

TITLE:

**EFFECTIVENESS OF TRANSFER PRICING REGULATION IN NIGERIA IN
RELATION TO FOREIGN DIRECT INVESTMENT FLOW**

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DECLARATION

I declare that this Mini-Dissertation which is hereby submitted for the award of Legume Magister (LL.M) in International Trade and Investment Law in Africa at International Development Law Unit, Centre for Human Rights, Faculty of Law, University of Pretoria, is my original work and it has not been previously submitted for the award of a degree at this or any other tertiary institutions. - Osita David.

DEDICATION

This Mini-Dissertation is dedicated to God of Soughtout People Bible Church (God of Three Days) and in memory of my father, Honourable Jotham Onuora Osita-Ogamba (Deceased).

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ACRONYMS

- APA- Advance Pricing Agreement
- BTT – Bilateral Tax Treaties
- CAMA – Company and Allied Matters Act
- CBN – Central Bank of Nigeria
- CFRN – Constitution Federal Republic of Nigeria
- CITA – Company Income Tax Act
- CITN – Chartered Institute of Taxation of Nigeria
- CP – Cost Plus
- CUP – Comparable Uncontrolled Price
- DCF – Discounted Cash Flow
- FDI – Foreign Direct Investment
- FGN – Federal Government of Nigeria
- FIRS – Federal Inland Revenue Services
- IFRS – International Financial Reporting Standard
- GDP – Gross Domestic Product
- IPSAS – Integrated Public Sector Accounting System
- JTB – Joint Tax Board
- LDC – Least Developed Countries
- MTT – Multi-lateral Tax Treaties
- OECD – Organisation for Economic Corporation and Development
- PITA – Personal Income Tax Act
- PSM – Profit Split Method
- RPM – Resale Price Method
- SCN – Supreme Court of Nigeria
- TNMM – Transactional Net Margin Method
- TP – Transfer Pricing
- UN – United Nations
- USA – United State of America
- VAT – Value Added Tax
- WHT – With Holding Tax
- ZBB – Zero Based Budgeting

CASES

- **Shell Petroleum Development Company v. Federal Inland Revenue Service (2013)**
- **Boeing Co. v. Inland Revenue Services**
- **Eaton Corporation v. Inland Revenue Services**
- **DHL Incorporated v. Inland Revenue Services**
- **Salini Case**
- **Shell Producing v. FIRS**
- **Unilever Kenya v. CIT (2014)**
- **Kanju Nazenje v. Income Tax Commissioner**
- **Scott v. Rusell (1948) 2 ALL E.R.I**

TREATIES

- United Nations Model Tax Law Convention
- Organisation for Economic Corporation and Development Model Tax Law and Guidelines
- Double Taxation Treaties (Bilateral)

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CHAPTER 1

GENERAL INTRODCUTION

1.1 Introduction

The basic responsibility of every government is to provide for the welfare of her citizens. The citizens expect the government to provide basic infrastructure and amenities that would support their economic activities. For the government to fulfill the welfare responsibility as enshrined in the constitution financial commitment is required and that could only be provided by the government through the imposition of tax.¹ Tax is defined as a compulsory levy imposed by the government for the purpose of raising money to finance the most of her projects for the benefit of the citizens. Tax could be imposed on both companies and individuals as legal personalities and entities and on both goods and services.²

It is expected that government revenue should be adequately collected without any leakages. However, the reverse is the case as a large chunk of government revenue from company tax is lost as a result of transfer pricing regime of inter -company and related company transactions that involve a holding company and subsidiaries and associates³.

In a bid to attract foreign direct investment, Nigeria opened up her economies to multi-national companies to do business and make profits and at the same time, they are expected to be honestly tax compliant in terms of their business operations and remittances.⁴ However, the multinational companies and their allies have used transfer pricing mechanism to make the government lose a lot of revenue. Therefore, to protect the Nigerian Tax base, the Federal Government of Nigeria through her fiscal agency, the Federal Inland Revenue Services, rolled out a regulatory framework in form of subsidiary legislation called the Income Tax Transfer Pricing Regulations, 2012.⁵

¹ Constitution Federal Republic of Nigeria 1999 as Amended.

² Teju Somorin ' Teju Tax Reference Book'.

³ Report of the Revenue and Fiscal Committee of the National Assembly.

⁴ Bilateral Investment Agreement Model with Countries.

⁵ Federal Inland Revenue Services Act.

The above Regulation came into existence after a wide-range consultation with the relevant stakeholders such as the tax institute, tax practitioners, government policy formulators, and tax authorities.⁶

1.2 Research problem

In order to accelerate the economic development of Nigeria, generate employment opportunities, technology transfer, improve the country's balance of payment situation, generate revenue through taxation, the Nigerian government has invited and offered incentives to foreign companies to encourage them to invest in the economy. Consequently, Nigeria has received the largest amount of foreign direct investment (FDI) in Africa⁷. Most sectors of the Nigerian economy are dominated by multinational companies. While these multinational companies are in Nigeria with the ultimate aim of making profits, the government is also interested in sharing in their profits through taxation. For the Nigerian government to obtain commensurate tax revenue from multinational companies operating in the country, the Federal Inland Revenue Service (FIRS) must keep a watchful eye over the practice referred to as transfer pricing.

A large proportion of world trade is accounted for by cross-border trade taking place within multinational enterprises, where branches or subsidiaries of the same multinational enterprise exchange goods or services. These transactions within the group are not exposed to the same market forces as transactions between independent enterprises. If the prices of these transactions are artificially lowered or increased they may lead to taxable profits being shifted from one country to another⁸. Nigeria is able to capture only 40% of their tax potential⁹. Transfer pricing abuse within multinational groups has been identified as the major contributor to this loss of tax revenue. Some multinationals may manipulate the transfer prices of their transactions with related companies in Nigeria in order to minimize their tax liability and enhance group profit. It is against this background that the Federal Inland Revenue Services issued the Income Tax (Transfer Pricing) Regulations, 2012 with commencement date of 2nd of August, 2012 as earlier mentioned.

⁶ Chartered Institute Taxation of Nigeria.

⁷ Corporate Guides International Ltd, 2010/2011.

⁸ According to Silberstein (2013).

⁹ As noted by the Nigerian Tax Compact, 2011.

