

CHALLENGES OF THE FINANCE ACT ON THE TAXATION OF DIGITAL ECONOMY IN NIGERIA

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Abstract

*The enactment of the Finance Act on 13 January 2020 introduced various changes to the principal tax laws in Nigeria, among which was the commencement of a new regime on taxation of digital services and products on persons and corporate bodies in Nigeria. Also brought under the new tax regime was the imposition of Value Added Tax (VAT) on intangible supplies and services. In that vein, the Finance Act 2020 had since its inauguration undergone several amendments. The growth in digital activities introduced a digital economy that has a solid potential of increasing the revenue of government vis-à-vis taxation in Nigeria. Foreign institutions seem to have populated the digital scene with the likes of Net Flex, Twitter, Appl, Amazon etc thus making a fortune from the country. There are challenges facing taxation of digital economy which include problem of identifying the income and profits of non-resident companies, lack of accurate data, lack of specialized court, among others, which have continued to pose serious threats to the new tax regime. Thus, providers of services/merchants seem to have been making so much out of the nation's purse without any corresponding economic return. The aim of this paper is to examine the challenges torpedoing the taxation of digital economy, and also, advocated further amendments to the extant legal framework for taxation of digital economy as a way forward. This paper adopted doctrinal legal research methodology with the use of analytical approach. The paper used statutes and case law as primary sources and also made use of textbooks, journal articles, and Internet materials as secondary sources. At the end, the paper concluded that the extant legal framework for taxation of digital economy is shrouded with numerous legal challenges which are born out of the decreasing relevance of physical presence in the jurisdiction of consumers thereby destabilizing conventional tax regimes that are location based. The paper recommended among other things that the extant tax laws in respected of taxation of digital economy in Nigeria be amended to be in line with global best practices. **Keywords: Taxation, Digital Economy, E-Transaction, Significant Economic Presence***

1.0 Introduction

1.1 The Advent of Taxation of Digital Economy

The outbreak of the Covid-19 pandemic and its ensuing side effects, including increased inflation, unemployment, public debt, as well as other negative economic indicators resulted in various importunate monetary policy interventions and fiscal policy measures targeted at cushioning the severity of economic decline. These birthed the Finance Act 2020 and other fiscal measures. The Act continues the tax reforms introduced by the Finance Act 2020 and provides clarity for ambiguities contained in the preceding tax laws¹. The new law makes changes with significant implications for non-resident companies and the digital economy.

The growth and development of digital trade facilitates globalization which ensures international development through the establishment of borderless economic relationship. However, concomitant with these advantages are taxation challenges within the international system. These challenges are borne out of the decreasing relevance of physical presence in the jurisdiction of consumers which destabilizes conventional tax regimes which are inherently location based. The proliferation of the aforementioned and the fast –paced nature of digitalization have resulted in critical discussions on the reformation of the Nigeria taxation regime². Globalization plays an

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¹ R Ogidan, 'Taxation of the Digital Economy in Nigeria. Analysis of the Policy, Legal and Administration Dimension (A project submitted to Faculty of Law, University of Lagos 2021).

² *Ibid.*

essential role in determining the world's future and digitalization has been identified as one of the primary drivers.

The world is still only in the early days of the data-driven economy and by the end of 2024, Global (IP)³ traffic is projected to reach 150, 700 GB per seconds fueled by the expansion of Internet of Things (IOT). The Undeniable reality is that digitalization has changed business models and the world as we know it. The digital economy is now accounting for up to 15% of Global GDP⁴, This expansion has created multiple economic opportunities which were not foreseeable of digital economy resulted in tremendous changes in the “Brick and Mortar” economy which had formed the basis our of tax laws. The current trend circumvents the requirement of permanent establishment for the completion of transaction, by multi-national companies. This development has result in severe revenue losses especially for developing countries unable to properly tax the revenue due to the absence of physical establishment within the relevant country.

1.2 Meaning of Digital Economy

A digital economy is an economy that is based on technologies especially electronically and through the internet such as e-commerce platforms, app stores, rides hailing apps online advertising, online payment services, cloud computing and participative networked platform etc⁵. Digital economy also refers to operations carried out entirely online without necessarily having to come out in contact with any physical structure of the company providing the services i.e Non-Resident Companies (NRC), some of these operations include e-commerce, online payment services, cloud computing and the likes⁶.

