FEDERAL INLAND REVENUE SERVICE

International Tax Department

<u>Frequently Asked Questions on Transfer Pricing</u>

1. *What is Transfer Pricing?*

Transfer Pricing (TP) involves setting appropriate prices for goods, services, loans and intangibles supplied or transferred by one enterprise to another; both of them being members of the same group or otherwise connected. It is the pricing adopted by related parties for goods, services, intangible assets, loans and other transactions between or among themselves.

2. *Is TP another form of Tax?*

No. TP is not another form of tax; however, it may affect the amount of tax payable (particularly Income Tax, Capital Gains Tax or Value Added Tax) should there be mispricing of transfers between related parties.

3. *Who sets Transfer Prices?*

It is the duty of the taxable person to set the appropriate transfer price. In setting the transfer price, care must be taken to ensure that the prices accord with the arm's length principle.

4. *What is the role of the tax authority in Transfer Pricing?*

If the transfer price does not reflect arm's length price, the Federal Inland Revenue Service (FIRS) has the legal right to adjust the price to reflect the arm's length price (TP Adjustment).

TP adjustments usually result into additional tax liabilities which the tax authority may assess in addition to the amount of tax previously assessed.

5. *Are there Laws or rules that regulate TP in Nigeria?*

Yes. These Regulations give effect to relevant provisions of:
Companies Income Tax Act Cap C21 LFN 2004 (as amended)
Petroleum Profits Tax Act Cap. 13 LFN 2004 (as amended)
Capital Gains Tax Act Cap. C1 LFN 2004,
Personal Income Tax Act Cap. P8 LFN 2004
Value Added Tax Act Cap. V1 LFN 2004.

6. *When did the TP Regulations come into force in Nigeria?*

The TP Regulations first came into force on 2nd August 2012. However, the Income Tax (Transfer Pricing) Regulation No 1 2012 has been revoked by the Income Tax (Transfer Pricing) Regulation 2018 which came into force on 12 March 2018.

7. *What is the essence of the TP Regulations?*

The essence of the Regulations is to provide guidance on the administration and implementation of transfer pricing in Nigeria. It provides guidelines as to how arm’s length pricing should be applied to transactions between related parties.

8. *What is the scope of the Nigerian TP Regulation?*

The scope of the Regulations is on all transactions between connected persons; which could be domestic or cross-border transactions. Transactions covered include:

- Sale and purchase of goods and services
- Sales, purchase or lease of tangible assets
- Transfer, purchase, licensing or use of intangible assets,
- Provision of services;
- Lending or borrowing of money
- Manufacturing arrangement
- Transactions between head office and permanent

establishments ("PEs")

- Any transaction which may affect the profits or loss of a company whether domestic or cross-border.

9. *Are the TP Regulations applicable to all taxpayers?*

No. The TP Regulation applies only to taxpayers that are connected persons; persons who are associated, related or connected to one another as defined in the TP Regulations. Generally, persons are deemed connected where one person has the ability to control or influence the other person in making financial, commercial or operational decisions.

10. *Are there materiality thresholds for TP purposes?*

Yes. There is a materiality threshold for the application of TP rules.
A company having total controlled transactions of less than N300 million may not maintain contemporaneous documentation, except on request by the Service, showing that the transactions have been appropriately priced in accordance with the arm's length principle.

11. *What TP Methods may a taxable person use?*

The Nigeria TP Regulations aligns with the five methods recommended by OECD and the UN to determine the arm's length price. The methods are:

- Comparable Uncontrolled Price method (CUP)
- Cost Plus Method (CPM)
- Resale Price Method (RPM)
- Transactional Net Margin Method (TNMM)
- Profit Split Method (PSM)

12. *Is the taxpayer limited to only the 5 methods?*

No. The taxpayer may use any other method provided it can prove to the satisfaction of the FIRS that:

i. none of the five methods can be reasonably applied in its case to determine the arm's length price of the transaction; and

ii. the method used justifies the arm's length price of the transaction.

13. *What would be the implication of comparability analysis and TP methodology regarding two or more transactions that cannot be reliably analysed separately?*

Such economically closely linked transaction or transactions that form a continuum may be combined or bundled in order to perform the comparability analysis and apply the TP methods.