Therefore, this research effort tends to examine the tax implications of transfer pricing and the plethora of problems and challenges confronting the Federal Inland Revenue Services in implementing the provisions of the Income Tax (Transfer Pricing) Regulation, 2012. And some of these challenges range from information gaps, knowledge and skill gaps, to mention a few. Equally, it will discuss ways of overcoming these challenges such as the need for Federal Inland Revenue Services to employ Transfer Pricing specialists, train some staff to acquire transfer pricing skills and knowledge, develop detailed transfer pricing manuals, develop a database of local comparable, seek technical support/assistance from relevant international organizations and tax authorities in other countries that are more experienced in transfer pricing, cooperate with tax authorities in other jurisdictions on exchange of information, automatic transfer pricing processes and adopt risk-based transfer pricing audit procedures.

1.3 Research question(s)

The core research question which this study will seek to answer is how effective is the transfer pricing regulation in relation to foreign direct investment in Nigeria?

- What is transfer pricing?
- What are the inherent loopholes in the Nigerian transfer pricing regulation?
- What are the challenges confronting the effective and efficient implementation of the transfer pricing regulation in Nigeria?
- What are the solutions for effective implementation of the transfer pricing regulation in Nigeria?

1.4 Thesis Statement

This thesis argues that though there is an extant regulatory framework for Transfer Pricing in Nigeria, its effectiveness in curbing the manipulative income shifting and transfer mispricing in Nigeria is yet to be seen. There is abuse of the Transfer Pricing mechanism by Multinational Companies in Nigeria and the need to control such abuse through a regulatory framework provided by the Transfer Pricing Regulations, 2012 must be enhanced for increased tax revenue.

1.5 Significance of the Study

This study will assist the Nigeria to re-assert herself and to ensure total leakage control of her revenue earning from company income tax devoid of transfer pricing abuse.

1.7 Literature Review

This chapter will review the extant Federal Inland Revenue Services Transfer Pricing Act, 2012 with the aim to critically analyse most of the relevant provisions and their effectiveness in regulating the transfer pricing regimes

1.8 Research Methodology

This research is done on the basis of analytical, descriptive and comparative inferences.

1.9 Outline of Chapters

Chapter 1

In chapter 1, an introduction to the research topic, highlights of the research problem, research questions, and significance of the study thesis statement, research methodology and outline of chapters are presented.

Chapter 2

This chapter will review the extant Federal Inland Revenue Services Transfer Pricing Act, 2012

Chapter 3

In chapter 3, the study will embark on a critique of the provisions of the Transfer Pricing Regulations, 2012.

Chapter 4

This chapter will analyse the challenges of the Transfer Pricing Regime in Nigeria

Chapter 5

This chapter will tend to proffer some ways to solving the Transfer Pricing Problems in Nigeria.

Chapter 6

This chapter concludes and makes recommendations.

CHAPTER 2

THEORETICAL ANALYSIS

2.1 Introduction

The aim of this chapter is to briefly analyze the theories that are relevant to the study. However, before going into the theoretical discussion, the historical perspective to this study will be presented.

2.2 Historical perspective

Historically, taxes were levied in Britain for the fight against Napoleon from 1799 to 1816, and in America taxes were levied to pay for the civil war from 1861 to 1965. In 1874, England made income tax a permanent levy on its citizens. In 1913, an income tax became permanent in the United States with the adoption of the 16th Amendment to the Constitution. At one time, Americans were anti-tax. There was the excessive tax on tea that led to the famous Tea Party in Boston Harbor, an incident that helped ignite the Revolutionary War. It took approximately 50 years in both England and the United States to sell the idea of a regular income tax.

What these historical dates failed to reveal is that both of these taxes were initially levied against only the rich. Yet, when you study the history of taxes, an interesting perspective emerges. The passage of taxes was only possible because the masses believed in the Robin Hood theory of economics, which was to take from the rich and give to everyone else. The problem was that the government's appetite for money was so great that taxes soon needed to be levied on the taxable class of persons including corporations.

It must be mentioned that corporations was popular in the days when sailing ships became a vehicle to limit the risk of merchants to the assets of each voyage. They put their money into a corporation to finance the voyage. The corporation would then hire a crew to sail to the New World to look for treasures. If the ship was lost and the crew lost their lives, the loss to the merchants would be limited only to the money they invested for that particular voyage. But what many people who never formed a corporation did not know was that a corporation was not really a thing. A corporation was merely a file folder with some legal documents in it, sitting in some attorney's office registered with a state government agency. It was not a big building with the name of the corporation on it; it was not a factory or a group of people. In the modern world, a corporation is merely a legal document that creates a legal body without a soul. They do not just sit there and

voluntarily pay more taxes. They search for ways to minimize their tax burden. They hire smart attorneys and accountants, and persuade politicians to change laws or create legal loopholes. They have the resources to effect change.

The Tax Code of the United States also allows other ways to save on taxes. Most of these vehicles are available to anyone, but it is the rich who usually look for them because they are minding their own business. For example, "1031" is jargon for section 1031 of the Internal Revenue Code, which allows a seller to delay paying taxes on a piece of real estate that is sold for a capital gain through an exchange for a more expensive piece of real estate. Real estate is one investment vehicle that allows such a great tax advantage. As long as you keep trading up in value, you will not be taxed on the gains, until you liquidate. People who do not take advantage of these tax savings offered legally are missing a great opportunity to build their asset columns.

Historically in Nigeria, the taxation principles and practices adopted were handed down by the British Colonial Administration and all the taxation laws were in conformity with what that of other commonwealth countries of the world. After the Nigerian independence, some sets of indigenous tax laws were promulgated to give effect to tax administration and they include laws such as the Income Tax Management Act (1961), Finance Law of Eastern Nigeria (1956), Income Tax Law of Western Nigeria (1957), Personal Income Act (1961), and Northern Nigerian Income Act (1962). There were many amendments to the respective tax laws for instance, the Income Tax Management Act (1961) which was mainly an arrangement for the prevention of double taxation was repealed and replaced with the Personal Income Tax Decree (1993) and codified as at today in the Laws of Federation of Nigeria as amended.¹⁰

2.3 Definition of taxation

¹⁰ Constitution Federal Republic of Nigeria, 1999 as amended.

