

Administration of Capital Gains Tax in the Digital Assets Economy

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Introduction

Recent advancements in industrial value creation have accelerated, leading to the digitalization of individual and industrial products through blockchain technology. This technology creates virtual goods and products, establishing ownership that often results in economically transferable assets. While some jurisdictions view digital assets as a medium of exchange, others treat them as capital assets. Prior to 2023, the legal status of digital assets in Nigeria remained uncertain. However, the Finance Act of 2023 has since recognized digital assets, prompting this discussion on their treatment under the Capital Gains Tax Act (CGTA) in Nigeria and comparative international contexts.

Understanding Capital Gains Tax

Capital Gains Tax (CGT) is a levy on the profit realized from the sale or exchange of a capital asset. The word "asset" is not defined in the CGTA, but the list of chargeable assets recognized in the CGTA suggest that a capital asset is typically considered to be property held for investment purposes, such as real estate, stocks, currency other than the Nigerian currency and bonds.¹ The CGT is calculated on the profit made from the transaction, deducting costs such as broker fees and commissions² when a disposal/sale of such asset is made. The CGT rate is typically fixed at 10% but may vary in cases involving resident of countries with which Nigeria has tax treaties. Typically, both individuals and entities must report their capital gains as part of their annual tax filings.³

Compliance with Capital Gains Tax in Nigeria

In Nigeria, the Capital Gains Tax Act (as amended)⁴ oversees the reporting and payment of CGT. Individuals and entities must follow specific procedures to ensure compliance with the tax regulations. The law mandates that every person who has disposed of a chargeable asset must:

- a. **Compute the CGT:** Taxpayers must calculate the tax based on the net capital gains from the disposal of the asset. This involves determining the proceeds from the sale

¹ Section 3 of the Capital Gains Tax Act

² Section 6 of the CGTA

³ Organization for Economic Co-operation and Development (OECD) - Capital Gains Taxation

⁴ Section 2 (3) & (4) CGTA

and deducting allowable expenses such as acquisition, enhancement, preservation, and disposal costs.

- b. **File a Self-Assessment Return:** This return must detail the computed capital gains and the resulting tax liability. The self-assessment approach requires taxpayers to honestly declare their gains and calculate their tax dues accordingly.
- c. **Pay the Computed Tax:** The tax computed on the capital gains must be paid within the stipulated deadlines. For individual taxpayers disposing of assets, the state tax authority where the asset is owned and disposed, is responsible for collection, whereas the federal tax authority collects CGT from companies disposing of assets.

Deadlines for Reporting and Payment

Taxpayers must adhere to specific deadlines for filing CGT returns, structured as follows:

- **30th June:** For assets disposed of between January 1st and June 30th, taxpayers must compute the CGT, file the self-assessment return, and pay the tax by June 30th.
- **31st December:** For assets disposed of between July 1st and December 31st, the same process of computation, filing, and payment must be completed by December 31st.

Compliance and Enforcement

Failure to comply with these CGT requirements can result in penalties and interest charges⁵. The Nigerian tax authorities actively monitor compliance and have the power to enforce compliance. Taxpayers are encouraged to ensure accurate computation and timely fulfillment of their tax responsibilities.

Overview of Digital Assets⁶

The term "digital asset" lacks a precise legislative definition, though various treatises have provided insights into its nature and concept. Some scholars typically describe a digital asset as "an ownership with any kind of data in binary form stored in your computer or over the internet in a cloud somewhere". Others consider it as "any item of text or media that has been formatted into a binary source that includes the right to use it."⁷ This broad definition

⁵ Section 55(4) & (5) of CITA and Section 92 CITA. The CGTA does not make provision for penalties on failure to file tax returns. However, the Schedule to CGTA provides for the application of CITA..

⁶ Law Commission "Reforming the Law" <<https://lawcom.gov.uk/project/digital-assets/>> accessed on 13th May 2024

⁷ Toygar, Alp; Rohm, C.E. Taipei Jr.; and Zhu, Jake (2013) "***A New Asset Type: Digital Assets,***" Journal of International Technology and Information Management: Vol. 22: Issue. 4, Article 7.

covers a range of intangible assets that are created virtually and are accessible for purposes such as transfer, sale, or inheritance.

