



The Income Tax (Transfer Pricing) Regulations, 2018 – Is this a game changer?

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Introduction

With the release of the Income Tax (Transfer Pricing) Regulations, 2018 (“2018 TP Regulations”) on 27 August 2018, Nigeria took yet another very bold step in its quest towards adopting and

implementing recent international multilateral initiatives. These initiatives, aimed at enhancing tax disclosure rules and tackling tax evasion, arose from the Base Erosion and Profit Shifting (“BEPS”) program.

The 2018 TP Regulations are the first update to transfer pricing (TP) rules in Nigeria, which were first introduced in 2012. Highlights of the changes introduced by the 2018 TP Regulations and the implications are set out below:

- **Materiality threshold for maintaining contemporaneous TP documentation:** In a bid to reduce tax compliance costs, which is one of the indices used to measure the ease of doing business, the obligation to maintain contemporaneous TP documentation has been relaxed for companies whose controlled transactions are of total value of less than ₦300m. In essence, a company with intra-group transactions below ₦300m is not obliged to prepare documentation (record with sufficient data and analysis to verify compliance with the arm's length principle) as the transactions are consummated.

However, FIRS may still require such companies to prepare and submit their documentation within 90 days of receipt of a notice. Default in providing the documentation within the 90-day period will result to a penalty equal to 1% of the value of related party transactions in addition to ₦10,000 for each day in which the default continues.

The exemption may create a tendency in qualifying taxpayers to ignore their TP obligations and the need to keep required documents / information. This may lead to practical difficulties in preparing/providing the documentation upon request by FIRS. Qualifying taxpayers, who intend to take advantage of this exemption, are advised to keep all documents/information that may be required to prepare the documentation in future.

- **Scope of application:** The scope of application of TP in Nigeria under the old Regulations included Personal Income Tax, Companies Income Tax and Petroleum Profits Tax. The 2018 TP Regulations expand the scope to include Capital Gains Tax (CGT) and Value Added Tax (VAT).

While the legislation on CGT and VAT have provisions for applying market value as arm's length value of controlled transactions, it was uncertain if the recommended TP methods were applicable under the old TP regime. Furthermore, its implications on intercompany transfer/sale of assets during mergers & acquisition transactions need to be considered, as it will potentially increase compliance obligations.

- **Advance Pricing Agreements (APA):** Under the old TP Regulations, a request for an APA could only be made where the total value of transactions was not less than ₦250m in a year of assessment, albeit the Federal Inland Revenue Service (FIRS) did not implement the provisions for APAs under the old TP Regulations. The new TP Regulations provide no threshold for making a request for an APA to the tax authority. However, it is safe to assume that materiality of transactions would be considered by FIRS in processing any request for APAs by taxpayers. Furthermore, the 2018 TP Regulations suggest that implementation of APAs would be based on FIRS' specified guidelines.

It therefore remains to be seen if FIRS will, in future Notices or Guidelines for implementing APA, provide a threshold for APA applications. Certainly, the need to implement APA in Nigeria cannot be overemphasised considering the certainty and incentives it gives to taxpayers and other investors.

- **Additional documentation requirements:** The 2018 TP Regulations require taxpayers to maintain additional information/documents as part of their TP documentation. One of such additional documents is the "Master File" of the multinational enterprises (MNE) group, which should contain high-level overview of the MNEs group's business, the nature of its global business operations, overall TP policies, its global allocation of income and economic activity, among others.

Though the Master File is expected to be prepared by the group's ultimate parent company, subsidiaries and associates will need to keep copies of the document as part of their local TP documentation obligations in Nigeria.

- **Penalties:** The 2018 TP Regulations make several changes to the penalties a connected person may be liable to for non-compliance with certain TP obligations and they include:

Instance of non-compliance	Applicable penalty
Declaration Form: Failure to make or submit a declaration within 18 months after the date of incorporation or within six months after the end of the accounting year, whichever is earlier (due date)	₦10m and ₦10,000 for every day in which the failure continues.
Declaration Form: Failure to submit updated declaration to FIRS where applicable	₦25,000 for each day in which the failure continues.
Disclosure Form: Failure to make disclosure by the due date	Higher of ₦10m or 1% of the value of undisclosed controlled transaction(s); and ₦10,000 for every day the failure continues
Disclosure Form: Incorrect disclosure	Higher of ₦10m or 1% of the value of controlled transactions incorrectly disclosed
TP Documentation: Failure to submit TP documentations within: <ul style="list-style-type: none"> • 21 days from FIRS’ request for transaction above materiality threshold • 90 days from FIRS’ request for transactions below materiality threshold 	Higher of ₦10m or 1% of the value of controlled transaction(s); and ₦10,000 for every day the failure continues