There is always definitional challenge to the concept of taxation, however, it can be described as a ratable portion of the produce of the property and labour of the individual citizens, taken by the nation, in the exercise of its sovereign rights, for the support of government, for the administration of the laws, and as the means for continuing in operation the various legitimate functions of the state. It could be a charge imposed by governmental authority upon property, individuals, or transactions to raise money for public purposes.¹¹

Taxation can equally be described as a monetary-based compulsory contribution payable by the public as a whole or as a substantial sector thereof to a government. The purpose of taxation is to fund government expenditures and to attain socio-economic and political objectives.¹²

2.2.1 Overview and philosophy

In its basic form, taxation is simply a means of generating revenue for government. However, in developed nations and economies, taxation is no longer viewed as merely an avenue for revenue generation by government. Rather it is a means by which citizens contribute to a common purse for the provision of infrastructure, utilities, security and border needs by the governments to raise revenue by means of taxation in order to provide funds, which will be utilized for the benefit of the entire citizenry.¹³

In Nigeria, there is absence of such a clear understanding of the philosophy behind taxation. It is therefore necessary that government at all levels, clearly articulate and propagate this philosophy to their citizens. The tax policy can only set out general guidelines on the role of taxation in national development; however it is the duty of Government to take the message to the generality of the people, so that a tax culture can be imbibed in Nigeria.

2.2.2 Objective

¹¹ Nigerian Tax Policy Paper

¹² Tejutax Series.

¹³ Ade Ipaye on "Tax Evasion Impact on Economy".

The fundamental objective and derivative principle of the government of Nigeria is to contribute to the well-being of all Nigerians and taxes, which are collected by government, are used to impact on the lives of the citizens. This can be accomplished through proper and judicious utilization of the revenues collected by government to provide infrastructures such as hospitals, education, transportation, telecommunication, agriculture and so on.¹⁴

And in the line with the above, these objectives include-

Promote fiscal responsibility and accountability

One of the primary objectives of taxation is to ensure that government transparently and judiciously provide the revenue it requires to invest in the provision of infrastructure and public goods and services. And a good taxation would provide the government with a tool for National development.¹⁵

Facilitate economic growth and development

Taxation allows for stimulation of the economy and it is only through sustained economic growth that the potential ability to offer improvements in the well-being will arise. And as such, taxation should not be a burden, but should be applied proactively with other policy measures to stimulate economic growth and development.¹⁶

Income re-distribution

To provide the government with stable resources for the provision of public goods and services, taxation is used to address equalities in income distribution. It is such that it takes cognizance of citizens' peculiar economic circumstances and ensure that those with the highest incomes should pay the highest percentage of tax.¹⁷

Pursuit fairness and equity

¹⁴ Nigerian Tax Policy Paper.

¹⁵ Foluso Fasoti Ex- President CITN on " Manufacturing Companies and taxation".

¹⁶ Teju Tax Consulting for Effective Taxation Management.

¹⁷ Moshood Oyeleke on "Government Tax Revenue and Economic Meltdown".

Taxation is expected to be fair and should institutionalize horizontal and vertical equity. By horizontal equity, taxation ensures equal treatment of equal individuals and avoids discrimination against economically similar entities. In vertical equity, on the other hand, it addresses the issue of fairness among different income categories. In other words, taxation shall recognize the ability – to – pay principle, that is, individuals should be taxed according to their ability to bear the tax burden such that individuals and entities earn high incomes should pay a corresponding high percentage of tax.¹⁸

Correction of Market Failures or Imperfections

One of the objectives of taxation is to correct market failures in cases where it is the most efficient device to employ. In this regards taxes may be reviewed upwards or downwards as may be necessary to achieve government's intentions. Market failures which the taxation may address are those that are as a result of externalities and those arising from natural monopolies.¹⁹

2.4 Theoretical Analysis

2.4.1 Theories of Taxation

Taxation is an important fiscal instrument employed in every modern economy to promote economic activities and growth while ensuring that there is balance and fair play among the parties. In other words, taxation can be said to be a compulsory levy imposed by the government on its citizens to raise fund that will be used for public purposes. All over the world, taxation is a common phenomenon. There is no country that can do without imposition of taxation to boost its revenue generation. Taxation can be said to be a weapon used by any government to share from the wealth of an individuals and corporate bodies. Hence, taxation is a forceful imposition and not allowed to be voluntary.²⁰

There are many theories of taxation in modern economics whether developing and developed economies. These theories include: the Cost of Service / Benefit Theories and Ability to Pay Theory. These two theories will be discussed below.

¹⁸ TejuTax in respect of CITN MPTP on "Principles of Tax Management".

¹⁹ Omoigie Okaru EX-Chairman FIRS.

²⁰ CITN 2007.

i. Benefit Theory

Under the Benefit theory, the tax levels are automatically determined because tax payers pay proportionately for the government benefits they receive. In other words, the persons who benefit the most from public services are made to pay the most taxes than those who derive lesser benefits. This is viewed in the interest of equity.²¹ The public expenditure is regarded as cost of services rendered to the citizens by the government that must be paid for as a price for the people to enjoy those services.²² Therefore, taxes should be the prices or rates paid for the services provided to each person by government according to the cost incurred.²³

The benefit theory has formed a standard by which taxes are appropriated and thus, has an important influence on taxation.²⁴ However, it has been argued that the theory has no place in modern economies because it cannot be measured, among other things.²⁵

ii. Ability to Pay Theory

The ability to pay theory postulates that individuals who are productive and possess income must pay taxes in order to support public expenditures based on their ability to pay. In other words, those who have the means to pay should be made to pay while those who do not have then should not pay. Thus, the subject of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities.²⁶ However, the theory is very central to the concept of taxation globally because it provides objective criteria to measure the ability to pay and that can be based on the individual property and wealth, income level and consumption expenditures respectively.²⁷

2.4.2 Theory of Foreign Direct Investment (FDI)

²¹ Zubairu A.D. "Understanding Nigerian Taxation".

²² Krugman & Others "International Economics" 9th Edition.

²³ Beulher A. G. "Public Finance".

²⁴ Beulher A. G. "Public Finance".

²⁵ Zubairu A.D. "Understanding Nigerian Taxation".

²⁶ Mills J.S..

²⁷ Krugman & Others "International Economics" 9th Edition.