In the context of today's digital and cyber society, digital assets can include any form of digital information stored on computers, smartphones, digital media, or clouds. This extends to social media accounts like Facebook, LinkedIn, TikTok, Twitter (now X), and Instagram, which are increasingly recognized as digital assets. These assets represent a wide category of electronically stored data with utility and value in various sectors. Beyond traditional media like images or documents, digital assets also include cryptocurrencies, non-fungible tokens (NFTs), stablecoins, and central bank digital currencies (CBDCs). Beyond traditional media like images or documents, digital assets also include cryptocurrencies, non-fungible tokens (NFTs), stablecoins, and central bank digital currencies (CBDCs).

- a. **Cryptocurrencies:** Cryptocurrencies are digital or virtual currencies secured by cryptography, which prevents double-spending within a distributed network.⁸ These decentralized digital currencies, such as Bitcoin, Ethereum, and Ripple (XRP), operate without central authority oversight and are typically based on blockchain technology—a distributed ledger recording transactions.
- b. **Non-Fungible Tokens (NFTs):** NFTs are unique digital tokens that signify ownership of specific items or content, such as digital art, music, or virtual real estate. Built primarily on Ethereum's ERC-721 standard, NFTs differ from cryptocurrencies in that each token is unique (non-fungible) and cannot be exchanged on a one-to-one basis like fungible ERC-20 tokens.⁹
- c. **Digital Securities:** Also known as security tokens, these are digital versions of traditional financial assets like stocks or bonds, managed and traded on blockchain platforms. They combine the benefits of blockchain technology, such as enhanced liquidity and transparency, with compliance to securities regulations.
- d. **Stablecoins:** Stablecoins are a type of cryptocurrency designed to minimize price volatility by being pegged to stable assets like fiat currencies (e.g., USD) or commodities (e.g., gold). Their stability makes them suitable for transactions requiring consistent valuation.

⁸ Shubhani Aggarwal, Neeraj Kumar and Pethuru Raj "***The Blockchain Technology for Secure and Smart Applications across Industry Verticals***" Published in Advances in Computers, Volume 121, 2021, Pages 227-266

⁹ Spyridon Georg Koustas et al. in "***A blockchain-based IIoT traceability system: ERC-721 tokens for Industry 4.0***" published in Procedia CIRP 120 (2023) 1280–1285 at 1281

- e. **Central Bank Digital Currencies (CBDCs):** CBDCs are digital forms of fiat currencies issued by central banks to modernize financial systems and enhance financial inclusion. An example is Nigeria's eNaira, which aims to complement traditional Naira by providing a secure, efficient means for banking services, thereby reducing transaction costs and aiding monetary policy implementation. Despite its potential, the eNaira faces challenges related to adoption rates and privacy concerns within its regulatory framework.

Growth of the Digital Assets Market

The digital assets market has experienced remarkable growth, propelled by the widespread adoption of blockchain technology and the increasing recognition of digital assets' utility across both financial and non-financial sectors. This growth trajectory is marked by several key developments: the rising use of cryptocurrencies for transactions and investments, the burgeoning market for NFTs in the arts and collectibles space, and the exploration of CBDCs by several nations' central banks as they aim to modernize their financial systems.

The transition of digital assets from a niche interest to a significant economic force highlights the development of robust infrastructures and regulatory frameworks that accommodate these technologies. The dynamic growth of digital assets is also evident in social media and cloud sectors, such as TikTok, Facebook, X (formerly Twitter), and Instagram. Here, account holders with significant followings increasingly engage in transactions where accounts are sold and purchased for monetary gains, further integrating digital assets into everyday economic activities.

Chargeability of Digital Asset to Capital Gains Tax in Nigeria

Digital assets like bitcoin, cryptocurrencies, NFTs, and stablecoins are often used as currencies and means of exchange in the digital market economy. Simultaneously, assets such as digital securities and cryptocurrencies are acquired and later disposed of at a premium, reflecting their asset-like characteristics.

The fluctuating nature of digital assets has spurred discussions on whether they should be considered chargeable assets. Under the Finance Act of 2023 (FA), digital assets have been explicitly recognized as chargeable assets for CGT purposes in Nigeria, highlighting the government's acknowledgement of the economic impact of digital currencies. According to the CGT Act, even if cryptocurrencies and other digital coins are treated primarily as currencies, they are still subject to CGT since the FA includes "currency other than Nigerian currency¹⁰" as part of chargeable assets. However, Nigeria's regulatory framework for the

¹⁰ Section 3(b) of the CGTA

taxation of digital assets remains somewhat undefined, prompting calls for clearer guidelines to ensure comprehensive and effective taxation compliance.