14. *How has the Regulation defined its arm's length range?*

This has been clearly defined to stipulate an **inter-quartile range** derived from the use of a statistical approach.

15. *How would TP adjustments be made?*

The regulation empowers the FIRS to adjust Financial Indicators falling outside the arm's length range to **the most appropriate point** considering the facts and circumstances of the transactions.

16. *What would be the effect of customs valuation in determining the arm's length transfer price of goods?*

FIRS is not bound to accept Customs Valuation when considering the Income Tax implication of non-arm's length importation.
However, custom duties remain an allowable deduction for income tax purposes.

17. *What prices should be considered for transactions involving commodities?*

Quoted price on the date of the transaction shall be the sales price of computing taxable income of the person except proven otherwise; either in the case of exports where price agreed with connected person is lower than the quoted price or in the case of imports where price agreed with connected person is higher than the quoted price.

Quoted prices would also apply in respect of goods exported from Nigeria to a related party which were later resold to unrelated party.

18. *What are the special provisions on arm's length pricing of Intra-group Services?*

Intra group services should satisfy performance test, benefit test, non-duplicative test, shareholders cost test and appropriateness of allocation keys.
Where intra-group services fail to satisfy these tests, such transactions may not be allowable for tax deduction.

19. *What are the special provisions on Intangibles?*

FIRS now considers the contractual arrangements giving regards to the activities leading to the development, enhancement, maintenance, protection and exploitation **(DEMPE)** of the intangible asset.

20. *Is there a threshold on royalty payments?*

There is a Cap on Royalty; allowable royalty payments shall not exceed 5% of EBITDA plus the consideration (i.e. the Royalty itself).

21. *How would profits or losses associated with financial risk be allocated?*

The capacity to manage and control risk would determine the reward; therefore, allocation shall go to entity(ies) who manage those risk and have the capacity to bear them.

However, Risk-free returns would be allocated to the funding entity(ies) who do not control or manage the financial risks.

22. *Can I agree transfer prices in advance with the FIRS?*

Yes. Taxpayers may enter into advance pricing agreements (APAs) with the FIRS in order to establish a set of criteria to be used in determining whether or not the person has complied with the arm's length principle for certain future-controlled transaction.

The set of criteria referred to above may include the nature, volume and origin of the transaction, the transfer price, the TP method and the assumptions upon which the future transaction would be based.

23. *Are there materiality thresholds for APA purposes?*

No. APAs can be made in respect of transactions in any year of assessment covered by the arrangement.

24. *Will there be TP audits?*

Yes. The FIRS may carry out TP examinations in order to verify that prices adopted by a company with respect to controlled transactions comply with the arm's length principle.

25. *How far back will TP audits go?*

TP audits shall apply to accounting years commencing from 2nd August 2012. To this end, relevant taxable persons must maintain TP documentation from this date onward and for a minimum period of 6 (six) years for each successive accounting period. In the event of wilful default or fraud, there may be no limit to how far back the tax authority can go in order to deal with such criminal tendencies.

26. *Is TP audit replacing regular tax audit?*

No. Regular tax audit will continue to hold in order for the Service to satisfy itself that taxable income sources have been fully and properly disclosed and that deductions allowed are wholly, reasonable, exclusively and necessarily incurred for the purposes of earning the income.

27. *Is TP audit not a duplication of the regular tax audit?*

No, TP audit is not a duplication of regular tax audit.

While regular tax audit is to verify whether or not a taxable person complied with statutory provisions with respect to proper disclosure of income and business expenses, TP audit is concerned with the pricing of transactions occurring between connected taxable persons. In other words, regular tax audit is checking to ensure full compliance with legal provisions on income and expenses, whereas TP audit is checking to ensure full compliance with arm's length prices for all transactions occurring with persons connected with the taxable person.

28. *Is the taxpayer expected to submit any documentation?*

Yes. The TP Regulations require relevant connected persons to maintain contemporaneous TP documentation and provide them to the Service.

29. *Does a taxpayer have an option of not maintaining TP documentation?*

Yes. Relevant connected persons whose total value of controlled transaction is **less than Three Hundred Million Naira** may choose not to maintain contemporaneous documentation

30. *What is TP Documentation?*

TP documentation is the taxpayer's justification that the transactions were conducted and priced at arm's length. They are records maintained by connected taxable persons as proof that the arm's length principle was followed in the pricing of transactions between related persons.