The world witnessed a rise in the FDI over the past forty (40) years most especially in the developed industrial countries. Most of the FDI flows relate to cross-border mergers and acquisitions whereas direct production process remains relatively stable²⁸. Worldwide flows of FDI have significantly increased since the mid-1990, though the rate of increase has been very uneven. Historically, most of the FDI have gone to the developed countries. However, the proportion of the FDI inflows going to the developing and emerging economies has steadily increased over time and accounts for half of worldwide FDI flows in 2009.²⁹

Now there is a constraint as to what the definition of FDI is. There is no single definition of what constitutes foreign investment. International investment agreements usually define investment in very broad terms. They refer to “every kind of asset” followed by an illustrative but usually non-exhaustive list of assets recognizing that investment forms are constantly evolving. The International Centre for the Settlement of Investment Disputes (ICSID) Convention does not define the term investment.³⁰

It is, however possible to identify certain typical characteristics of investment under the Convention which have been increasingly used by arbitral tribunals such as duration of the project; regularity of profit and return; risk for both sides; a substantial commitment; and the operation should be significant for the host state’s development. It must be noted that these criteria are based on the SILAS Case.

Most multilateral and bilateral investment treaties and trade agreements include broad definition of investment. Their approach is to give the term “investment” a broad non-exclusive definition, recognizing that investment forms are constantly evolving.³¹

Under the 1994 US Model BIT, the notion of investment is described as “any kind of investment owned or controlled directly or indirectly” followed by a non-exhaustive list of asset categories falling within the definition of investment. The 2004 US Model BIT and the recent US FTSA represent a departure from the previous definition: they define investment broadly as every asset

²⁸ Jhingan M.I. “Money, Banking, International Trade and Public Finance”.

²⁹ UNCTAD World Trade Report.

³⁰ Tejutax Series.

³¹ N. Rubins, “The Notion of Investment’ in International Investment Arbitration”.

owned or controlled, directly or indirectly, by an investor, “which has the characteristics of an investment” and include a non-exhaustive list of forms” such investments may take.

FDI is a business decision whereby a multinational enterprise has a controlling/ownership of a foreign company. The controlling company is called the parent company while the controlled is called the subsidiary/associate/affiliate company. The company builds some production plants and engaged in real manufacturing and may decide to acquire some existing companies such as is the approach of Chinese companies model of foreign investment. The foreign investor may look for an already going concern and acquire same with the intension of using their own business culture to run the enterprise for good returns on investment.³² Developed countries dominate the list of the top countries whose companies engage in outward FDI and more recently, companies from some big developing countries such as China and India have performed significantly more in FDI undertakings.

There are two types of FDI namely: horizontal and vertical FDI decisions which have to do with proximity-concentration trade-off. In horizontal FDI, the company would avoid trade costs by building the production facilities in a foreign territory not minding that the building of the production facilities will be costly but the average fixed cost is expected to be written off over a period of time, that is, at the long run. The advantage is that the arrangement will lead to large scale of economies as it is expected to sell more of its products to foreign customers.³³ Vertical FDI decision involves the production cost differences for the particular part of production chain that are being moved to the foreign territory and those cost usually stems from comparative cost advantage available.

In Nigeria, the government has always used policies to attract FDI through the grant of tax incentives and some other non-tax measures. These incentives include but not limited to the following:³⁴

- Tax Holidays – by which government grants tax holidays to pioneer companies for the newness of their products;

³² Jhingan M.I. “Money, Banking, International Trade and Public Finance”.

³³ Jhingan M.I. “Money, Banking, International Trade and Public Finance”.

³⁴ Zubairu A. D. “Understanding Nigerian Taxation”.

- Reduction of corporate tax rates to make business more competitive;
- Accelerated capital allowance – for the earlier write-off of assets used for business;
- Investment allowance – which is granted as a proportion of qualifying assets in addition to the initial allowance for the early write-off of the assets;
- Joint Venture – by which the government enters into a joint venture agreement with foreign companies, especially in the oil industry in order to reduce the financial risks and therefore, make the project more attractive to foreign investors
- Production Sharing Contract – whereby the government arranges for the crude oil producing companies to recover costs, pay taxes and take shares of profits with crude oil allocation.
- Non-tax consideration – these include political stability, currency convertibility, repatriation of profits, skill and capacity development and potential market deepening.

However, it must be noted that the tax incentives have not yielded the expected results to attract the FDI because of the absence of well laid –down tax policy designed to achieve the desired gains from the incentives granted. First, the tax incentives are granted in piecemeal as part of the annual budget process; secondly, there is no attempt to measure the effectiveness of the incentives by comparing the revenue foregone with the gains; third, tax holiday is subject to various abuses that the pioneer companies hardly grows beyond the pioneer status as the beneficiary companies appropriate all the benefits of the tax holiday without ‘reinvesting’ back the advantage into the system.

2.5 Conclusion

In this chapter, the historical perspectives to taxation is discussed, thereafter, the theories that underpin taxation and foreign direct investment are examined. It is found that taxation is an important fiscal instrument employed in every modern economy to promote economic activities and growth while ensuring that there is balance and fair play among the parties.

In the next chapter, the meaning, nature and context of transfer pricing globally and in the Nigerian context will be investigated.

CHAPTER 3

NATURE AND CONTEXT OF TRANSFER PRICING

3.1 Introduction

In chapter 2, the historical perspectives to taxation was discussed, thereafter, the theories that underpin taxation and FDI were examined. It was found that taxation is an important fiscal instrument employed in every modern economy to promote economic activities and growth while ensuring that there is balance and fair play among the parties.

In this chapter, however, the meaning, nature and context of transfer pricing globally and in the Nigerian context will be investigated. In addition, the international treaties, and the domestic laws and regulations that govern transfer pricing are also analyzed.