Current CGT Framework for Digital Assets

Taxation of Digital Assets under CGT

Digital assets, such as cryptocurrencies and NFTs, are increasingly recognized as property for tax purposes in numerous jurisdictions, including the United States. In Nigeria, the approach is somewhat broader, with "currency other than Nigerian currency" classified as a chargeable asset. This classification subjects the gains from the sale or exchange of digital assets to CGT, reflecting the tangible economic value these assets hold.¹¹

In the United States,¹² recent legislative developments such as the Infrastructure Investment and Jobs Act have clarified and expanded the rules surrounding digital asset transactions. This Act has introduced more stringent requirements for brokers and businesses to report transactions involving digital assets to the IRS.¹³ Although digital assets are now acknowledged for CGT purposes under the CGTA in Nigeria, there remains a significant need for a tailored legal framework. This framework should specifically address the peculiarities of the digital asset market, tackling issues such as jurisdictional challenges and the identification of taxpayers engaged in the digital economy.

Cross-Border Transactions and CGT

The taxation of cross-border transactions involving digital assets hinges significantly on the residence of the asset owner and the location of the asset at the time of disposal or transfer. The residence of the buyer or the jurisdiction hosting the transaction platform generally does not affect the determination of the competent tax authority responsible for collecting CGT. However, tax treaties between countries can play a crucial role. These treaties may specify the tax rates applicable or provide exemptions for nationals or corporate entities involved in asset disposal.

Computation of Capital Gains Tax on Disposal of Digital Assets in Nigeria¹⁴

¹¹ Section 3(b) of the CGTA, Digital Assets < <https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets> >

¹² U.S. Department of the Treasury, IRS Release Proposed Regulations on Sales and Exchanges of Digital Assets by Brokers < <https://home.treasury.gov/news/press-releases/jy1705> > accessed 13th May 2024

¹³ Taxation of Cryptocurrency and Other Digital Assets < <https://pro.bloombergtax.com/brief/cryptocurrency-taxation-regulations/> > accessed 13th May 2024

¹⁴ Section 6 CGTA

In Nigeria, CGT is imposed on the gain realized from the disposal of chargeable assets. The gain is calculated as the net proceeds from the disposal of the asset after subtracting allowable expenses. The allowable expenses include:

- a. **Acquisition Cost:** This includes the cost or value of the consideration (either in money or equivalent) wholly, exclusively, and necessarily incurred in providing the asset.
- b. **Enhancement Costs:** Expenses wholly, exclusively, and necessarily incurred to enhance the asset's value, provided these are reflected in the asset's state or nature at the time of disposal.
- c. **Preservation Costs:** Expenses wholly, exclusively, and necessarily incurred in establishing, preserving, or defending the title or right over the asset.
- d. **Disposal Costs:** These are incidental costs related to the disposal process, including fees for professional services (surveyors, valuers, accountants, legal advisers), and costs related to transfer or conveyancing such as stamp duties and advertising.

It is important to note that expenses deductible under income tax calculations for a trade, business, profession, or vocation are not allowable for CGT purposes. Similarly, premiums or payments made under insurance policies against risks of damage, injury, loss, or depreciation of the asset are not deductible. However, qualifying assets for capital allowances do not preclude the deduction of allowable expenses in computing capital gains.

Illustration

Let's consider a hypothetical scenario involving Ada, who resides in Lagos State, Nigeria. Ada purchased 200 Bitcoins in January 2018 for ₦40,000 each, totaling ₦8,000,000. On January 15, 2023, she sold both Bitcoins for ₦20,000,000. The following expenses were incurred related to the acquisition, enhancement, and disposal of the Bitcoins:

- **Acquisition and Initial Costs:**
 - Purchase price: ₦8,000,000
 - Transaction fees for acquisition: ₦200,000
- **Enhancement Costs:**
 - Security for wallet (software and hardware): ₦50,000
- **Disposal Costs:**
 - Transaction fees for sale: ₦100,000
 - Professional advisory fees: ₦150,000

Calculation of Capital Gains Tax

Total Sale Proceeds: ₦20,000,000

Total Allowable Expenses:

- Purchase price: ~~₦~~8,000,000
- Transaction fees for acquisition: ~~₦~~200,000
- Software and hardware wallet security: ~~₦~~50,000
- Transaction fees for sale: ~~₦~~100,000
- Professional advisory fees: ~~₦~~150,000
- **Total Expenses:** ~~₦~~8,500,000

