TRANSFER PRICING IN THE NIGERIAN CONTEXT

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Transfer pricing is an issue in International Taxation which has continue to befuddle both the taxpayer and the tax authorities. It is a valid business practice for associated companies in the pricing of inter-related sales within the group and on the other side of the divide, it creates a suspicion for the tax authorities that the pricing may be a form of profit shifting with the result of providing avenues for tax avoidance.

In the Nigerian context, the issue is not helped further as there is an absence of clear transfer pricing regulations. An increasingly share of world trade consists of cross-border transactions within groups of affiliated companies, more so the advent of considerable foreign direct investments in Nigeria. These has literally collapse the national boundaries between countries and this situation has created difficult transfer pricing questions in cases where there are inter-related transactions.

This article will seek to examine the provisions of Nigerian law on transfer pricing and circumstances that would trigger the recognition of a transfer pricing model as a potential scheme for tax avoidance. The article also is intended to serve as a guidepost for potential investors in structuring an effective transfer pricing method.

The Nigerian tax laws on transfer pricing

The key principle of transfer pricing is based on the arm’s length rule. This being that pricing terms between related party in the exchange of goods and services should achieve same result as if parties are unrelated. In other words, related parties must act as if they are unrelated. The essence of this requirement is that the quantum of profit which ordinarily should be subjected to domestic tax does not become a gain to another country to which profit is shifted.

Under the Nigerian tax laws, the basis for charge to tax of transactions between related companies is provided in section 13 (2) (d) Companies Income Tax Act (CITA) Cap C21 Laws of the Federation 2004 (section 11 (2) (d) CITA Cap 60 LFN 1990) as follows:

(2) The profits of a company, other than a Nigerian company from any trade or business shall be deemed to be derived from Nigeria –

(d) Where the trade or business or activities is between the company and another person controlled by it or which has a controlling interest in it and conditions are made or imposed between the company and such person in their commercial
or financial relations which in the opinion of the Board is deemed to be artificial or fictitious, so much of the profit adjusted by the Board to reflect arm’s length transaction.

The Act has empowered the Federal Inland Revenue Service (hereinafter called “the Revenue”) to make adjustments in order to reflect arm’s length transaction in situations where in its opinion it deems the trade or business or activities between related parties to be artificial or fictitious.

Section 22 of the Companies Income Tax Act LFN 2004 (section 18 CITA LFN 1990) provides the meaning of artificial transaction as follows:

“Where the Board is of opinion that any disposition is not in fact given effect to or any transaction which reduces or would reduce the amount of any tax payable is artificial or fictitious, it may disregard any such disposition or direct that such adjustments shall be made as respects liability to tax as it considers appropriate so as to counteract the reduction of liability to tax affected, or reduction which would otherwise be affected, by the transaction and any company concerned shall be assessable accordingly”.

The thrust of this provision is that the Revenue shall disregard any disposition, which in this effect means any trust, grant, covenant, agreement or arrangement that would reduce the tax payable and direct any such adjustments in order to counteract the reduction of liability to tax. By implication, the tax authority is conferred with the responsibility to make adjustments where the internal pricing mechanisms of the related parties tend not to reflect the open market prices.

The implication of the above sections seems to place issues of determining transfer pricing within the Nigerian context as an exercise of subjective judgement by the tax authority. The Revenue’s duty of making adjustments to provide for arm’s length treatment of intercompany transactions is based on where it is of the ‘opinion’ that there are threats of tax avoidance by virtue of the transaction.

In our present corporate environment in which business strategies and planning are driven more or less by certainty and risks reduced to its barest minimum, any cloud of uncertainty on any indices of planning are potential deterrents and adverse to investments. Investors, particularly seek to be guided by a bird-eye view of any business environment before committing resources in such venture. The popular saying, “fools rush where angels fear to thread” does hold true in every tax planning strategy.

