

# 1. Tax Alert ? **The Income Tax (Transfer Pricing) Regulations, No. 1, 2012**

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Introduction

The proposed Income Tax (Transfer pricing) Regulations, 2012 ("TPRs") is published by the Federal Inland Revenue Service ("FIRS") in pursuance of the powers conferred on it by Section 61 of the Federal Inland Revenue Service (Establishment) Act. No.13 of 2007.

The proposed commencement date for the implementation of the Transfer Pricing Regulations is 1st January 2013.

Objectives of the Transfer Pricing Regulations, 2012

One of the primary objectives of the Transfer Pricing Regulations is the provision to the Nigerian tax authorities, tools to fight tax evasion, which is usually promoted through over or under-pricing of transactions between associated enterprises or corporations not adhering to the arm's length tax principle.

Two other objectives of the Transfer Pricing Regulations are the reduction of the risks of economic double taxation; and the provision of a level playing field between associated companies on the one hand and independent un-associated companies doing business in Nigeria on the other hand.

Transfer Pricing ? Arm Length and Artificial Taxable Transactions

Section 17 of the Personal Income Tax Act (as amended), Section 22 of the Companies' Income Tax Act (as amended) and Section 15 of the Petroleum Profit Tax Act authorises FIRS to disregard and substitute a proper tax assessment for a prior tax assessment where any transaction is intended to artificially or fictitiously reduce the amount of the tax that will otherwise be assessed and paid by a tax payer in Nigeria.

A transaction will be deemed to be artificial or fictitious where one of the parties either has control over the other party, or the parties are so related that the terms of the transaction will be biased or more favourable as amongst the controlled or related parties; in contrast to where the parties are engaged in the same or similar transactions as independent parties, dealing at arm's length basis.

A company that is affected by a decision of FIRS in the above regard has a right to appeal against such a FIRS decision in the first instance to a FIRS appointed Decision Review Panel, with a further right of appeal to the Federal High Court, the Court of Appeal and the Supreme Court which is the Court of last resort in Nigeria.

## Permanent Establishments and Transfer Pricing Regulations, 2012

The proposed Nigerian Transfer Pricing Regulations, 2012 now formally provides that permanent establishments ("PE") will be treated under these Regulations as separate tax entities, and any transaction between a permanent establishment and its parent company or head office, or between it and another connected taxable persons, shall be treated as a controlled transaction liable to the application of the provisions of the Transfer Pricing Regulations, 2012.

Compliance with Arm's Length Principle, Documentations, Advance Pricing Agreements, etc.

**Arm's Length Principle:** The arm's length principle requires that the conditions of a transaction, between connected taxable persons, should not differ from the conditions that would have applied if the connected persons were independent contracting parties engaged in comparable similar transactions carried on under comparable similar circumstances.

Connected persons are therefore required by Article 4 of the Transfer Pricing Regulations to always ensure that all taxable profits that result from transactions between them are in compliance with the arm's length principle. Where connected persons fail to abide with the arm's length principle, the Federal Inland Revenue Service is authorised to make such necessary tax adjustments that will bring the transaction within the parameters of the arm's length principle.

### Transfer Pricing and Comparability Factors

Barring repetition, Article 9 of the proposed Transfer Pricing Regulations, 2012 provides that for the purpose of determining whether the pricing and other conditions of a controlled transaction are consistent with the arm's length principle, the tax payer shall, in the first instance, ensure that the transaction is comparable with a similar or identical transaction between two independent persons carrying on business under comparable conditions.

### Transfer Pricing Methods

Some of the Transfer Pricing Methods that can be applied in determining whether a transaction is transacted within the parameters of the Arm's Length Principle include (i) the Comparable Uncontrolled Price ("CUP") method, or (ii) the Resale Price Method, or (iii) the Cost Plus Method, or (iv) the Transactional Net Margin Method, or (v) the Transactional Profit Split Method, or (vi) any other method as may be prescribed by FIRS, from time to time.

The Cost Plus Method is described by the proposed Transfer Pricing Regulations to mean the method in which the mark-up on the costs directly and indirectly incurred in the supply of goods, property or services in a controlled transaction is comparable with the mark-up on those costs directly or indirectly incurred in the supply of similar goods, property or services in a comparable uncontrolled transaction.