31. *How is TP Documentation to be maintained?*

Nigeria TP Regulations provide for *contemporaneous documentation* which shall be in place prior to the due date for filing the income tax returns for the year in which the documented transactions occurred.

Contemporaneous TP documentation simply means that TP documentation maintained for each transaction as the transaction occurs.

32. *What is the approach to maintaining TP Documentation?*

Relevant taxpayers are required to adopt a three-tiered TP Documentation structure of:

- Master file
- Local file
- Country by Country Reporting

33. *What is the Master File:*

This provides an overview of the global business operations of the Multinational Enterprises (MNE) Group to which the ultimate holding company belongs.

34. *What is the Local File?*

This discloses detailed information on the enterprise's related party transactions

35. *What is the Country-by-Country Report (CBCR)?*

The Country-by-Country Report (CBCR) provides aggregated information by tax jurisdiction, showing MNE's allocation of income, income tax paid, and certain indicators of the location of economic activity among tax jurisdictions in which the MNE group operates.

36. *What is the timeline for submission of TP Documentation?*

In the case of a company having controlled transactions of N300m or more, ***Master File*** *and the* ***Local File*** shall be furnished within **21days** of the receipt of FIRS' notice requesting for the submission of the TP documentation;

In the case of a company having controlled transactions of less than N300m, ***Master File*** *and the* ***Local File*** shall be furnished within **90 days** of the receipt of FIRS' notice requesting for the submission of the TP documentation

37. *What is the timeline for submission of CBCR?*

Without notice or request, country-by-country reports shall be filed, no later than **12 months** after the end of the relevant accounting year of the MNE group.

38. *What is the timeline for compliance with a notice to furnish information or document?*

Information or document must be submitted to the Service within the time specified in the notice.

39. *Can requests for extension of time to comply with a notice or submit documentation be made?*

Yes. The Service may grant an extension of time in writing where a connected person applies in writing to the Service before expiration of time stipulated for initial submission and such applicant shall show good cause for its inability to meet stipulated submission dates.

Please see Para 6.6 & 6.7 of the Guidelines on TP Documentation for the list of conditions for granting extension of time and the timing of requests for extension.

40. *What is the consequence of failure to comply with TP*

Documentation request?

Administrative penalty of the higher of N10 Million or 1% of the total value of all controlled transactions and N10,000 for every day in which the failure continues.

41. *What is the consequence of failure to furnish information or document within specified timing in the notice?*

Administrative penalty of a sum equal to 10 million naira or 1% of the value of each controlled transaction for which the information or document was required, whichever is higher in addition to N10,000 for every day in which the failure continues.

42. *What is the consequence of failure to meet extended submission dates granted.*

Administrative penalty for failure to comply with TP Documentation request or failure to furnish information or document within specified timing will apply as if no extension was ever granted.

43. *When does administrative penalty take effect?*

The administrative penalties imposed by the TP Regulations shall be fully visited upon any taxpayer who neglected or failed to comply with required obligations by the set date of 31^{st} December 2018.

44. *Do other penalties apply for non-compliance?*

Yes. Failure to comply with any provisions of this Regulation where no administrative penalty is provided shall be as prescribed in the relevant tax laws.

45. *What is the requirement of the Regulation on procurement documents?*

There is a requirement to submit 3rd party invoices, contracts, bills or similar documents whenever goods or services are procured from related parties or done through group procurement centers.

46. *For how long must TP Documentation be maintained?*

TP Documentation must be maintained for a minimum period of 6 (six) years from the date of filing the relevant TP returns.

47. *What is TP Declaration?*

This is the requirement on a connected person to declare its relationship with all connected persons whether such persons are resident in Nigeria or elsewhere.
TP Declaration shall be in a form as may be prescribed by the Service from time to time.

48. *What is TP Declaration Form?*

TP Declaration Form give the details of the structure of group companies in terms of ownership, management, control and nature of business.

The basic information requested in this form is on shareholding, directorship, relationship, location of companies who are members of the same group or otherwise connected with one another and the nature of their business.

49. When should the TP Declaration Form be filed?

The TP Declaration Form contains information of a fairly permanent nature. To this end, it is to be **submitted in the first year** of rendering a TP return and whenever there are changes in the structure of group companies in terms of ownership, management, control and nature of business.

