

THE 2018 TRANSFER PRICING REGULATIONS

INTRODUCTION

Transfer Pricing (TP) is a mechanism mostly used in taxation and accounting which refers to the rules and methods for pricing transactions within and between enterprises under common ownership or control. Generally, It is the setting of prices for goods and services sold between controlled or related legal entities within an enterprise. For example, if a subsidiary company sells goods or provides services to a parent company, the cost of those goods/services paid by the parent to the subsidiary is the transfer price.

Funds Transfer Pricing (FTP) is a method used to individually measure how much each source of funding contributes to the overall profitability of a firm. The FTP process is most often used in the banking industry as a means of outlining the areas of strength and weakness within the funding of the institution.

Due to the evasive strategies of many organizations who attempt to use transactions involving cross-border management and control as an avenue to alter taxable income, transfer pricing rules allow tax authorities to adjust prices for most cross-border intra-group/intra-organizational transactions, including transfer of tangible or intangible property, services, and loans

Activities and transactions that warrant transfer pricing are also common in Nigeria. This has prompted the Government to put in place strict compliance regulations for enterprises engaged in such, in order to ensure proper monitoring of taxable incomes which are generated from these subject matter transactions.

The Federal Inland Revenue Service (FIRS) was empowered to set up a Transfer Pricing (TP) division to standardize transfer pricing compliance in Nigeria. Specific TP Regulations were first released in October 2012 based on the general anti-avoidance provisions in the various tax laws which require related party transactions to be conducted at arm's length¹. The regulations are applicable to accounting periods commencing after August 2012. For example, a company with an accounting year end date of 31st December, 2012 will be required to have its TP documentation in place for the accounting year commencing 1st January, 2013, for returns to be filed by June 2014. Accordingly, it is best practice for companies to act accordingly early in each accounting year, in order to ensure that the appropriate transfer prices are reflected from the first day of the new accounting year. In other words, it is advisable for relevant companies to begin the collation of all necessary documents early, rather than making year-end adjustments which may be difficult to defend.

¹ This is better explained under Footnote 4

TRANSFER PRICING REGULATIONS 2018

The Federal Inland Revenue Service (FIRS) recently released the revised Income Tax (Transfer Pricing) Regulations 2018 (the Regulations). The Regulations ushered in a new ‘specific penalties’ regime.

The FIRS, in exercise of the powers conferred on it by Section 61 of the Federal Inland Revenue Service (Establishment) Act No.13 of 2007, repealed the Income Tax (Transfer Pricing) Regulations No. 1, 2012 (the 2012 Regulations). The 2012 Regulations took effect on 2nd August 2012 and was in force until repealed recently.

The revised Regulations has an effective date of 12th March 2018. However, it is applicable to the period commencing after 12th March, 2018².

The Regulations were issued to ensure alignment with the developments in international tax practice as it relates to Transfer Pricing (TP), particularly the Base Erosion and Profit Shifting (BEPS) project embarked upon by the Organisation for Economic Cooperation and Development (OECD) on the request of the Finance Ministers of the G20 countries.

The OECD developed thirteen (13) Action Points to mitigate BEPS. Action Point 8 to 10 (Aligning Transfer Pricing Outcomes with Value Creation) and Action Point 13 (Transfer Pricing Documentation and Country by Country Reporting) focused on intangibles, contractual allocation of risks between Multi-National Entities (MNEs), level of returns to funding provided by a capital-rich MNE group members and the requirements for filing “Master and Local files” among other issues.

Transfer Pricing Specific Penalties Regime

Unlike the 2012 Regulations, the 2018 TP Regulations introduced administrative penalties for TP related offences. The penalties are highlighted below:

S/N	TRANSFER PRICING OFFENSE	PENALTY
1.	Failure to file Transfer Pricing declaration within the specified period	N10, 000, 000 (Ten Million Naira) in the first instance and N10, 000 (Ten Thousand Naira) for every day the default continues.

² FIRS Releases Revised Transfer Pricing Regulations : <https://andersentax.ng/firs-releases-revised-transfer-pricing-regulations/> extracted 5th September, 2018 at 3:45pm

2.	Failure to file updated Transfer Pricing declaration/ notification in relation to change in Directorship	N25, 000 (Twenty Five thousand Naira) for each day of default
3.	Failure to file Transfer Pricing disclosures within the specified period	The higher of: N10, 000, 000 (Ten Million Naira) or 1% percent of the value of the undisclosed controlled transaction and N10, 000 for every day the default continues.
4.	Incorrect disclosure of transaction	The higher of: N10, 000, 000 (Ten Million Naira) or 1% percent of the value of the incorrectly disclosed controlled transaction
5.	Failure to file Transfer Pricing documentation upon request.	The higher of: N10, 000, 000 (Ten Million Naira) or 1% percent of the value of all controlled transactions and N10,000 for every day the default persists
6.	Failure to furnish information or document within the specified period	1% of the value of each controlled transaction for which the information or documentation was required and N10, 000 for every day the default persists.

