interest, and royalties paid by all DTT Residents<sup>3</sup>. With effect from July 1, 2022, the previous 7.5% rate is no longer applicable. What now apply are the tax rates in Nigerian tax legislations to the extent that such rates do not exceed maximum tax rates in the respective DTTs. In the event that the rate in any Nigerian tax legislation exceeds what is contained in a DTT on the same subject-matter, the maximum rate in the DTT will apply as the withholding tax rate.

The Notice lists sixteen (16) countries that Nigeria has entered into DTTs with and sets out various withholding tax rates payable in line with the provisions of the respective DTTs. Tax rates on dividends are either 7.5% or 10%, depending on the DTT Country and whether or not the shares' voting power is below 10% or not<sup>4</sup>. The WHT rates on interest paid to companies or individuals are either 7.5% or 10%, depending on the DTT Country. Royalties paid to (a) companies are exigible at either 7.5% or 10%, depending on the nationality of the DTT Resident, and (b) individuals are 5% for all DTT Countries.

## The Circular

The Notice is to be read in conjunction with the updated Circular No 2022/15 on the Claim of Tax Treaties Benefits in Nigeria, published on May 11, 2022 ("**Updated Circular**"). The Notice also provides that *"any ruling, direction or approval that has previously been issued by the Service on the WHT rate applicable with respect to any of these tax treaties is hereby withdrawn with effect from 1st July 2022."*

The Updated Circular provides that the WHT rates contained in DTTs do not apply to payments (i) not beneficially owned by a DTT Resident, or (ii) made to non-residents in Nigeria that are connected to their "permanent establishments" in Nigeria.<sup>5</sup>

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<sup>2</sup> Only with respect to operation of aircraft and shipping transportations.

<sup>3</sup> <https://assets.kpmg/content/dam/kpmg/ng/pdf/tax/information-circular-on-the-claim-of-tax-treaties-benefits-in-nigeria.pdf> last accessed August 8, 2022. Please note that this circular has been withdrawn and replaced by a circular dated May 11, 2022.

<sup>4</sup> We interpreted the phrase "company with voting powers of 10% and above" in the Notice to refer to the percentage of shareholdings in a company.

<sup>5</sup> See Updated Circular, para. 4.2.2.

On beneficial ownership, WHT rates under the DTTs will apply to income not directly received by a DTT Resident provided that such income is beneficially owned by the DTT Resident. On the other hand, income received by a DTT Resident that is beneficially owned by another entity will not be covered by the DTTs. What is essential is beneficial ownership, and not just raw receipt of income.

## “Permanent Establishment”

“Permanent establishment” refers to “a fixed place of business through which the business of an enterprise is wholly or partly carried on.”<sup>6</sup> Thus, relevant domestic WHT rates will apply to profits that are attributed to the “permanent establishment” of a DTT Resident in Nigeria. The rate of withholding tax payable by Nigerian residents on (i) dividend is 10% for both corporate bodies and individuals, (ii) interest is 10% for both corporate bodies and individuals, and (iii) royalties is 10% for corporate bodies and 5% for individuals.<sup>7</sup>

On the face of the Notice and the Updated Circular, the Notice will apply to withholding tax on dividends, interest or royalties paid by a Nigerian resident to a DTT Resident. It will not apply to WHT on dividends, interest or royalties paid by any of: (i) a Nigerian resident to another Nigerian resident; (ii) a Nigerian resident to a DTT Resident in respect of the latter’s permanent establishment in Nigeria; (iii) a Nigerian resident to a DTT Resident receiving the payment on behalf of a non-DTT Resident; (iv) a foreign resident to a Nigerian resident<sup>8</sup>; and (v) a Nigerian resident to a foreign resident of a country that Nigeria has no DTT with.

## “Residents”

Although neither the Notice nor the Updated Circular defines who is a “resident,” the FIRS has on a separate occasion defined the term. On April 11, 2022, the FIRS issued a circular on the Taxation of Non-Residents in Nigeria (the “Residence Circular”). The Residence Circular replaces an earlier circular dated June 3, 2021.

According to the Residence Circular, a company is “resident in Nigeria” if it is incorporated in Nigeria.<sup>9</sup> An individual is resident in Nigeria if he or she (i) is domiciled in Nigeria, (ii) lives in Nigeria for an aggregate period of at least 183 days in a 12-month period (inclusive of annual leave or temporary period of absence), (iii) has permanent residence for domestic use in Nigeria, or (iv) is a diplomat or diplomatic agent of Nigeria in another country.<sup>10</sup>

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<sup>6</sup> See Residence Circular, para. 3.2.7.1.