3.2 Nature and context of transfer pricing

With abundant natural resources, Nigeria needs direct foreign investment in all sectors of the economy such as the manufacturing, extractive, agriculture and agro-allied, construction, oil and gas, solid minerals, energy, telecommunication and so on. FDI is needed by the country to bridge the gap of supply capital deficiency as a result of dwindling oil revenue and tax receipts and expertise for optimization of the resources. In order to achieve this, government of Nigeria has entered into various bilateral treaties and membership of regional blocs such as ECOWAS with a view to attractive FDIs in the country. It must be appreciated that while FDI are provided with the requisite enabling environment for their investment to thrive and make profit, it is expected equally that they exhibit reasonable level of corporate citizenship by obeying tax regulations and remitting accurately the tax liabilities due to them to pay and nothing can be derogatory to taxation measures of the Nigerian government.³⁵

However, the principle of utmost good faith expected to subsist between the government and the foreign investors are usually violated when the Multinational Corporations (MNCs) tend to engage in the transfer pricing arrangement that are inimical to the revenue generation of the government. In dealing with this practice, Nigeria has entered into bilateral taxation treaties with a lot of

³⁵ Article 12 of Nigerian Bilateral Investment Treaties.

countries and these are double taxation treaties and Trade and Investment Framework Agreement (TIFA) with the United States in 2000.³⁶ Besides, in order to provide the regulatory framework for effective monitoring of the transfer pricing system, the Nigerian government has put in place the Federal Inland Revenue Services Transfer Pricing Regulation, 2000 that capture the respective taxation treaties for implementation.

3.3 Definition of Transfer Pricing

Conceptually, Transfer Pricing (hereafter TP) entails determining the values at which goods (tangible or intangible) and services are exchanged between divisions of the same entity or between different entities that are under common control. Sometimes the entities are within the same tax territory, but the importance for taxation becomes greater when they are located in different tax territories.³⁷ With particular reference to MNCs, TP is a mechanism used by the multinationals to transfer goods and services between their related or associated companies worldwide.³⁸ TP describes the process of setting the prices at which related entities transfer physical goods, intangible property or services between each other.³⁹ The price charged for goods or services supplied or transferred by one sub-unit of an organization to another submit or one member of a group to another can be referred to as a transfer price. It is the price at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises.⁴⁰

TP is a profit allocation method used to attribute a corporation's net profit or loss before tax to tax jurisdictions. Transfer prices are therefore the charges made between controlled or related legal entities, that is, within the same group. Legal entities considered under the control of a single corporation include branches and companies that are wholly or majority owned ultimately by the

³⁶ State Department's Office of Investment Affairs' Investment Climate Statement.

³⁷ Pedabo (2012, p.1).

³⁸ Chartered Institute of Taxation of Nigeria (2008, p.32).

³⁹ Deloitte (2012, p.1).

⁴⁰ Chartered Institute of Taxation of Nigeria (2008, p.34).

parent corporation. Certain jurisdictions consider entities to be under common control if they share family members on their board of directors.⁴¹

TP is the general term for the pricing of cross-border, intra-firm transactions between related parties. It therefore refers to the setting of prices at which transactions occur involving the transfer of property or services between associated enterprises, forming part of an Multinational Enterprises (MNEs) group. These transactions are also referred to as “controlled” transactions, as distinct from “uncontrolled” transactions between companies that, for example, are not associated and can be assumed to operate independently (“on an arm’s length basis”) in reaching terms for such transactions. It follows that, with the need to set such prices being a normal incident of how MNEs must operate, “transfer pricing” by itself does not necessarily involve tax avoidance. It is where the pricing does not accord with applicable norms internationally or at domestic law that we are entering into areas more properly called “mispricing”, “incorrect pricing”, “unjustified price pricing” or similar, and where issues of tax avoidance and evasion may arise.⁴²

In addition, TP refers to the structuring and pricing of transactions between members of the same controlled group. Typically, the concern is with cross-border transactions where income and expenses are allocated among taxpayers in different jurisdictions. However, many countries including Nigeria, also consider domestic transactions between affiliates. Transactions between related parties run the gamut from the sales of tangible goods and the licensing or sale of intellectual property to the provision of services and the extension of credit or financing. Virtually every category of transaction effected between third parties occurs between affiliates at one time or another.⁴³

⁴¹ Tayo Ogungbenro on Transfer Pricing: Concept and Processes.

⁴² Working Draft of UN Tax Committee’s Subcommittee on Practical Transfer Pricing Issues.

⁴³ Taiwo Oyedele, Anthony Curtis, Elizabeth Sweigart and Robert Smallwood on. The Impact of Nigeria’s New Transfer Pricing Rules on Multinational Enterprises.

Price charged by individual entities for goods or services supplied to one another in multi-department, multi-office, or multinational firms. Transfer price policy is generally aimed at (1) evaluating financial performance of different business units (profit centers) of a conglomerate, and/or to (2) shift earnings from a high tax jurisdiction to a low-tax one. Tax authorities usually frown at transfer pricing aimed at tax avoidance and insist that each internal part of the firm deals with the other on 'arm's length'.

Prices adopted by an enterprise have direct relationship with the profit. If any of the elements is artificial, the profit declared would be absurd. There is reverse shifting of income/profit from one state or country to another. There is a significant payment of less tax if the income has been shifted to a tax haven. There are increasing cases of tax evasion arising from transfer pricing manipulation

3.4 Tax Implications of Multinational Transfer Pricing

TP affects the profits on which the affected enterprises are subjected to tax. Since associated enterprises transact businesses between themselves, considerations other than market conditions sometimes dictate the prices at which goods and services are transferred within the group. This could result in the shifting of profit from tax jurisdictions in which they arise to jurisdictions which are more convenient to the MNCs.⁴⁴ MNCs may employ TP techniques that allow them to shift profits to low tax locations, thus lowering their overall tax burdens.⁴⁵ Transfer price will also affect custom duties paid on imports and exports. For example, if the transfer prices on imports into a country are lowered, the import duties and other tariffs based on the value of the import will equally be reduced. Another problematic area is where the head office of the multinational or a member of the group incur expenses which are for the benefit of all or many members of the group, the allocation of the joint costs to the group will certainly affect their profits and taxes. Management are one of the many ways that MNEs are using to reduce taxable profit in African countries. Usually these fees have no relationship with the actual cost of providing any management services. Often, management fees are charged where the local company has competent and capable

⁴⁴ Chartered Institute of Taxation of Nigeria (2008, p.34).

⁴⁵ Clausing (2000).

management of its own.⁴⁶ The parent company can also impose excessive charges on its foreign subsidiaries, associates, etc. in respect of the provision of intangibles such as patents, licenses, trademark, etc. and use these avenues to siphon fund to tax heaven or jurisdiction with favourable tax requirements. For example, when a Nigerian subsidiary pays royalties to its parent company based in another country for the right to manufacture the company's products in Nigeria, the taxable profits of the Nigerian subsidiary will be affected by the amount of royalties paid to the parent company. If the royalties paid by the Nigerian subsidiaries are too high, the taxable profits and tax liabilities in Nigeria would be reduced.