1.3 Taxation of Companies Prior to Finance Act

Under Nigerian law, all companies are subject to Nigerian Companies Income Tax (“CIT”) where such income accrues in, is derived from, brought into, or is received in Nigeria⁷. Thus CITA provides the basis for assessing the element of derivation for cooperate tax liability on the profits of an NRC in Nigeria prior to the enactment of the Finance Act, the profits of an NRC from any trade or business were only deemed to be derived from Nigeria and assessable to companies income tax⁸ if that company has a fixed base in Nigeria to the extent that the profit is attributable to the fixed base. Otherwise, if the company does not have a fixed base in Nigeria but habitually operate its 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 profits is attributable to business or trade or activities carried on through that person.

Likewise, where a company's profits from that trade or business or activities which involves a single contract for surveys, deliveries, installations or constructions, or 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 FIRS is deemed to be artificial or fictitious

³ J Braiden, 'The Role of Globalization in Economic Development' SSRN Electronic Journal via (<http://www.taxation> and role of globalization in economic development. Html> accessed 20th March 2024.

⁴ *Ibid.*

⁵ D Tapscott, The Digital Economy! Promise and Pesil in the Age of Networked Intelligence via(<https://cbralibrary.utoronto.ca>) accessed 2nd February 2024.

⁶ O Ngwyen, 'Digital Economy and its components: A brief Overview, via (<https://mpr.ub.uni-muenchen.de/116110/mptpaper>) accessed 25th December 2023.

⁷ *Toufic Karam v CIT* (1948) WACA 25; Companies Income Tax (Amendment) Act 2007 s9.

⁸ *Ibids* 13 (2).

The above provisions of the CITA limited the taxation of business profits of NRCs to only occasion where the NRC has a fixed base in Nigeria (which require some element of physical presence; or concludes contracts through a dependent agent in Nigeria or engage in turn-key project in Nigeria; or carries on trade or business with persons who have controlling interest in the NRC and the conditions made or imposed between the NRC and such person in their commercial or financial relations are deemed to be artificial or fictitious by the FIRS.

The regime did⁹ not contemplate the taxation of income derived by NRC's from digital services or products offered to persons resident in Nigeria. Multinational NRCs typically avoid operational or investment structures that result in the creation of a fixed base or permanent establishment ("PE") in Nigeria when they are providing digital goods or services. Although there is currently no statutory definition of "fixed base" under Nigerian law, however, decisions handed down by the Tax Appeal Tribunals, Courts¹⁰ and the provisions of CIT¹¹ all seem to ascribe a notion of a physical location/building and permanence to what would qualify as a fixed base. Intangible goods and digital services provided through internet media enable multinationals to easily avoid the physical presence that usually is indicative of a fixed base.

NRCs transacting largely through electronic means in Nigeria also do not need to habitually conduct business through a dependent agent in Nigeria or have any representatives or maintain stock or merchandise in Nigeria from which deliveries are made. Neither do they tend to contract for surveys, deliveries, installations or construction or carry on business with related entities that have controlling interest in the NRC. Based on the foregoing insofar as the profits of an NRC did not fall under any of the categories highlighted above, it was difficult to subject NRCs which provide digital goods or services to Nigeria to be liable to CIT payment obligations in Nigeria. Such was the status of the CIT on corporate tax liability prior to the emergence of the Finance Act.

1.4 Value Added Tax Prior to Finance Act

VAT is collected through persons who are known as "taxable persons". Section 8(q)¹² directs the Service to issue a taxpayer identification number (TIN) to everybody in Nigeria in collaboration with State Boards of Internal Revenue and the Local Government Revenue Boards. However, when TIN is generated, it suffices and covers all the types of taxes as no other registration number for any tax type will be required.