A connected taxable person however has the right to apply to FIRS for the application of a

different transfer pricing method other than the ones stated in the TP Regulations provided that such a TP method gives rise to a result that is consistent with that which exists between independent contracting persons engaged in comparable business or circumstances. A connected taxable person is also permitted by the Transfer Pricing Regulations to enter into an Advance Pricing Agreement with FIRS.

#### Advance Pricing Agreements with FIRS

Regulation 7(1) of the proposed Income Tax (Transfer Pricing) Regulations, 2012 provides that "A connected taxable person may request the service (which is FIRS) to enter into an Advance Pricing Agreement ("Advance Pricing Agreement") establishing an appropriate set of criteria for determining whether the person has complied with the arm's length principle for certain future controlled transactions undertaken by the person over a fixed period of time provided that such agreement shall be consistent with the requirements established by this regulation."

It however appears from the proposed Regulation 7(d) that only tax payers with an annual cumulative transaction amount of not less than Two Hundred and Fifty Million Naira (N250,000,000) can make the request to enter into an Advance Pricing Agreement with FIRS. Also, an Advance Pricing Agreement is only allowed to apply to controlled transactions for a period not exceeding three years. While the TPR is silent on the renewal or otherwise of these Agreements, it is expected that the Agreements will be renewable provided there is no prior breach, or non-compliance, or any material change in the tax legislations in Nigeria. Where any of the latter events occurs, FIRS is authorised to terminate the Advance Pricing Agreement.

#### Transfer Pricing Documentation

A connected taxable person is required to, in advance, record and provide sufficient information, data and analysis of the data submitted verifying that the pricing of the controlled transaction is consistent with the arm's length principle.

FIRS is however authorised to request for additional information where it deems it necessary to effectively carry out its functions under the proposed Transfer Pricing Regulations.

The burden of proof that the conditions of the controlled transactions are consistent with the arm's length principle is on the affected tax payer.

#### Transfer Pricing Disclosure

For each year of assessment, a connected taxable person must without notice or demand by FIRS, make a Transfer Pricing Disclosure in the form prescribed in the proposed Transfer Pricing Regulations. The Transfer Pricing Disclosure Form is required to be filed along with the connected taxable person's annual tax returns for each year of tax assessment.

#### Double Taxation Treaty and Transfer Pricing Regulations

The Transfer Pricing Regulations authorises FIRS to, upon request by a tax payer, make a corresponding tax adjustment where it is established that a connected taxable person, subject to tax in Nigeria, has suffered tax on a connected transaction in another country with which Nigeria has a subsisting Double Taxation Treaty ("DTT").

#### TPR and Supremacy of Tax Laws

All applicable Tax Laws in Nigeria shall prevail whenever there is any inconsistency between these tax laws and the 2012 Transfer Pricing Regulations or the United Nations ("UN") Practical Manual on Transfer Pricing, the OECD Transfer Pricing Guidelines for multi-national Enterprises and Tax Administrations.

Save for the above proviso, the Nigerian proposed Transfer Pricing Regulations, 2012 shall be applied in a manner consistent with the arm's length principle stated in Article 9 of the UN and the OECD Model Tax Conventions on Income and Capital as may be in force at the relevant time.

#### Limitation of Usage of Information

Documentation and correspondence provided by a connected taxable person for TP purposes shall only be used for the purpose of establishing the arm's length principle in respect of the controlled transaction for which the documentation was supplied to FIRS.

All records and data relating to any trade carried on by a tax payer for which documentation and or data are provided for any tax purpose are required to be preserved for a period of at least six (6) years from the date on which the tax return with the data relevant to their tax return was made.

#### Offences, Penalties & Dispute Resolution

Any taxable person who contravenes any of the provisions of the proposed Transfer Pricing Regulations, 2012 shall be liable to bear the penalties prescribed for such contravention as already stated in the applicable tax law.

Any dispute arising from the application of the various Transfer Pricing Regulations shall be referred to the Decision Review Panel set up by FIRS, for such Panel's further review and final decision. An aggrieved tax payer with any decision of the Review Panel has the right to appeal against such a decision to a Court with competent jurisdiction in taxation matters which is usually the Federal High Court when it comes to the taxation of corporations.

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