BANWO & IGHODALO

Grey Matter

Taxation Of Digital Assets In Nigeria: What Taxpayers And Businesses Should Expect.

NOVEMBER 8, 2023

Background

The Finance Act 2023 (the "**Act**") was signed into law on May 28, 2023, but took effect on September 1, 2023. Amongst other things, the Act expands the definition of "chargeable assets" under the Capital Gains Tax Act[1] (as amended) ("**CGTA**") to include "digital assets". This effectively imposes a Capital Gains Tax ("**CGT**") of 10% on the disposal of "digital assets" in Nigeria. Given the unconventionality of these digital assets in Nigeria, and the fact that the country is still a developing digital economy, there are legitimate concerns regarding the feasibility of digital assets taxation in the country. It is widely believed that the extant CGT regime may not be equipped to accommodate digital assets transactions. There also seems to be divergent views amongst regulatory agencies regarding the legality of digital assets trading in Nigeria. More importantly, there are certain practical challenges that will be encountered by both taxpayers and the relevant tax authorities in the administration of CGT on digital assets disposal. Taxpayers have therefore questioned the propriety or otherwise of digital assets taxation in the country and desire to know what to expect going forward in terms of the tax consequences of their digital asset transactions.

This commentary highlights the key ingredients of digital assets taxation under the Finance Act 2023 and what affected taxpayers/businesses should expect going forward.

Relevant provisions of the Finance Act 2023

By the combined provisions of sections 1 and 2(1) of the CGTA, 10% CGT is imposed on the total amount of chargeable gains accruing to any person in a year of assessment after making allowable deductions in the computation of such gains.[2] Section 3 of the CGTA (as amended by the Act) provides that subject to any exceptions provided in the CGTA, all forms of property shall be assets for the purposes of the CGTA, whether situated within or outside Nigeria, including: **(a)** options, debts, **digital assets**, and incorporeal property generally; **(b) any currency other than Nigerian currency**; and **(c)** any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired.

1. Cap. C1 Laws of the Federation of Nigeria 2004.
2. See section 2(2) of the CGTA.

Pursuant to Section 6(1)(c) and (d) of the CGTA, disposal of digital assets for CGT purposes occurs where any capital sum is derived from a sale, lease, transfer, assignment, compulsory acquisition, or other disposition of such digital assets, notwithstanding that no digital asset is acquired by the person paying the capital sum, particularly where: **(i)** any capital sum is received in return for forfeiture or surrender of rights, or for refraining from exercising rights, relating to the relevant digital asset; or **(ii)** any capital sum is received as consideration for the use or exploitation of any digital asset. 'Capital sum' for CGT purposes refers to any money **or money's worth**, which is not excluded from the consideration given and taken into account in the computation of CGT under the applicable provisions of section 11 of the CGTA.

This means that any money or money's worth derived from the sale, lease, transfer, assignment, compulsory acquisition, or other disposition of digital assets situated within or outside Nigeria by a taxable person in the country will be subject to 10% CGT after allowable deductions have been made.[3] By the provisions of section 4 of the CGTA, chargeable gains received or brought into Nigeria, in respect of digital assets situated outside the country, is subject to CGT. The provisions of section 5 of the CGTA are to the effect that capital losses are not allowed as an offset against chargeable gains accruing to a person from the disposal of any digital assets.

Section 2(4) of the CGTA requires taxpayers who have disposed a digital asset to, not later than 30 June and 31 December of the relevant year, compute the applicable CGT, file self-assessment CGT returns, and pay the computed CGT to the relevant tax authority in Nigeria.

Commentary

From the provisions of the CGTA and the Act highlighted above, the disposal of digital assets situated within or outside Nigeria by a taxable person in the country attracts 10% CGT. However, it is not clear what constitutes "digital assets" for CGT assessment purposes because, neither the CGTA nor the Act defines digital assets. Hence, a key practical challenge associated with the taxation of digital assets in Nigeria is the determination of what constitutes 'digital assets' for tax purposes.

It is believed that the general legal conception of what digital assets connote in private property law should suffice. In this regard, it is instructive to note that Principle 2 of the *UNIDROIT Principles on Digital Assets*[4] , published in 2023 by the International Institute for the Unification of Private Law, defines 'digital asset' to mean an **electronic record** which is capable of being subject to **control**. It further defines 'electronic record' to mean information which is **(i)** stored in an electronic medium and **(ii)** capable of being retrieved.