The VAT Act has been quite dynamic in the area of registration of taxable persons. The initial policy was to exclude public authorities from being taxable persons. "Taxable person" was initially defined as "a person (other than public authority acting in that capacity) who independently carries out in any place, an economic activity as a producer, wholesaler, a trader, supplier of goods and services (including mining and other related activities) or person exploiting tangible or intangible property for the purpose of obtaining income therefore by way of trade or business"¹³

In a bid to accelerate the rate of registration the VAT Act was amended to impose obligation on all government levels to act as VAT collecting agents. A taxable person is now defined as a person who independently carries out in any place an economic activity as a producer wholesaler, a trader, supplier of goods, supplier of services (including mining and other related activities) or person exploiting tangible or intangible property for the purpose of obtaining income therefore by way of trade or business and include an agency of the government acting in that capacity.

⁹ *Allan Gray Investment Management Nig Ltd v FIRS* (unreported judgment of the TAT delivered on Wednesday, November 13, 2019 in Appeal No TAT/LZ/VAT/019/2018; *Bank of Baroda v Iyalabani Co Ltd* (2002) LPELR 743(SC) per Ogundare JSC (pp. 38-39, paras G-C).

¹⁰Fixed Base (n8).

¹¹ VAT (Amendment) Act 2007.

¹² *Ibid* s 43.

¹³ VAT Act (n11).

Section 8 (13)¹⁴ specifically states that a taxable person (individuals, enterprises or corporate organizations) shall within six months of the commencement of business, whichever is earlier, register with the board for the purpose of tax. The phrase, whichever is earlier, that specifies the time for registration has caused a lot of pains on taxpayers in the VAT administration. It is not practical to expect a business just recently incorporated (say 2019) to have been registered in 1994 for the purpose of tax.

The futility of collecting consumption tax in Nigeria was underscored by the Supreme Court in the case of *Aberuagba v AG Ogun*¹⁵ State thus:

Developed countries where retail trade is carried on departmental stores, supermarkets, drug stores and shops where all sales are accounted for and the business addresses registered, it is convenient and save for any government to appoint retailers as its agents for the collection of Sales Tax. Every penny collected will ordinarily reach the government. The position is entirely different in Nigeria.

It is notorious fact that except in few departmental stores, shops and drug stores where accounts of sales are kept, the bulk of retail trade is carried on by swans of amorphous trades in the market places and in the homes, on our streets and highways, under bridges on trees. They do not keep record or account of their business dealings and they cannot be reached by any government¹⁶. Although section 93¹⁷ simply requires a taxable person to register for the VAT collection which presupposes a single registration¹⁸, in practice, the FIRS has however directed that where taxable person has more than one branch, each branch should register separately at the nearest tax office to it.

The implication of this is that such a business entity is obliged to have a multiple registration and maintain independent record of its VAT transactions at each branch. This directive has been severely criticized as imposing avoidable hardship on taxable persons¹⁹. Section 10 mandates a non-resident company carrying on business in Nigeria should register for VAT by using the address of person with whom it has a subsisting contract. A non - resident company shall include the tax in its invoice while the person to whom the goods and services are supplied shall remit tax in the currency of the transaction²⁰.

In *Vodacom business Nig v Federal Inland Revenue Service*²¹, the Tax Appeal Tribunal (TAT or the Tribunal), Lagos zone, held recently that transactions relating to the supply of satellite network bandwidth by non-resident company for VAT purpose under section 10 of the VAT Act in Nigeria for non-issuance of tax invoice by the non-resident company are irrelevant considerations.

As laudable as the provision maybe, they however pose certain administrative challenges in practice. For instance, where a foreign company has business dealing with more than one person whom are located in different places across the country, the foreign company will be required to register with tax office at different locations where its customers are located, which maybe administratively burdensome and discouraging. A better approach may be required where each local supplier shall disclose such transaction and withhold the requesting VAT rather than requesting the foreign

¹⁴ (1995) NWLR (pt 3) 385.

¹⁵ Per Bello, JSC (as he then was) at p. 33q.

¹⁶(n 11).

¹⁷*Ibid* s 8.

¹⁸IJ Musa, Impediments of the VAT Act, Daily Trust Newspaper (Abuja: 23 March 2020) 32.

¹⁹ (n 11).

²⁰ TAT/LZ/VAT/016/2015

²¹National Tax Policy (NTP) 2010 Article 3.4.

company to register. It is remarkable that the obligation to remit tax in the currency of transaction applies only to transaction involving foreign companies are usually denominated wholly in foreign currency or partly foreign and partly naira.