Chargeable Gain: ₦20,000,000 - ~~₦~~8,500,000 = ~~₦~~11,500,000

Capital Gains Tax (10%): 10% of ~~₦~~11,500,000 = ~~₦~~1,150,000

From the above illustration and considering the CGTA provision on deductible expenses, for digital asset owners like Ada, annual costs such as registration fees or licenses for maintaining web accounts, YouTube channels, social media platforms, and data bundles used for advertising or marketing the digital assets, if wholly and exclusively incurred in obtaining the gain, should be deductible when calculating the gain for CGT purposes. This ensures a fair computation that reflects the true economic gain after considering all relevant costs.

Limitations and Challenges of the Current CGT Framework for Digital Assets

The landscape of CGT as it pertains to digital assets is fraught with various challenges and limitations, not only in Nigeria but globally. These challenges arise from a combination of the need for adaptive regulations to keep pace with the rapidly changing digital asset market, the inherently volatile nature of digital assets, and the complexities of enforcing tax compliance. Key challenges include:

- i. **Regulatory Uncertainty:** A significant challenge is the lack of uniformity and clarity in tax regulations across jurisdictions. This ambiguity often leads to confusion among taxpayers and can complicate compliance efforts. For example, a directive from the Central Bank of Nigeria issued on February 5th, 2021, instructed banks and non-financial service institutions to avoid engaging in cryptocurrencies and crypto asset payment services, creating a layer of confusion for those involved in these transactions.

- ii. **Identification of Taxpayers:** The anonymous or pseudonymous nature of digital asset transactions complicates the process of identifying taxpayers. Most digital asset transactions occur online and can be designed to protect the identities of the parties involved, posing significant challenges for tax authorities in tracking and taxing such transactions.
- iii. **Technical Challenges in Transaction Tracking and Reporting:** The digital nature of these assets requires sophisticated and often expensive technological systems to track and report transactions effectively. Both taxpayers and tax authorities need advanced systems to manage the data associated with digital asset transactions, which can be a barrier to effective tax administration.
- iv. **Jurisdictional & Enforcement Issues:** Determining the jurisdiction for tax assessment and enforcing tax laws against defaulting taxpayers are significant challenges, especially in cross-border contexts. Digital assets can be managed from virtually any location, complicating the assessment of tax liability based on residency or the location of the asset. Enforcing tax laws becomes even more complex when transactions involve parties from different countries, requiring international cooperation and legal frameworks that can address the intricacies of international tax enforcement.
- v. **Computational Complexities:** Calculating the allowable costs and expenses to determine the actual chargeable gains can be problematic. The volatile prices of digital assets complicate this process further, as the valuation of the asset at the time of each transaction can fluctuate widely.
- vi. **Registration and Compliance for Digital Asset Businesses:** Another major challenge is enforcing registration requirements for businesses engaged in the digital asset market.

International approaches to Taxing Digital Assets

Countries around the world have adopted diverse strategies to tackle the taxation challenges of digital assets:

- **European Union:** The EU is advancing reforms such as VAT in the Digital Age (ViDA) and Customs Union Reform. These initiatives aim to streamline tax collection from

digital platforms, indirectly affecting digital assets by improving the efficiency of tax administration.¹⁵

- **Switzerland, Japan, and New Zealand:** These countries are investigating ways to expand tax collection duties for digital platform operators, potentially extending to transactions involving digital assets. This approach seeks to broaden the tax base to include digital transactions that were previously unregulated or underregulated.¹⁶
- **Singapore:** Known for its structured regulatory environment, Singapore categorizes digital tokens and applies specific tax rules to each category, enhancing clarity and compliance.¹⁷
- **Organisation for Economic Co-operation and Development (OECD):** The OECD plays a crucial role in guiding international tax reforms, including the advocacy for a global minimum tax. This initiative could influence how digital assets are taxed across borders.¹⁸
- **Nigeria:** In response to the digital market economy, Nigeria introduced the "Significant Economic Presence" (SEP) regulation through the Companies Income Tax (Significant Economic Presence) Order, 2020 (SEP Order), to complement the Finance Act 2019. This measure is designed to capture tax revenues from foreign entities that have a substantial economic footprint in Nigeria, including those operating within the digital assets space.