- Safe Harbour and approvals from other agencies:**
The old Regulations exempted connected persons from preparing and maintaining TP documentation where their controlled transactions are priced in accordance with the requirement of Nigerian statutory provision, or where the prices of such transactions have been approved by other Government regulatory agencies or authorities established under Nigerian law and satisfactory to FIRS to be at arm’s length.

However, the 2018 TP Regulations exempt a connected person from preparing TP documentation where the controlled transactions are priced in accordance with specific guidelines that may be published by FIRS for that purpose from time to time. In effect, approvals from

other regulatory agencies would not be acceptable as a basis for exemption unless as provided by specific guidelines published by FIRS.

The 2018 TP Regulations further state that FIRS is not obliged to use declared customs values of goods imported from related parties when evaluating the arm’s length nature of the terms in import transactions.

Further, there are certain changes in the 2018 TP Regulations that have raised some concerns for taxpayers and other stakeholders, which we expect FIRS to address through its Notices or Guidelines. These areas of concern include:

- Conflicting provisions with other laws:**
Regulation 7(5) caps payments between related parties for transfer of rights in Intangible Properties

(“IPs”) at 5% of earnings before interest, tax, depreciation and amortisation (“EBITDA”).

Given that “transfer of rights” is not defined in the 2018 TP Regulations and possibility of interpreting it to include licensing arrangements, there is a risk of FIRS adopting the expanded interpretation. Thus, FIRS may substitute the 5% cap for its current administrative practice of using approvals granted by the National Office for Technology Acquisition and Promotion (“NOTAP”) as a basis for determining tax deductibility of payments for licensing or sublicensing of IP rights.

This raises significant issues where these rates conflict. This is more so in view of the provision of Rule 4 of the Financial Reporting Council (FRC) that proscribes companies from recognising any expense without regulatory approval. This gives rise to a number of procedural issues/questions, which include whether taxpayers will be able to recognise the higher of the thresholds. Additionally, considering that FRC Rules require the relevant approval certification number (where necessary) to be quoted on the financial statement, would FIRS’ approval/acknowledgement of the TP returns (which is compliant with the 2018 TP Regulations) be permissible for FRC reporting purposes?

- More onerous documentation burden for taxpayers:**
Regulation 17(6) of the 2018 TP Regulations provides that for every product procured

from or through related parties, taxpayers in Nigeria are required to include, as part of their annual TP documentation package, the source documents issued by the original third party/unrelated manufacturers or distributors of such product (such as contracts, invoices, bills, etc.).

Complying with this documentation requirement will be very onerous for taxpayers who have significant volume of purchase transactions with related parties, as they will be required to obtain and retain several supporting documents for every piece of item purchased. This concern is further heightened by the significant administrative penalties attached to failure to provide any information or document requested by FIRS under Regulation 17(5) of the 2018 TP Regulations.

- **Possible retrospective application of obligations and penalties in the 2018 TP Regulations by FIRS:** There was anxiety among taxpayers upon the release of the 2018 TP Regulations due to the noticeable time-lag between the commencement date of 12 March 2018 and when it was

released to the public (27 August 2018). There were also apprehensions that the Regulations will affect obligations that were due under the old Regulations for prior basis periods.

These concerns may however be laid to rest as the 2018 TP Regulations clearly indicate that the provisions affect basis periods beginning after its effective date of 12 March 2018. Thus, basis periods beginning on or before the effective date would not be affected by provisions of the 2018 TP Regulations.

Conclusion

While efforts of government aimed at adopting and implementing contemporary international tax and fiscal regulatory initiatives are laudable and commendable, there is the likely risk that taxpayers may misjudge the overriding intentions of FIRS due to the weight and magnitude of the additional obligations and increased administrative penalties introduced by the 2018 TP Regulations. It is therefore expected that in enforcing the new TP rules, FIRS will abide by the spirit of the 2017 National Tax Policy, which requires that administration of taxes be simplified for easy

enforcement and compliance. Prompt issuance of relevant guidelines and transitional documents will go a long way to bring clarity and ease the impact of this game-changing piece of legislation.

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