In Nigeria, there are no hard and fast rule that are clearly indicative of whether specific intercompany transactions relating to their pricing terms are carried out in
variance to the open market price of the goods and services. Every multinational business entity is set up with the primary objective of making profits and several considerations underlying their profit motive come to bear in determining the pricing of their goods between associated parties.

Therefore, what are the factors that may cause the exercise of this ‘opinion’ by the tax authorities? What factors would trigger recognition of an intercompany transaction as being at variance with arm’s length principles?

1. Presence of intercompany intangible transactions
The presence of intercompany intangible transactions where there are large royalty payments by a loss-making affiliate is a factor that can trigger the Damocles sword of ‘deemed artificial or fictitious transaction’ by the tax authorities. This raises the concern of whether the Nigerian resident company is actually benefiting from the licensed intangible and the likelihood that the large royalty payments is a ploy for taking out profits attributable to the local affiliate outside of the tax net.

2. Transactions with companies situated in tax havens
Several countries have favorable tax rates and environment like Switzerland, Caymans Island, Bermuda and British Virgin Islands. They are generally seen as tax havens and as such have drawn lots of shelf companies which are set up for the major reason of taking advantage of their very friendly tax policies.

Therefore where intercompany transactions revolve around a controlling entity situated in any of the perceived tax havens, any such payments made for the benefit of the offshore entity would raise the presumption that the payments is to shift income to the tax havens. The company is ordinarily deemed to lack substance and such would not have justification to have earned the income if transacting at arm’s length.

3. Subsidiary of a foreign parent
A major corollary of intercompany transactions is the issue of control. Controlled relationships between affiliated or associated companies have elements of conditions imposed by the controlling entity and such conditions impact on profits because they are not at arm’s length. A subsidiary has its economic survival tied to the parent company and this implies that the commercial terms guiding their relationship are not evenly bargained.

Where there is a controlling interest by the parent company in the business of the subsidiary, the tax authority reserves the ‘opinion’ to deem it artificial and fictitious whereby it can make transfer pricing adjustment for the appropriate tax payable.
Suggested steps

Cross-border transactions have become a *fait accompli* in our present global economy. A schism in the Indonesian stock market has effects in far-flung places like the United Kingdom and Nigeria equally. The apparent paucity of regulations to guide the tax authority in appropriately determining transfer pricing issues has created a need for our legislations to be updated to incorporate such emerging trends.

Based on the foregoing, the following steps are suggested for both the taxman and the investor in charting a course for an appropriate transfer pricing policy;

1. **Adoption of the OECD Model**
   It is suggested that the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration be adopted as part of our domestic legislations. However, country-specific requirements should be incorporated into the Model to make it completely domesticated and address issues in accordance with our macro and microeconomic objectives.

   The beauty of such an exercise is that it would remove the cloud of ambiguity which besets both the tax authority and the tax payer in resolving issues of transfer pricing and intercompany related transactions. The adopted Model would set the rules clearly and enhances certainty which is an attribute of a good tax law.

2. **Proper documentation of legal framework and economic substance**
   Intercompany relations are generally guided by their adopted legal framework and economic model. Such framework supports the division of rights, risks and responsibilities between the contracting entities and also provides justification for their transfer pricing policy.

   It is therefore advised that inter-company agreements must match the economic substance of their transactions with proper documentations of their relationship. There have been instances where the inter-company contracts describe the associate entity as earning a mark-up income and in reality; its income transcends mere mark-up income. Such practice may not survive the scrutiny of the tax man in search of artificial or fictitious transactions.

Conclusion

The Nigerian tax laws should be more specific in its provisions on transfer pricing. The use of subjective considerations based on the ‘opinion’ of the tax authority does not show transparency that is imperative in today’s tax practice and such practice is not in tandem with contemporary standards. Specific transfer pricing rules will give both the taxpayer and the tax authority clear cut
guidelines on how to treat specific cases and most importantly, the comfort and assurance that transfer pricing related matters will be subjected to an objective testing.

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