It has been posited that in global economy where MNEs play a prominent role, governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdictions and that the tax base reported by MNEs in their countries reflect the economic activities undertaken therein. For taxpayers, it is essential to limit the risks of economic double taxation that may result from a dispute between two countries on the determination of the arm's length remuneration for their cross-border transactions with associated enterprises.⁴⁷

Obviously, transfer prices are significant for both taxpayers and tax authorities because they impact on income and expenses and, therefore, taxable profits of associated enterprises in different tax jurisdictions in which the MNCs operate. Multinational transfer pricing can provide an avenue for tax fraud. Companies within the same group which are under different tax jurisdictions may decide to overprice or underprice intra-group transactions depending on what they want to achieve.

Therefore, the above scenario depicts how the Nigerian government loses a lot of tax revenue through the TP arrangement and the Federal Inland Revenue Services (FIRS) must pay attention to taxes paid by subsidiaries, associates, etc of foreign companies operating in Nigeria. And one of the ways to control the TP menace is through regulation bearing in mind the provisions made available by both the domestic and other international laws.

3.5 Legal Framework

⁴⁶ OECD, (2012, p. 72).

⁴⁷ OECD (2012).

3.5.1 International Treaties

Nigeria is signatory to many taxation treaties with some countries of the world on regarding the issues of double taxation and transfer pricing with a view to safeguard her revenue base and equally be in the same frequency with dynamics of the contemporary state obligations. Some of the treaties and model taxation laws that have influenced the Nigerian TP monitoring include the Organization of Economic and Developed Countries (OECD) Model Taxation Law, United Nations Working Paper on Transfer Pricing, Economic Community of West African Countries (ECOWAS) Model Taxation Law, Bilateral Investment Treaties and many others.

Sources of international legal framework

Article 9: Associated enterprises

1. Where an enterprise of a contracting state participates directly or indirectly in the management, control or capital of an enterprise of the other contracting state, or the same persons participate directly or indirectly in the management, control or capital of an enterprise of a contracting State and an enterprise of the other Contracting State, and in either case, conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.⁴⁸
2. Where a contracting state includes in the profit of an enterprise of that state and taxes accordingly, profits on which an enterprise of other state has been charged to tax in that other contracting state and that other state agrees that the profit so included are profits which would have accrued to the enterprises of the first-mentioned state, if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other state shall make an appropriate adjustment to the amount of the tax charged on those

⁴⁸ OECD Model Tax Law: **OECD Guidelines on Transfer Pricing** are also relevant for a detailed study of transfer pricing. Transfer pricing denotes the process of determining the price of exchanges among related business entities and includes the transfer of intellectual property, stocks, among connected person.

profits. In determining such adjustment, due regard shall be had to the other provisions of this Agreement and the competent authorities of the contracting states shall if necessary consult with each other.⁴⁹

The provision of paragraph 2 shall not apply where judicial, administrative or other legal proceedings have resulted in a final ruling that by actions giving rise to an adjustment of profits under paragraph 1, one of the enterprises concerned is liable to penalty with respect to fraud, gross negligence or will default.

It must however be noted that this article establishes the rules for ascertaining the profits from transactions between a resident company and a non-resident company both of which are related members of the MNE. The ascertainment of the profit is for the purpose of adjusting the tax liability of the companies. Article 9 deals with the adjustment for TP between the related or associated persons.

In addition, a MNC or MNE is a corporation or enterprise that manages production or delivers services in more than one country. It can also be referred to as an international corporation.

The focus of Article 9 is on TP. Due to high level of inter-company transactions between members of the MNEs, TP issues usually arise to guide the taxation of the income and expenses from the transactions. It specifies three situations that are critical to the taxation of MNE: first, the existence of control between such companies; secondly, where the control impacts on the profits allocated to the local entity; thirdly, terms of business between such companies do not reflect arm's length principles respectively. Now the arm's length principle requires that a transaction between related companies should be on such conditions as would be available, if two independent companies were transacting.

Under this article, the controlled entity is determined in terms of direct or indirect participation in Capital, Control and Management of the enterprises by another company or group of companies. This may arise in several ways including: where one enterprise is a subsidiary of another; where both enterprises are members of the same group/ MNE; where substantially the same individuals

⁴⁹ Nigerian Double Taxation Treaty.

sit on the board of both enterprises; where one enterprise is a creditor of the other with certain rights of control in the credit agreement or debenture, etc.

The implications of the provisions are very important for the determination of the arm's length prices among MNEs. In the first instance, the special relationship existing between the associated companies allows for dictation of prices. Secondly, the prices so dictated may be different from what obtain in similar transactions between independent companies. And where by virtue of the relationship within the MNE, prices are dictated and the dictated prices are different from prices that would be obtained between independent parties for the same or similar transactions in the same or similar circumstance, adjustment should be made to establish the arm's length prices.⁵⁰

Participation in capital of a company may not be the same as participation in control since control may be different from ownership. What constitute control with regards to issued share capital may differ among contracting states. For instance in Nigeria, a holding of more than 50% of the issued share capital constitutes control. In United States, a U.S. company is considered foreign controlled and therefore, a subsidiary of a foreign-based multinational, if 10% or more of its stocks is held by a foreign company. This is to the effect that 10% is enough to convey effective control. Similarly, a U.S.-based company is considered multinational, if it owns more than 10% of a foreign firm. The "controlling firm" is called the multinational parent company while the "controlled firm" is called the multinational affiliate.⁵¹

Now Article 9(2) deals with a situation where Country A, in accordance with Article 9(1), adjusts the profit of a company and imposes tax on it and such profit has already been taxed on the related company by Country B. By its provision, Country B agrees that the original transaction was not in compliance with the arm's length principle; Country B shall adjust the tax liability of the related company appropriately. There is no time limit stated after the expiration of which Country B would not be obliged to make an appropriate adjustment.

The competent authorities of the contracting states are enjoined to consult each other in determining the arm's length price, if necessary. If there is a dispute between the other parties over

⁵⁰ Zubairu A. D. "Understanding Nigerian Taxation".

