

Transfer Pricing Audits: What should taxpayers expect?

The responsibility to provide accurate explanation and justification of related party policies and arrangements rests squarely on taxpayers and their business managers. This responsibility ultimately implies the duty to cooperate fully with FIRS. And if this responsibility is not adequately discharged to the satisfaction of FIRS, no taxpayer should blame FIRS where it resolves inconsistencies, ambiguities or paucity of information against them

It is a matter of when and not if, for a taxpayer engaged in related party transactions and which has submitted its transfer pricing (TP) returns to Federal Inland Revenue Service (FIRS), to receive either request for documentation as a prelude to a formal audit notification process or outright notification for a TP audit from FIRS.

Most companies that have 31 December year-ends have completed their second cycle of submission of TP returns to FIRS. They are now simply waiting for feedback from FIRS on those returns and quietly hoping that there will be no TP adjustments resulting in additional tax liability.

According to Eduardo Baistrocchi¹, there are six broad stages that countries generally go through in the evolution of their TP Dispute resolution process. These are:

Stage 1 – the period when the tax jurisdictions had only formal companies' income tax laws without TP legislations and no TP disputes were initiated by the tax administrators

Stage 2 – period when TP disputes started to arise between tax administrators and taxpayers bordering on the arm's length principle (ALP)

Stage 3 – period of enactment of formal TP legislations introducing the ALP into the local legislature

Stage 4 – period when TP disputes bordering on the ALP and TP regulations were not litigated but were resolved at the tax administration level

Stage 5(1) – pre mutual agreement procedures (MAPs) and advance pricing agreements (APAs) regime when TP disputes were resolved through litigations,

Stage 5(2) resolution of TP disputes in non-litigious administrative procedures through use of APAs and MAPs



Stage 6 – resolution of TP disputes through MAPs and APAs, with infrequent litigations

The introduction of the Nigerian TP Regulations in 2012 would imply that the country by-passed stage 2 of the evolutionary process in moving to stage 3. It may also be safely assumed that FIRS has transitioned into stages 4 and/or 5 as stated above given the wave of TP audits it has initiated on both local and foreign enterprises.

It is expedient for stakeholders to always bear in mind that every taxpayer with related party transactions or affiliations will be tax audited for TP purposes sooner or later, depending on the selection criteria or model adopted by FIRS.

Tax administrators normally select cases for TP audits/enquiries based on effective risk identification and assessment using system-based data analytic methods in identifying and

selecting specific cases of higher-risk taxpayers for TP audits. The selection may also be routine every few years based on criteria such as industry or sector groupings, locations etc., notwithstanding if specific risks have been identified or not.

Generally, triggers for TP audits include compliance level of TP obligations, value of related party transactions, loss making entities or winding down of business, trade with entities in tax havens or constantly reported low profit margins.

FIRS may obtain Information relating to these risk factors through its collaboration with other government regulatory agencies like the National Office for Technology Acquisition and Promotion (NOTAP), the Nigerian Customs Services (NCS), Ministry of Finance, Central Bank of Nigeria (CBN), etc. It may also obtain them from TP Returns filed by taxpayers.

Irrespective of the selection criteria

however, any company with related party transaction may be selected for audit. In the course of the TP audit, the taxpayer would usually be required to provide additional information and documents such as contract agreements, trial balance, invoices, expatriate information, etc.

Taxpayers and their business managers therefore need to take adequate steps to develop a robust TP compliance process and effectively prepare for FIRS TP audits. An immediate step in this direction would be to ensure appropriate TP policies - which are compliant with Nigerian TP regulations and international guidelines - are in place, as well as processes for periodic internal reviews to determine the level of compliance with the policies. This will afford the company the opportunity of updating the policies to take into account any changes that may have occurred in any particular accounting period or year of assessment.

Consequently, these managers need to have and demonstrate adequate knowledge of group and local company's business operations, value chain, value propositions and pricing arrangements by local management staff. This will prevent avoidable exposure of the taxpayer to wrongful TP audit adjustments and assessments arising from a TP audit exercise.

The responsibility to provide accurate explanation and justification of the related party policies and arrangements rests squarely on taxpayers and their business managers. This responsibility ultimately implies the duty to cooperate fully with FIRS. And if this responsibility is not adequately discharged to the satisfaction of FIRS, no taxpayer should blame FIRS where it resolves inconsistencies, ambiguities or paucity of information against them.

¹ In his book "Resolving Transfer Pricing Disputes: A Global Analysis" where he reviewed the following twenty (20) countries: Canada, Germany, Spain, UK, USA, Australia, Japan, Korea, Singapore, Brazil, Russia, India, China, Argentina, Chile, Israel, Kenya, Namibia, South Africa and Tanzania

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