Inside Tax

Deloitte.

Transfer Pricing Regime in Nigeria – How far have we gone?

As FIRS embarks on its first set of TP queries and audit reviews following submission of the first and second sets of TP Returns by taxpayers, it is expected that taxpayers and stakeholders will be afforded opportunities of discovering FIRS' dispositions to issues on which it appears to have remained silent prior to this period...

Prior to the enactment of Transfer Pricing Regulations in Nigeria in 2012 (the Regulations), the tax authorities in Nigeria had relied solely on the general anti-avoidance rules (GAAR) in the various Nigerian tax legislation to review intra-group arrangements.

The GAAR provisions laid emphasis on 'sham arrangements' ("…dispositions that are not in fact given effect to…"), and 'artificial/ fictitious transactions' ("…transactions which have not been made on terms which might fairly be expected to have been made by persons engaged in the same or similar activities dealing with one another at arm's length…")

One of the key defects of the GAAR provisions was that it did not provide clear guidelines and parameters on which affected transactions by taxpayers will be evaluated. Thus, the provisions were therefore ineffective to achieve its set objective - ensuring Nigeria's tax base is not eroded and it gets a 'fair share' of tax on revenue sourced therefore (not necessarily eroding other jurisdiction's tax base).

Decisions by tax authorities relying on the GAAR provisions were often discretionary, subjective, speculative and arbitrary triggering usually avoidable contention, controversies and/or disputes with taxpayers.

The introduction of the Regulations provided a more structured regime for assessing affected transactions and combating mispricing of intra-group commercial relationships and the attendant tax flight allegedly being suffered by Nigeria. Similarly, multi-national companies appreciated the potential for relief from arbitrariness under the erstwhile regime.

Despite the euphoria that heralded the introduction of the Regulations, and its almost 3 years of existence, it has become necessary to assess the extent to which Federal Inland Revenue Service is achieving the policy objectives of the TP regime; the extent to which it is succeeding in promoting taxpayers' compliance through adequate communication, and managing the tax compliance burden on taxpayers.

It is commendable that FIRS has made significant efforts in developing the technical competence of its personnel by creating a separate and dedicated TP division and providing them with both local and international training opportunities. FIRS has made very laudable efforts in sensitizing taxpayers and stakeholders on their obligations in relation to TP through public seminars and allied programs.

However, efforts aimed at positively changing or promoting taxpayers' compliance behavior also requires providing them with adequate administrative guidance in the form of regular explanatory circulars, practice notes or guidance on how specific provisions of the TP regulations will be implemented by FIRS.

A lot of uncertainties currently exist in relation to the minimum requirements that will be acceptable to FIRS on issues like – scope and content of documentation reports, parameters for selection of comparable companies in benchmarking prices or profits of related party transactions, etc.

In addition to providing guidance and direction to the affected public, practice pronouncements will also serve the purpose of enabling FIRS adapt its administrative policies to issues in the evolving international tax landscape like the Base Erosion and Profit Shifting (BEPS) initiatives and the Convention on Mutual Administrative Assistance in Tax Matters recently ratified by the Nigerian government.

Increased tax compliance burden on taxpayers is another important issue that has gained prominence during this period of the Regulations' existence. It is instructive to note that on the Ease of Doing Business Index published by the World Bank organization which ranks 189 economies, Nigeria climbed 5 places from 175 to 170 in 2015, but dropped 2 places from 177 to 179 on the ranking for ease of paying taxes. The ease of paying taxes indicator evaluates the taxes and mandatory contributions that a medium-size company must pay in a given year, as well as the administrative burden of paying taxes and contributions.

The non-harmonization of administrative compliance requirements of the National Office for Technology Acquisition and Promotion (NOTAP) and the TP regulations is a relevant example.

Reg. 15 of the Regulations gives tax payers some reprieve by providing that taxpayers may be exempted from TP documentation requirements "…where the controlled transactions are priced in accordance with the requirement of Nigerian statutory provisions…" or "…the prices of connected transactions have been approved by other Government regulatory agencies or authorities established under Nigerian law and satisfactory to the Service to be at arm's length…".

Thus, approvals granted by NOTAP is an example of a qualifying safe harbour transaction. However, its applicability as a 'safe harbour' is rendered doubtful as a result of the caveat contained in Reg.15 – FIRS' satisfaction that the approval is at arm's length.

NOTAP and FIRS are both federal government institutions created by law. However, their functions overlap where it concerns recognition and accepting payments of technical, license and management fees (or for other qualifying transactions) to offshore entities providing service to their Nigerian affiliates and/or related parties. This overlap needs clarification to enhance better understanding of their confluence by taxpayers.

Additionally, FIRS is yet to adopt the salient cost-reducing factors promoted by the OECD such as setting minimum financial threshold for transactions subject to transfer pricing documentation and commencing implementation of the advanced pricing agreement provisions in the TP regulations.

As FIRS embarks on its first set of TP queries and audit reviews following submission of the first and second sets of TP Returns by taxpayers, it is expected that taxpayers and stakeholders will be afforded opportunities of discovering FIRS' dispositions to issues on which it appears to have remained silent prior to this period to enhance opportunities for significant growth, development and sophistication of the Nigerian TP regime in coming years.

[1] http://www.doingbusiness.org/data/exploreeconomies/nigeria/