2.0 Emergence of Finance Act and Digital Taxation on VAT Transactions

2.1 Finance Act on VAT Transactions

2.1.1 Increase in VAT Rate and Palliative Measures to Manage its Impact

A tenet of Nigeria's National Tax Policy (NTP)²² is a gradual shift from reliance on direct tax to indirect tax for economic growth. To mitigate the impact of the revised VAT rate increase from 5% to 7%, the Finance Act introduces palliative measures for micro and small enterprises which initiate a VAT compliance threshold. Thus the cost of tax administration will reduce because the FIRS can now focus its compliance monitoring efforts on large business only²³. Another noteworthy palliative is exemption of service rendered by microfinance banks.

2.1.2 Broadening Scope of VAT Coverage.

The erstwhile provisions of the VAT Act²⁴ did not contain a definition of goods. Consequently, VAT able goods had, in practice, been limited to tangible goods that are not exempted under the First Schedule to the Act, incorporate property was generally accepted as non-VAT able, by taxpayers, on the basis that such property neither constitutes goods nor service and supply thereof cannot attract VAT. In fact, the Federal High Court had ruled in the case between *CNOOC Expiration and Production Nigeria Limited v FIRS*²⁵ that interest in rights in an oil economic in an incorporeal property; it is neither a good nor service, which are the two categories of taxable items under the VAT Act. This judgment further validated the view that transactions in incorporeal property should not attract VAT. The Finance Act²⁶ however, seeks to expand the definition of "goods" to include any intangible product, asset or property over which a person has ownership where he derives benefits, and which can be transferred from one person to another, excluding interest in land". Consequently, the VAT ability of incorporeal property, such as rights, patents, trademarks, royalty, etc, that was hitherto debated has now been legislated in favour of the treasury.

Another controversial issue that may potentially be resolved by the Finance Act²⁷ is the VAT ability (in Nigeria) of services provided outside Nigeria by a non-resident company (NRC) to a Nigerian company. One view on the subject is that such transaction should be liable to VAT in Nigeria because the recipient is in, and consumed the services in Nigeria meaning that the services were effectively supplied in Nigeria. The contrary view is that a service supplied outside Nigeria should not be liable to VAT in Nigeria simply because it was enjoyed by a Nigeria based customer. The differing views on the subject have been debated extensively by taxpayers and the FIRS, and has even been submitted to the courts, including the Courts of Appeal (CoA), for determination. According to the Court of Appeal, in the case between *Vodacom v FIRS*²⁸, such services should be liable to VAT in Nigeria if provided to a Nigeria-based customer and enjoyed in Nigeria. It is noteworthy that this conclusion aligns with the Organization of Economic Cooperation and Development's Destination Principle (OECD)²⁹.

²² Finance Act 2019 s 38.

²³ *Ibid*.

²⁴ VAT (Amendment) Act First Schedule to the Act.

²⁵ (2013) 9 TLRN 28.

²⁶ VAT (Amendment) Act (n24).

²⁷ CA/L/556/2018 (Unreported).

²⁸ Finance Act (n22) 515.

²⁹ *Ibid* s 7.

2.2 Finance Act on CIT

The Finance Act has brought some sweeping changes to the CIT, and these reforms include introduction of a progressive CIT system³⁰ changes to modalities for payment of tax³¹, a new tax holiday for agric business³², and also amendments to the legislation regulating stamp Duties³³ and also, the insurance sector³⁴, and among others.

Further, the new Act replaces the cumbersome procedure for computing minimum tax, under the CITA, with a simplified base rate of 0.5% of the qualifying company's turnover less franked investment income.³⁵ The modification was made in recognition of the need to shift the impact of minimum tax from capital busy to a purely revenue-based approach.

Equally, the Finance Act introduces new provisions under the CITA aimed at, among other things, capturing the digital economy by adopting "significant economic presence" (SEP) to affix the affected companies with a fixed base in Nigeria.³⁶ Prior to the new Act, section 13 of the CITA subjected a Non-resident company (NRC) to tax in Nigeria only if such company had a fixed base in Nigeria and the taxable profit attributable to that fixed base³⁷.