These international efforts reflect the continuous evolution of tax policies in response to the digital economy, aiming to establish a more coordinated and equitable taxation system globally.

Proposed Changes and Implementation Strategies for Expanding CGT to Digital Assets in Nigeria

- **Definition and Scope:** The first step involves amending the CGTA to explicitly define what constitutes an asset and digital asset. This definition should include

¹⁵ International Tax Changes for 2024 – What You Need to Know By: Ted Rogers < <https://www.digitalriver.com/blog/2024-international-tax-updates/> > accessed 12th May 2024

¹⁶ International Tax Changes for 2024 – What You Need to Know By: Ted Rogers < <https://www.digitalriver.com/blog/2024-international-tax-updates/> > accessed 12th May 2024

¹⁷ Digital Currencies: International Actions and Regulations < <https://www.perkinscoie.com/en/news-insights/digital-currencies-international-actions-and-regulations-2023.html> > accessed 10th May 2024

¹⁸ International tax reform: OECD releases technical guidance for implementation of the global minimum tax < <https://www.oecd.org/tax/beps/international-tax-reform-oecd-releases-technical-guidance-for-implementation-of-the-global-minimum-tax.htm> > accessed 12th May 2024.

cryptocurrencies, NFTs, digital tokens, and any other asset existing in digital formats. Providing a clear definition will reduce legal ambiguities and ensure comprehensive coverage under the law.

- **Recognition by the Central Bank of Nigeria:** It is crucial for the Central Bank of Nigeria to formally recognize digital assets. This recognition should align with the Federal High Court's ruling in *Rise Vest Technologies v Central Bank of Nigeria – Suit No: FHC/ABJ/CS/822/2021* which confirmed that transactions involving digital assets, such as cryptocurrencies or bitcoins, are lawful. .
- **Taxable Events:** For effective taxation of digital assets, it is necessary to define specific events that trigger CGT liabilities. These events could include sales or exchanges of digital assets, conversions into fiat currency, and acquisitions of digital assets in exchange for services or goods. Clarifying these taxable events will help taxpayers understand their responsibilities and facilitate better enforcement by tax authorities.
- **Valuation Principles:** Given the volatile nature of digital assets, the legislation must establish clear guidelines for their valuation. It should mandate that digital assets be appraised at their market price on the date of the transaction. The law should also specify acceptable sources for these valuations, such as reputable cryptocurrency exchanges, to ensure consistency and reliability in tax calculations.

Enhanced Infrastructure for Tax Administration

To effectively manage and track digital asset transactions, the Federal Inland Revenue Service (FIRS) could upgrade its infrastructure to integrate technologies that interface with digital asset platforms, enabling real-time data access. Additionally, establishing a detailed reporting system for all digital asset transactions, supported by robust record-keeping practices, would aid compliance and streamline tax administration, ensuring more accurate oversight of digital financial activities.

Conclusion

Updating the CGT framework to include digital assets is essential, reflecting the evolving landscape of investment and asset management. Proper taxation of digital assets upholds principles of equity and has the potential to enhance government revenue without causing significant economic disruption. The rise in digital asset creation and trading represents a shift in the traditional nature of asset management, requiring stakeholders to adapt to new storage solutions like iCloud and portal warehouses, and to understand the nuances of disposal and incidental expenses in calculating chargeable gains.

The movement towards including digital assets in taxation frameworks is gaining momentum globally, with many countries refining their tax codes to encompass digital currencies and tokens. This trend may necessitate more comprehensive regulations and international cooperation to address the challenges posed by decentralized assets.¹⁹

Recommendations for Policymakers and Stakeholders

Policymakers are encouraged to continue dialogues with stakeholders to ensure that the tax system remains equitable and efficient, keeping pace with technological advances. It is recommended that regulatory bodies such as the CBN establish specialized units to address issues arising from digital asset transactions, supported by legislative backing from the National Assembly. This initiative will empower tax authorities to clarify their jurisdiction and enhance government tax revenues. For stakeholders, staying informed and actively engaged with regulatory updates is crucial for effectively navigating the future of digital asset taxation.

For further questions or insights, please reach out to SimmonsCooper Partners at: bashir.ramoni@scp-law.com or info@scp-law.com.

¹⁹ International Tax Changes for 2024 – What You Need to Know By: Ted Rogers < <https://www.digitalriver.com/blog/2024-international-tax-updates/> > accessed 12th May 2024