Essentially, the provisions of the UNIDROIT Principles on Digital Assets suggest that the disposal of a digital asset occurs where there is a 'change of control' of that digital asset. That is, when there is a transfer of the abilities outlined in Principle 6(1)(a) to another person, and this includes the replacement, modification, destruction, cancellation, or elimination of a digital asset, and the resulting and corresponding derivative creation of a new digital asset (a 'resulting digital asset' which is subject to the control of another person). [5]

3. Two points arising from this general proposition are that: (i) digital assets that are for personal use (such as payment for purchase of items or services) may not attract CGT unless the required statutory is met; and (ii) transfer of digital assets from one digital wallet to another digital wallet may not be not considered as a disposal of digital assets for tax purpose so long as the person responsible for the wallet-to-wallet transfer maintains ownership of both wallets. Taxpayers and businesses are encouraged to consult their tax lawyers for professional advice and regulatory support – where required.

4. UNIDROIT Digital Assets and Private Law Principle 2(2) – https://www.unidroit.org/wp-content/uploads/2023/09/Principles-on-Digital-Assets-and-Private-Law.pdf

5. See Principle 6(2) of the UNIDROIT Principles on Digital Assets.

Transfer of a digital asset means the change of a proprietary right in the digital asset from one person to another person. Transfer includes the acquisition of a proprietary right in a resulting digital asset and the grant of a security right in favour of a secured creditor. A 'transferee' includes a secured creditor. In our view, these provisions provide helpful guidance to taxpayers and relevant tax authorities alike on the criteria for determination of what constitutes 'digital assets' for tax purposes in Nigeria.

While definitions regarding the scope of 'digital assets' are divergent, there appears to be some consensus on the point that 'digital assets' include (but are not limited to) cryptocurrencies, Non-fungible Tokens ("**NFTs**"), and the likes, which are clearly covered by the definition in Principles 2 and 6 of the UNIDROIT Principles on Digital Assets.[6]

Notably, the Securities and Exchange Commission (**"SEC"**), the apex regulatory authority in the Nigerian capital market, has classified crypto-assets, utility tokens, and security tokens as tradable/investible securities (except where proven otherwise by their issuer or sponsor) and are therefore subject to SEC's regulatory remit pursuant to the Investments and Securities Act of 2007 (as amended). In May 2022, the SEC issued the *Digital Asset Rules*[7], which provides for the issuance, registration, and exchange of digital and virtual assets and other related matters in Nigeria.

Flowing from the recognition of digital assets in the capital market and the above guidance from the UNIDROIT principles, the term "digital assets" is no longer totally nebulous notwithstanding that it is not defined in either the CGTA or the Act. It should therefore be clear that chargeable gains arising from the disposal of cryptocurrencies, NFTs, or other digital assets by any taxable person in Nigeria should attract 10% CGT.

Another practical challenge associated with the taxation of digital assets in Nigeria is difficulty associated with the fair market valuation of digital assets for tax purposes. This is because the worth of most digital assets is derived from the context in which they are used, rather than from an independent free market value.[8] Valuation of a digital asset is central to the computation of the tax payable upon its disposal.

The problem of valuation of digital assets for tax purposes directly ties to other practical concerns like how to tax employees that receive digital assets as part of their employment remuneration. It remains open to question whether such remuneration will be treated as bonus shares that will be subject to income tax when received and then CGT when sold. It is also open to question how chargeable gains on digital assets should be calculated in terms of deduction of expenses and other statutory allowances for tax purposes. Taxpayers and relevant tax authorities alike may expect to have very sharp disputes arising from these issues in the implementation of digital assets taxation in Nigeria.

Perhaps a significant practical challenge to taxation of digital assets in Nigeria is the added difficulty that will be encountered by relevant tax authorities in tracking digital asset transactions for tax compliance and enforcement purposes giving the current restrictions put in place on cryptocurrencies by the Central Bank of Nigeria ("**CBN**"). In February 2021, the CBN issued a circular[9] to deposit money banks, non-bank financial institutions, and other financial

6. See the commentary in Principle 2 of the UNIDROIT Digital Assets and Private Law Principle 2(2).
7. SEC: Rules on Issuance, Offering Platforms and Custody of Digital Assets (May 11, 2022)
8. See Eqvista Inc., "Why and how to value digital assets?" (2023), online (blog): < https://eqvista.com/business-assets/value-digital-assets/#:~:text=The%20network%20value%2Dto%2Dtransaction,the%20valuation%20of%20digital%20assets.> (accessed October 16, 2023).
9. See CBN's Letter to financial institutions, dated February 5, 2021, with reference number: BSD/DIR/PUB/LAB/014/001

institutions (OFIs), directing them to close the accounts of persons or entities involved in cryptocurrency transactions within their systems. The CBN further warned local financial institutions against dealing in crypto assets or facilitating payments for crypto exchanges with threat of sanction on any erring institution.