Thus the direct consequence of the above was tax revenue leakage for the Nigeria Government. To address the challenges of taxation of the digital economy, the Finance Act introduces SEP to create a nexus for taxing profits derived by the NRCs from digital operation in Nigeria³⁸.

The new Act vests in the Honourable Minister of Finance (MoF) with the powers to issue an order on SEP³⁹. Above were some of the changes brought along by the new Act on CIT in Nigeria.

3.0 Challenges Facing Taxation of Digital Economy in Nigeria

3.1 Absence of Consensus-Based Long-Term Solutions

While recognizing the work by the Organization for Economic Co-operation and Development (OECD) aimed at creating a uniform approach to taxing multi-national companies especially those operating in the digital space, yet a uniform approach has not been attained⁴⁰. The absence of a predictable, sustainable and efficient international tax system prescribing uniform rules for the taxation of non-resident companies poses a major challenge. What are obtainable are numerous bilateral treaties and unilateral approaches adopted by various nation-states to prevent tax avoidance by multi-national companies.

3.2 The Imposition of Value Added Tax (VAT)

Value added tax is a challenge associated with taxing the digital economy VAT remains considerable revenue for states and has been impacted by the growth of digital economy. The revenue loss from VAT typically arises from sale of goods and services and intangibles⁴¹ to local consumers from suppliers abroad. In the absence of a practical international framework to ensure VAT collection in

³⁰ CIT (Amendment) Act 531.

³¹ (n 22) s 7.

³² CIT (n22) s 6.

³³ (n 22) s 13.

³⁴ CIT (Significant Economic Presence) Order 2020

³⁵ *Ibid.*

³⁶ Organization for Economic Cooperation and Development (OECD) Base Erosion and Profit Shifting (BEPS) Point 1 (2019).

³⁷ CIT (Significant Economic Presence (n34).

³⁸ LLP Bird, Digital Services Tax: Over of the Progress of Implementation by European Union Member states, 2e8 October 2019. Also available at (<https://www.lexology.com/library/detail.aspx?>) accessed 28 November 2023.

³⁹ Finance Act s33.

⁴⁰ *Ibid.* s78.

⁴¹ *Ibid.*.

the jurisdiction of consumption, most states have suffered tremendous reduction in revenue, a situation that is further worsened by the difficulty in ensuring that VAT is remitted to the relevant tax authority⁴²

3.3 Lack of Accurate Digital Taxpayer Information

Lack of accurate data of these digital non-resident companies is one of the major challenges facing the Federal Inland Revenue Service (FIRS) in taxation of the digital economy. The Companies and Allied Matters Act (CAMA) 2020⁴³ makes it mandatory for every foreign company having the intention of carrying on business in Nigeria to take all steps necessary to obtain incorporation as a separate entity in Nigeria. Until so incorporated⁴⁴, the foreign company shall not carry on business in Nigeria or exercise any power of a registered company and shall not have a place of business or address for service or processes in Nigeria.⁴⁵ If a foreign company fails to comply with the requirement of registration, the company has committed an offence and liable to be prosecuted.

3.4 Lack of Clear – Cut Legal Framework for Taxation of Digital Economy

Prior to the advent of the Finance Act 2019, and other subsequent laws⁴⁶, taxation of digital non-resident companies under the digital economy was captured by the Companies Income Tax Act, but it was drafted in line with the traditional basis of taxation, which makes it impossible to effectively monitor or properly tax companies operating in the digital economy or digital space because having a permanent establishment in Nigeria was the basis of taxation for companies operating within the Nigeria's jurisdiction.

However, the advent of the digital economy made it possible for digital non-resident companies to conduct business or carry out digital economy activities without the need for a fixed base or permanent establishment thereby making the traditional basis of taxation grossly ineffective. This prompted the legislative and tax administrators to amend the substantive laws which brought in the Finance Act 2023 and the Companies Income Tax Act (Significant Economic Presence) Order 2020

3.5 Problem of Identification of Income and Profits for these Digital Non- Resident Companies and Persons

Digitalization allows business to engage in significant business activities without meeting the requirement of having permanent establishment in Nigeria. The Companies Income Tax (Significant Economic Presence) Order provides that a company other than Nigerian company shall have a significant economic presence in Nigeria where it derives gross turn over or income of more than ₦25 million naira or its equivalent in other currencies through these digital activities. It shall be deemed that the company has a significant economic presence in Nigeria and such income and profit made will be subjected to tax in Nigeria.