The 2018 Regulations also introduced the following changes, among others:

- Guidelines on the filing of updated TP declaration form

Taxpayers are expected to make updated declarations to the FIRS where:

- there is a merger of the taxpayer or its parent company;
 - an acquisition of up to 20% of the taxpayer or its parent company by previously unrelated persons or company;
 - any other change in the structure or arrangement of the taxpayer; and
 - where there is an appointment or retirement of a director;
- Threshold for maintaining concurrent documentations³

A connected person whose total value of controlled transactions is less than ~~N~~300, 000, 000 (Three Hundred Million Naira) is no longer required to maintain concurrent documentation. However, such connected person will be required to prepare and submit relevant documentation within 90 days upon receipt of a notice from the FIRS.

³ These are documentations involving different transactions occurring, arising, or operating at the same time

- A new safe harbour regime where taxpayers may be exempted from verifying the arm's length⁴ nature of controlled transactions, provided the controlled transactions are priced in accordance with guidelines published by the FIRS, as opposed to the adoption of statutory or "regulator prescribed" prices as contained in the 2012 Regulations.
- Specific criteria for determining the arm's length nature of intra-group transactions.
This involves an evaluation of the substance, benefits, economic value of the activities, and the arm's length nature of pricing for the services provided.
- Inclusion of guidelines on the use of quoted prices in determining the pricing for the exportation and importation of commodities.
- Limitation of deductions on royalty payments for intangibles⁵ to not more than 5% of earnings before interest, tax, depreciation and amortization.
- Inclusion of clear procedures and documentary requirements for the application of Advance Pricing Agreements (APAs);

GRID OF EFFECTED CHANGES

No.	PARTICULARS OF CHANGE	OLD REGULATIONS (2012)	REVISED REGULATIONS (2018)
1.	Scope of Application	<p>The Regulations gave effect to the provisions of the following legislation, as they relate to connected transactions:</p> <ul style="list-style-type: none"> • Personal Income Tax Act • Companies Income Tax Act • Petroleum Profits Tax Act 	<p>The scope of the Regulations have been expanded to also include the following legislations:</p> <ul style="list-style-type: none"> • Capital Gains Tax Act • Value Added Tax Act

⁴ A principle of transfer pricing stating that the amount charged by one related party to another for a given product must be the same as if the parties were not related

⁵ Assets that are not physical in nature. These includes goodwill, brand recognition and intellectual property such as patent, trademark and copyrights

2.	Materiality threshold for applying for Advance Pricing Agreement (APA")	The materiality threshold for APA was set at ₦ 250, 000, 000	There is no materiality threshold
3.	Materiality threshold for maintaining concurrent documentation	There was no materiality threshold	The threshold for maintaining concurrent documentation is set at ₦ 300, 000, 000
4.	Documents required to be filed with FIRS	The following documents were required to be filed on annual basis: <ul style="list-style-type: none"> • TP Disclosure form, • TP Declaration form and • Local TP Documentation 	A Group Master file is now required to be filed with the FIRS in addition to the documents under the Old Regulations
5.	Penalty for failure to file TP Declaration form within the stipulated time	<ul style="list-style-type: none"> • ₦25,000 for the first month of default; and • ₦5,000 for every month the default continues 	Penalty has been increased as follows: <ul style="list-style-type: none"> • ₦10, 000, 000 for the first month of default • ₦10,000 for every day the failure continues
6.	Penalties for failure to file (1) TP Disclosure Form, or (2) TP Documentation within the stipulated time	₦ 25,000 for the first month of default and ₦ 5,000 for every month the failure continues	Penalty has been amended as shown below: <ul style="list-style-type: none"> • ₦10, 000, 000 or 1% of the value of controlled transaction(s) not disclosed; whichever is higher, for the first month of default, and • ₦10,000 for every day the failure continues
7.	Penalties for making an incorrect disclosure in the TP Disclosure Form submitted to FIRS	None	₦ 10m or 1% of the value of controlled transactions incorrectly disclosed, whichever is higher, shall apply.
8.	Failure to provide FIRS with any information or document required within the time specified in a notice issued to the taxpayer by FIRS	None	<ul style="list-style-type: none"> □ 1% of the value of each controlled transaction for which the information or document was required □ ₦10,000 for each day the failure continues

9.	Failure to submit updated TP Declaration form	None	• ₦25,000 for every day the failure continues
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CONCLUSION

With the above changes, the FIRS has shown that it is keeping pace with the recent changes and international best practices as it relates to taxation, with special focus on transparency and disclosures aimed at reducing the incidence of BEPS.

However, it should be noted that some of the changes, particularly the new penalty regime, appears to be beyond what can be effected vide the Regulations alone and may be contested by taxpayers. The penalties also appear not to be in line with the Federal Government’s drive for foreign investment and ease of doing business initiative. The threshold of N300, 000, 000 (Three Hundred Million Naira) introduced for taxpayers not required to maintain concurrent documentation does not appear to be an exemption, as the FIRS may still request for the documentation at any time and failure to comply would attract penalty.

It is therefore advisable that all companies operating a group structures/as a conglomerate ensures strict compliance with the Regulations, to avoid sanctions by the FIRS.

Conclusively, the revised Regulations has introduced a stiffer TP regime in Nigeria, which ultimately has resulted in stiff administrative penalties for TP offences as highlighted above, with the aim of prompting taxpayers to act as required.

Taxpayers will need to review their related party transactions and relevant associated documents to ensure that they are fully compliant with the arm’s length principle and documentation requirements. This will help to mitigate the risks associated with incidences of significant assessment of additional tax liabilities and administrative penalties.