⁵¹ Jhingan M.I. "Money, Banking, International Trade and Public Finance".

the amount and character of the appropriate adjustment, the mutual agreement procedure should be implemented.

Nonetheless, in August 2012, Nigeria enacted the Federal Inland Revenue Service Transfer Pricing Regulation to spell out the rules guiding transactions between associated enterprises. This is to clarify the basis of application of the provisions in the domestic tax laws addressing transactions between related companies that are not at arm's length.

3.5.2 Domestic laws

TP falls within the purview of taxation and it is contemplated that relevant tax laws in that regard must have both constitutional and statutory backups. Thus, the relevant tax laws consist of the following:

i. 1999 Constitution as amended

The power of the National Assembly to make laws for the peace, order and good government of the Federation with respect to any matter included in the Exclusive Legislative List shall, save as otherwise provided in this Constitution, be to the exclusion of the Houses of Assembly of States.⁵² In other words, it is only the Federal Government that can account for the federal taxation of incomes, profits and capital gains, except as otherwise prescribed by the Constitution.⁵³ The powers and jurisdictions so conferred on the Federal government in respect of the collection and administration of the federal taxation cannot be delegated. And to streamline the jurisdiction issue, the Federal Government came out with a list of levies and taxes that should be collected by the central government to include company income tax, withholding tax, petroleum tax, value added tax, education tax and stamp duties and so on.⁵⁴

In Part I of the Second Schedule of 1999 Constitution of Nigeria, under items 16, 25, 39, 58 and 59, listed the following taxes as exclusively reserved for the Federal Government; they include

⁵² Section 4.3 Part II: Powers of the Federal Republic of Nigeria.

⁵³ Schedule II: Legislative Powers Part I: Exclusive Legislative List Item 59.

⁵⁴ Tax and Levies (List of Collection) Law of Federation of Nigeria 2004.

Customs and Excise Duties, Export Duties, Mines & Minerals, Stamp Duties and taxation of incomes, profits and capital gains.

In Part H of the Second Schedule of 1999 Constitution of Nigeria, item 7 provides that the National Assembly may delegate the collection of the taxes and duties on incomes, profits and capital gains to the State governments. The Constitution, under items 8 and 10 however ensures the elimination of multiplicity of taxes in carrying out such delegated collection of taxes and duties.⁵⁵ Taxes and Levies (Approved List for Collection) Act No. 21 of 1998 goes further to provide the details of the taxes and levies each tier of government is responsible for collecting.

However, there are some flaws observed in the provisions of Act No. 21 of 1998 which are largely responsible for its ineffective implementation by the relevant tiers of government especially the state and local governments. The Act does not set (and it could not have set) boundary for the number and types of taxes collectible by each tier of government. Under section 7 and Part II of the Second Schedule (items 9 and 10) of the 1999 Constitution, the States' Houses of Assemblies need to pass the relevant provisions of Act No. 21 of 1998 into laws.

Meanwhile, Act No. 21 of 1998 provides for 8, 11 and 20 types of taxes for collection by the Federal, States and local governments respectively as follows:

- Federal Government
 - Companies Income Tax; Withholding Tax on companies. residents of Abuja and non-resident individuals; Petroleum Profits Tax (PPT); Value Added Tax (VAT); Education Tax; Capital Gains Tax on residents of Abuja, Corporate bodies and non-resident individuals, Stamp Duties on corporate bodies and residents of Abuja, Personal Income Tax of members of the armed forces, Nigeria Police Force, residents in Abuja, nonresident individuals and staff of Foreign Affairs Ministry.
- State Governments
 - Personal Income Tax of residents of the State, Withholding Tax for individuals living in the State, Capital Gains Tax for individuals living in the State, Stamp Duties on instruments executed by individuals, pools betting and lotteries, gaming

⁵⁵ Constitution Federal Republic of Nigeria, 1999 as amended.

and casino taxes, road taxes, business premises registration fees in urban and rural areas, development fees for individuals only, naming of street registration fee in State capital; right of occupancy fee on lands owned by the State government in urban areas of the state, market taxes and levies where state finance is involved.

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- Local Governments

- Shops and kiosks rates, tenement rates, on and off liquor license fees, slaughter slab fees, marriage, birth and death registration fees; naming of street registration fees excluding street in the state capital, right of occupancy fees on land in rural areas, excluding those collected by the federal and state governments excluding the state capital; market taxes and levies excluding markets where State finance is involved, motor park levies, domestic animal license fees, bicycle, truck, canoe, wheel barrow, and cart fees, other than a mechanically propelled truck; cattle tax payable by cattle farmers only, merriment at road closure levy, vehicle radio license fees, wrong packing charges, public convenience, sewage and refuse disposal fees; customary burial ground permit fees, religious places establishment permit fees, signboard and advertisement fees, radio and television license fees (other than radio and television transmitter).

- Others

There are other taxes legally collected by the Federal Government outside Act no. 21 of 1998. Under the Customs and Excise Act, the Federal Government collects import duty on imported goods, export tax on exported goods and excise duties on locally manufactured goods. Under the Petroleum Act and Mining Act, the Federal Government also collects royalties on crude oil and minerals produced in the country.

Also agencies of the Federal and State governments levy charges on individuals and corporate bodies for services rendered such as port charges, water rates, airport charges, etc. These imposts are legally collected even though they are not listed in Act No. 21 of 1998. These taxes and levies

are strictly to be collected in accordance with the enabling Acts or Laws of the Federal or State governments.

ii. Company Income Tax Act (CITA), 1990

CITA is a piece of statute and a secondary legislation on the administration of income tax in Nigeria as it makes provisions for double taxation arrangement and method of calculating relief to be allowed for double taxation.⁵⁶

The artificial transaction provision of Section 22 of the Companies Income Tax Act CAP C21 LFN 2007 stipulate as follows-

(1) Where the Board is of opinion that any disposition is not in fact given effect to or that any transactions which reduce 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 in respect of 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.