<sup>7</sup> <https://www.firs.gov.ng/withholding-tax-wht-faq/>; Guidelines on the Collection Procedure for Withholding Tax (WHT) and Value Added Tax (VAT) by Ministries, Parastatals and other Agencies of Government, 1995.

<sup>8</sup> On this point, the Updated Circular provides at para. 4.2.1 that “For Nigerian residents, the treaty WHT are to be granted to them by the other treaty countries when payments are made to them from a source in those other countries.”

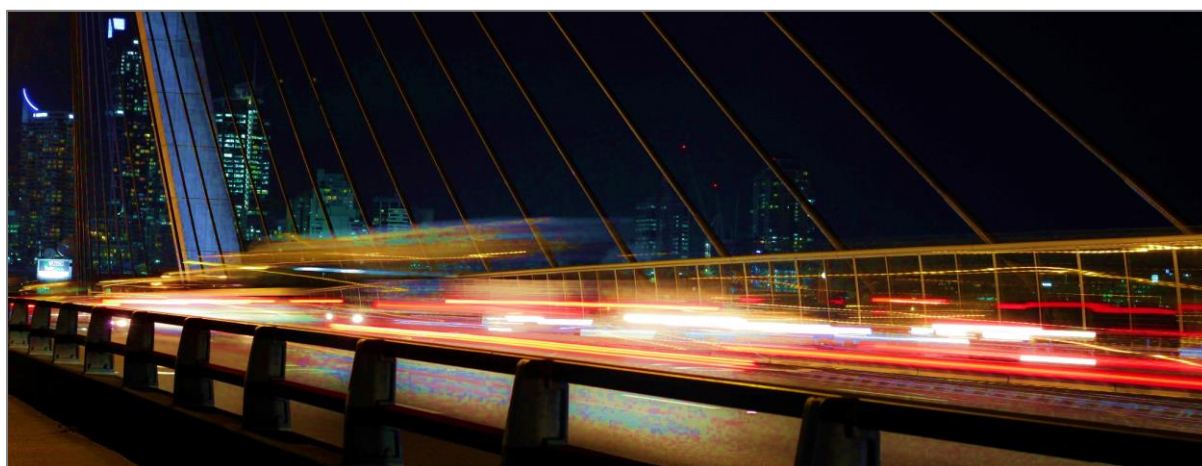
<sup>9</sup> Residence Circular, para. 2.2.

<sup>10</sup> Residence Circular, para. 2.1.

## The Future

DTT Residents will pay higher rates of taxes (10%) on their dividends from July 1, 2022 except they (a) are corporate bodies resident in South Africa, China, Singapore, Sweden or Spain, and (b) hold 10% or more of the voting rights in the Nigerian obligor company. Chinese and Singaporean DTT Residents will also continue to enjoy the 7.5% WHT rate even if they (a) are natural persons, or (b) hold less than 10% of the voting rights in the Nigerian obligor company.

Prior to the Notice, where Eurobonds are issued using an SPV, the SPV will typically be organized in DTT Countries and subscribe to a note issued by the Nigerian sponsor company (the “**Senior Notes**”). The proceeds of the Eurobonds issuance will flow into the SPV and pass through to the Nigerian company. The terms of the Eurobonds will typically mirror the terms of the Senior Notes.



For example, before the Notice was issued, the WHT rate applicable to interest payments due to a Dutch DTT Resident was 7.5%. However, with the issuance of the Notice, that advantage is no longer applicable and the applicable WHT rate is now 10%. The only DTT Residents that still enjoy a 7.5% rate are residents of South Africa, China, Singapore, Sweden and Spain (not those of the UK, France, Belgium or the Netherlands, for example).

A number of Eurobonds that have been sponsored by Nigerian issuers featured the use of SPVs incorporated in the Netherlands in large part to take advantage of the reduced WHT rate under the old DTT regime. Will the Netherlands remain the preferred choice for Eurobond SPV incorporation in the future or will prospective issuers now look to the countries with the reduced rates? Time will tell.

## Conclusion

The new tax rates contained in the Notice are already in force. Equity and debt investors need to be aware of how and to what extent the new rates may impact the after-tax returns on their investment in Nigeria.

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