The CBN cited concerns regarding money laundering, terrorism financing, cybercrime, and the volatility of cryptocurrencies as reasons for the ban on cryptocurrency transactions in Nigeria. The CBN followed this directive by launching an investigation into financial institutions offering services to cryptocurrency traders. While the Federal High Court has confirmed that "cryptocurrencies" and "crypto assets" are not illegal[10], deposit banks and other financial institutions have refused to provide services to companies in the "crypto" space for fear of sanction by the CBN. It goes without saying that the legal and regulatory position regarding the taxation of digital assets in Nigeria is not yet settled.[11]

Therefore, conducting digital asset transactions (such as crypto and NFT trading) through the financial institutions in Nigeria may inevitably put both the taxpayer and the relevant financial institution in breach of CBN directives. Exposure to both criminal and administrative sanctions by the CBN for both the taxpayer and the relevant financial institution may follow. The lack of any clear distinction between "cryptocurrencies" and "digital assets" has resulted in many digital asset providers been shut out of the traditional financial system and are operating primarily on the blockchain and/or the dark web. This directly impacts the taxpayers' ability to pay the tax arising from their taxable digital asset transactions in the country.

It also directly impacts the ability of the relevant tax authorities to enforce tax on digital asset transactions if players in the industry are forced to avoid the traditional banking system in the country due to the stringent CBN directives. Thus, the tax authorities must be prepared to take additional steps if they wish to tax the gains from digital asset transactions as the anonymous nature of some blockchains may create difficulty in identifying individuals.

It goes without saying that the legal and regulatory position regarding the taxation of digital assets in Nigeria is not yet settled. This is not surprising as the International Monetary Fund ("**IMF**") has recently noted that policymakers are struggling to accommodate cryptocurrencies within tax systems not designed to handle them[12]. As the IMF noted, the greatest challenge presented by the taxation of digital assets is that of implementation. The quasi-anonymity of digital assets like cryptocurrencies is an inherent hindrance to third-party reporting which could be problematic for the enforcement of digital assets taxation by relevant tax authorities.

In our opinion, CBN needs to consider regulating the settlement of crypto assets transactions through financial institutions rather than banning it. Mindful of the subsisting order of the Federal High Court on the legality of cryptocurrencies, recognition of crypto assets as securities by the SEC, classification of digital assets as chargeable property under the CGTA, recent adoption of a National Blockchain Policy by Nigeria, and the country's overall efforts at attaining a full digital economy, it will be counterproductive for the CBN to continue to maintain its ban on crypto trading through financial institutions.

The identified challenges notwithstanding, the Act remains the law in Nigeria until amended, repealed or nullified by the courts. As such, taxpayers and businesses who engage in the buying and selling of digital assets like cryptocurrencies and NFTs are obliged by law to report all such transactions to the relevant tax authorities and pay the CGT applicable

10. Rise Vest Technologies v Central Bank of Nigeria – Suit No: FHC/ABJ/CS/822/2021
11. See our previous article, "Virtual Times Call For Virtual Assets Regulation …" – https://www.banwo-ighodalo.com/assets/resources/f89bcb0c07f852037575f3ff4d4fd8d4.pdf
12. See IMF Working Paper WP/23/144, published in July 2023.

to the chargeable gains derived by them from such transactions. The combined provisions of the CGTA and the Act essentially require individuals, companies, and non-resident taxable persons in Nigeria who dispose any digital assets like cryptocurrencies and NFTs within or outside the country to compute the CGT applicable to the chargeable gains derived therefrom and remit same to the relevant tax authority after all allowable deductions and expenses incurred in the digital asset disposal have been adjusted in the manner required by law.

Taxpayers and businesses are encouraged to consult their tax lawyers for advice and regulatory support regarding the possible tax consequences of their digital asset transactions, compliance requirements, and recourse available to them against relevant tax authorities under applicable law.

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo.

Contact Persons:

Azeezah Muse-Sadiq

Partner

E: asadiq@banwo-ighodalo.com

Isa Alade

Partner

E: ialade@banwo-ighodalo.com

Emmanuel Onyeabor

Senior Associate/Tax Team Lead

E: eonyeabor@banwo-ighodalo.com

Oluwatoba Oguntuase

Senior Practice Support Lawyer

E: ooguntuase@banwo-ighodalo.com