It therefore follows that non-resident companies do not need to provide evidence of a permanent establishment in Nigeria before doing business in Nigeria. Digital economic activities need not be accompanied by a physical presence. This is because these online activities and businesses are done with intangible assets and these intangible assets are easily moved around the world through digital technologies including the satellite. This no doubt makes it increasingly difficult for the tax authority (FIRS) to identify income generated through these intangible assets

⁴² (n39) s35.

⁴³ Finance Act 2020; Finance Act 2021; Finance Act 2022 and Finance Act 2023.

⁴⁴ OECB Action 1, 2015 chapter vii.

⁴⁵ *Ibid.*.

⁴⁶ Finance Act (Effective Date Variation) Order by President Bola Ahmed Tinubu, the Act introduces crucial amendments in 11 key statutes.

3.6 Lack of a Specialized Court

There is no specialized court that entertains tax matters in Nigeria. The Tax Appeal Tribunal established by the Federal Inland Revenue (Establishment) Act 2011 and the Tax Appeal Tribunal Procedure Rules 2010 are a mere administrative Tribunal set up to determine the correctness of assessment to tax and entertain tax matters. The Federal Inland Revenue Service (FIRS) can appeal to the tribunal against a non- resident taxpayer for non- payment of tax or for non-compliance with the provisions of the tax laws and non- resident tax payer can as well appeal to the Tribunal challenging an assessment to tax. However, appeals from the tribunal goes to the Federal High Court and further appeal from the Federal High Court goes to the Court of Appeal and then to the Supreme Court.

Tax Appeal Tribunal is not a Superior Court of record like the Federal High Court. That is why all appeals from the tribunal goes to the Federal High Court as against when all appeal from the tribunal moves straight to the Court of Appeal. The Tribunal not being a Superior Court of record will defeat its majority objective which is to maximize the delays and bottlenecks in adjudication of tax matters and improve the tax payer's confidence in the Nigerian Tax system. When these objectives are not achieved the aim or reason for the creation of the Tribunal will be defeated. This is one of the major challenges facing taxation of digital economy in Nigeria.

4.0 Conclusion

The Significant Economic Presence Order and other provisions of the Nigerian laws seem to have failed to provide a formula for determining the profits of (NRCs) in Nigeria which would be liable to corporate taxes. The Unilateral approaches can only be effective when there is an operative established formula for allocating taxing rights.

5.0 Recommendations

It is recommended that Nigeria liaises with other Nations in the international tax community to adopt a particular profit allocation formula which can be subsequently domesticated to address this lacuna. That calls for urgent amendments of the extant tax laws in respect to taxation of digital economy to embrace global best practices.

There is also need for the Federal Inland Revenue Service (FIRS) to make adequate use of technology to increase tax compliance. The revenue authorities should use different ranges of technology tools, data source and analytics to increase tax compliance. This is because economic activities carried out under the digital economy are basically done through the internet. These digital non- resident companies do not need a physical establishment in Nigeria before carrying out digital economic activities, for that reason, the revenue authority needs an advanced technology tool in order to ensure tax compliance in Nigeria.

Also, there is need to identify the income and resources of these taxable digital non- resident companies and persons in Nigeria. In order to achieve an effective tax administration and enforcement under the digital economy, proper identification of these digital taxpayers' income and resources must be done by the FIRS. The Tax Identification Number (TIN) of these digital non- resident tax payers should be made to reveal the income and financial status of these digital non- resident taxpayers. This will help in achieving effective taxation of the digital economy in Nigeria.

Finally, there is need for elevation of Tax Appeal Tribunal to a Superior Court of record. The Tax Appeal Tribunal is a mere administrative tribunal which do not have the status of a court. An appeal from the tribunal goes to the Federal High Court as a Superior Court of record. When the status of the tribunal is elevated to that of a Superior Court of record, its appeal will go straight to the Court of Appeal instead of the Federal High Court. This will no doubt aid in the speedy dispensation of justice in taxation matters.