

Cost Contribution Arrangements (“CCAs”) - Managing conflicts between domestic laws and adopted international tax guidelines and best practices in Nigeria

The last six years have witnessed significant efforts by Nigeria to align its domestic tax laws and regulations with international initiatives on modernization of tax principles and enhancement of transparency and disclosure requirements. These efforts include the introduction of Income Tax (Transfer Pricing) Regulations No.1 in August 2012 (“TP Regulations”), which adopted international best practices for determining the arm's length/market value of transactions between related parties. Nigeria has also been participating in global initiatives aimed at tackling tax evasion and tax revenue leakages.

However, these adopted international best practices and rules may, in some instances, be in conflict with Nigeria's domestic laws, principles and administrative practices, thereby limiting or nullifying the desired effects of the adopted international tax principles.

One of the areas where potential conflicts exist relates to local implementation of the principles and guidelines for determining arm's length nature of Cost Contribution Arrangements (“CCAs”). CCAs are defined in the *Transfer Pricing Guidelines for Multinationals and Tax Administrators* as “...contractual arrangements among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create benefits for the individual businesses of each of the participants.”

[Organization for Economic Cooperation and Development, July 2017] (“OECD TP Guidelines”). CCAs are classified into either Development (for the joint development, production or the obtaining of intangibles or tangible assets), or Service (for the joint procurement of services) CCAs.

While CCAs represent sharing of resources to achieve a common goal, each participant's contribution



should still be at arm's length - consistent with the benefits they expect to derive from the arrangement. Hence, to aid in verifying arm's length nature of the arrangements, OECD TP Guidelines recommend inclusion of certain information in any CCA, such as list of the participants, the nature and extent of each participant's expected benefit from the underlying activities, the cost allocation/ contribution mechanism, arrangements for monitoring the operations of the CCA, etc.

As currently worded, the TP Regulations do not contain specific requirements for CCAs and the Federal Inland Revenue Service (FIRS) is yet to release any administrative guideline(s) on it.

Considering that the TP Regulations adopt the OECD TP Guidelines, it is expected that stakeholders should be able to rely on the OECD TP Guidelines on CCAs. However, it is crucial for taxpayers to ensure that they do not trigger any conflicts or inconsistencies when applying the OECD TP guidelines and any local laws/regulations in Nigeria, as the latter prevails in the event of any conflict.

Potential areas of conflict include:

a) Restriction on deductibility of expenses incurred within or outside Nigeria, or incurred on behalf of another company outside of Nigeria:

The provision of Companies' Income Tax Act (“CITA”) which gives FIRS the discretion to allow/disallow such expenses poses a great risk to CCAs although it is arguable that FIRS' discretion should not be arbitrary and such expenses should be allowed upon provision of adequate supporting documents.

b) Additional condition for deduction of R&D cost:

According to CITA, R&D costs; which are not deductible under other generic provisions, will be allowed as deductible only if the **tax payer proves, to the satisfaction of FIRS that the expenses relate to R&D.** However, the provision does not clearly indicate the proofs that will be adequate and conclusively satisfactory to FIRS, giving rise to ambiguity and discretion in favour of FIRS.

This therefore poses a risk that underlying CCA costs may not be deductible where FIRS is not convinced that it relates to R&D.

On this note, tax payers will require adequate documentation and probable expert documentation to

confirm this and ensure deductibility.

c) Regulatory restrictions on R&D Costs: The Revised Guidelines by the National Office for Technology Acquisition and Promotion (“NOTAP”) for Registration and Monitoring of Technology Transfer Agreements (RTTA) in Nigeria imposes a limit on the amount of R&D expenses allowed. This is limited to 0.5 - 1% of Net Sales. Thus, the contribution of a Nigerian entity under R&D CCAs may not be allowed to exceed RTTA's threshold. Also, the Financial Reporting Council of Nigeria (FRCN) mandates non-recognition of expenses which require regulatory approval where such approval is not in place. Thus, any CCA expense which exceeds the approved NOTAP threshold will not be recognized as a valid expense in the financial statement; ultimately increasing the taxpayer's tax exposure.

d) Inappropriate description of CCAs: Sometimes due to bad drafting, arrangements that are in substance CCAs are wrongly characterized as service arrangements which have adverse tax implications such as triggering applicability of value added tax, withholding taxes and the requirement for regulatory approval (e.g. where inappropriately described as Management services which may require approval under RTTA and may not be deductible for tax).

The above potential conflicts may limit the amount of contribution in a CCA a Nigerian taxpayer will be allowed to claim as a tax deductible expense, irrespective of the value of the benefits they derive from the CCA. Thus, a Nigerian participant's share of the overall contributions to a CCA may be inconsistent and disproportionate to the share of the overall benefits it receives under the CCA. Ultimately, while the efforts being made to align Nigeria's domestic tax laws and regulations with current international tax initiatives are laudable, there is a crucial need for all stakeholders to

ensure reduction of conflicts to the barest minimum.

On the one hand, government should hasten the pace of the tax reforms and provide timely guideline on ambiguous areas. Taxpayers should also review and monitor their business arrangements carefully, keep appropriate documentation and engage professionals to avoid possible pitfalls.

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