This form shall be made and submitted to the Service not later than eighteen months after the date of incorporation or within six months after the end of the accounting year whichever is earlier.

50. *What conditions necessitate making an updated*

declaration?

An update become necessary upon occurrence of the following:

- Mergers of person with another company or person's parent with another company outside the group
- Acquisition of up to 20% of the person or person's parents by persons not connected to the group
- Merger or acquisition of the person by another person outside the group
- Sale or acquisition of a subsidiary by the person
- Other changes in structure, arrangement or circumstances of the person
- An appointment or retirement of a director of the connected person

51. *What is the consequence for non-submission of TP Declaration?*

Administrative penalty of N10Million in addition to N10,000 for every day in which the failure continues.

52. *What is the consequence for not submitting an updated declaration?*

Administrative penalty of N25,000 for each day in which the failure continues.

53. *What is TP Disclosure?*

This is the requirement on a connected person to, without notice or demand, make a disclosure of controlled transactions for each year of assessment.

54. *What is TP Disclosure Form*

The is the disclosure of controlled transactions using the TP Disclosure Form.

This form should give details of the type, volume and value of controlled transactions.

The form must still be completed and filed even when there are no such controlled transactions with connected persons within a year.

55. *When should TP Disclosure Form be filed?*

The disclosure shall be made and submitted to the Service not later than six months after the end of each accounting year or eighteen months after the date of incorporation whichever is earlier.

56. *What is the consequence for non-submission of TP Disclosure at the prescribed time?*

Administrative penalty of the higher of N10 Million or 1% of the undisclosed transactions, plus N10,000 for every day in which the failure continues.

57. *What is the consequence for failure to make correct disclosures?*

Administrative penalty of the higher of N10 Million or 1% of the incorrectly disclosed transactions

58. *Can requests for extension of time be made for making declarations or disclosures?*

Yes. The Service may grant an extension of time in writing where a connected person applies in writing to the ***International Tax Department*** before expiration of time stipulated for disclosures and declarations and such applicant shows good cause for its inability to meet stipulated submission dates.

59. *What is the consequence of failure to meet extended submission dates granted?*

Administrative penalty for failure to comply with TP Disclosure and declaration within specified timing will apply as if no extension was ever granted.

60. *What are the contents of Annual TP Returns?*

Annual TP returns are made up of the following documents:

i. Duly completed and signed TP Disclosure Form;
ii. Audited Financial Statements (in detailed format);
iii. Copy of income tax self-assessment; and
iv. Tax computation (in detailed format) with all schedules;

These documents must be submitted annually to the Service alongside the usual income tax return **via the online TP platform** (e-TP Plat).

61. What is safe harbor?

This is the exemption enjoyed by connected persons from documentation requirements of the Regulation.

62. Will safe harbour approval be granted by the Service?

The Service will not grant prior safe harbour approvals. Approvals will be subject to specific guidelines that may be issued by the Service from time to time and not from any other regulatory authority.

The guidelines issued by FIRS will be to defined category of taxpayers or transactions.

63. How will TP disputes be resolved?

The TP Regulations provides for the setting up of a Decision Review Panel (DRP). The DRP's decision on an objection to a TP adjustment shall be the final position of FIRS. Thereafter, a Notice of Refusal to Amend Assessment shall be issued. The taxpayer may, however, appeal against the assessment in line with extant provisions of the tax laws.

64. *Is the Decision Review Panel a court?*

No, the Decision Review Panel is not a court of law. It is an administrative organ of the Service set up by the TP Regulations to promote quick and cheap dispute resolution. Its decisions are the final decisions of the Service in respect of an objection to a TP adjustment. A taxable person who is displeased with any of the DRP's decisions may challenge it at the Tax Appeal Tribunal or the Federal High Court.

65. Where can I obtain further information on transfer pricing?

Further information can be obtained from the following sources:

i. The Director,
International Tax Department,
3rd Floor, FIRS Building,
17B, Awolowo Road,
Ikoyi – Lagos

ii. The Coordinating Director
Special Tax Operations Group
15 Sokode Crescent,
Wuse Zone 5,
Abuja.

iii. The Executive Chairman,
Federal Inland Revenue Service,
15 Sokode Crescent,
Wuse Zone 5,
Abuja.