(2) For the purpose of this section-

(a) "Disposition" includes any trust, grant, covenant, agreement or arrangement;

(b) *transactions* between persons one of whom either has control over the other or, in the case of individuals, who are related to each other or between persons both of whom are controlled by some other person, *shall be deemed to be artificial or fictitious if in the opinion of the Board those transactions have not been made on terms which might fairly have been expected to have been made by persons engaged in the same or similar activities dealing with one another at arm's length.*

(3) A company in respect of which any direction is made under this section, shall have a right of Appeal in like manner as though for the purposes of Part X of this Act such direction were an Assessment.⁵⁷

⁵⁶ Section 45, 56 Company Income Tax Act (LFN 1990) .

⁵⁷ CITA LFN, 2007.

The combined effect of the above provisions of the Company Income Tax Act can be explained as follow:

- transactions between associated persons are artificial or fictions where such transactions are not made on terms which might have been expected to be made between independent parties engaged in the same or similar activities and dealing with each other at arm's length
- for the prices to be appropriate, they must be prices expected to be charged for the same or similar transactions between independent persons dealing with each other at arm's length
- in the determination of the profit of the associated persons, artificial or fictitious arrangements should be re-written to counteract any reduction of tax occasioned by the artificial or fictitious arrangements
- the dispute that may arise here is between the taxpayers and authority.⁵⁸

Connected persons versus arm's length

Transactions between persons and individuals one of whom has control over the other or are related respectively or between persons both of whom are controlled by some other person are deemed to be artificial or fictitious if in the opinion of the Board those transactions have not been made on terms which might fairly have been expected to have been made by persons engaged in the same or similar activities dealing with one another at arm's length basis.⁵⁹

A similar provision can be found in **Section 20 of the Capital Gains Tax Act** and **Section 15 of the Personal Income Tax Act**.

Section 15 of the Petroleum Profit Tax Act CAP13 LFN 2004 shows the applicability of the arm's length principle to petroleum producing companies.

Any transaction that would reduce the amount of tax payable is considered artificial or fictitious and should be disregarded and adjusted to bring the prices in line with arm's length principles.

⁵⁸ Igho, Andy and Others on "Nigerian Taxation Principle and Practice"

⁵⁹ Igho, Andy and Others on "Nigerian Taxation Policy"

There are various areas of taxation where artificial transactions abound in order to evade or avoid taxes or both. Transfer pricing is one of the important areas.⁶⁰

Section 5(3) of the Value Added Tax Act advocates the open market value of supply of goods and services.

iii. Federal Inland Revenue Services (FIRS) Act, 2007

FIRS is a statutory body saddled with the responsibility of regulating the entire taxation and fiscal policies and practices in Nigeria with a view to achieving certainty in the entire taxation system of the Federal Government. It has a board of directors that is appointed by the executive arm of the government and has representatives that cut across oil and gas, finance ministry, population commission, customs, and so on.⁶¹ The FIRS is empowered to do, among other things, assess and collect all taxes and ensure efficient and effective administration of taxes.⁶² It also has a technical committee that acts on advisory capacity and considers every other matter that requires professional and technical expertise and makes recommendation therein.⁶³

a) Transfer Pricing Regulation, 2012 (Federal Inland Revenue Service)

By virtue of the extant powers conferred on the Federal Inland Revenue Services, agency came up with Transfer Pricing Regulations in 2012 with the intention of controlling and monitoring the transfer pricing mechanism in group and holding company transactional relationship. Income Tax (Transfer Pricing) Regulation No. 1 2012 states the rules guiding transfer pricing in Nigeria and replaces any arrangement in place before the regulation came into force. The FIRS Transfer Pricing Regulations is discussed below:

Purpose

⁶⁰ Akinyemi Eben on "Mystery OF Hydrocarbons Taxation in Nigeria".

⁶¹ Section Federal Inland Revenue Services Act ,2007.

⁶² Section Federal Inland Revenue Services Act ,2007.

⁶³ Section Federal Inland Revenue Services Act ,2007.

The Nigerian legal system has through various legal reforms given credence to consolidating most of her statutes into the Laws of the Federation of Nigeria and some of laws in taxation matters include the Personal Income Tax Act, CAP P8, Companies Income Tax Act, CAP C21, Companies Income Tax Act, CAP C21 and others. The principal purpose of the Federal Inland Revenue Services Income Tax (Transfer Pricing) Regulation, 2012 is to give effect to those statutes with a view to providing certainty and uniformity in all taxation and fiscal policies of the government. This is important so that the various foreign investors would avail themselves of the relevant legislative statutes and ensure compliance.⁶⁴

Objectives

While it is the responsibility of the Nigerian government to create the enabling environment for FDI to thrive, it is equally the right of the government to ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activities conducted by taxable persons in Nigeria, including their transactions and dealings with associated enterprises. The issue of tax offences is grievous because it makes the government to lose a lot of tax revenue through tax avoidance and evasion thereby making it quite impossible for them to give the citizens the dividends of democracy. Thus, this regulation provides the Nigerian authorities the tools to fight tax evasion through over or under-pricing of controlled transactions between associated enterprises. Nigeria has entered into some double taxation agreements with some countries with a view to reducing the tax burden threat on profit of the foreign investors and such risk of double taxation is intended to be mitigated by the instant regulation. Competitiveness of both the foreign investment and domestic going concerns cannot be achieved except a level playing field is provided and this is one of the objectives of the transfer pricing regulation. This is because competition helps in bringing out the best in the participants and adds value to the economy. The agony of every investor has being the risk of operating in an environment devoid of unstable legal, economic and political policies. The fact that taxation laws are also in a flow has made the transfer pricing regulation an indispensable framework to bring about the required certainty to taxable persons with respect to transfer pricing treatment in Nigeria.⁶⁵

⁶⁴ Dandago, Masud and Others on “Tax Compliance in Africa and Public Governance Quality”.

⁶⁵ Zubairu A. D. “Understanding Nigerian Taxation”.

Scope

Some foreign direct investments have grown over the years thereby expanding their operations across territories with their subsidiaries and associate companies operating in Nigeria. Though they have a consolidated group account and financial statements, but the respective entities that make up the group must operate at arm's length as different entities in all their transactions for tax purposes else the government would be at a risk of losing so much tax revenue. Therefore, the regulation apply to transactions between connected taxable persons carried on in a manner not consistent with the arm's length principle and includes sale and purchase of goods and services; sales, purchase or lease of tangible assets; transfer, purchase, license or use of intangible assets; provision of services; lending or borrowing of money; manufacturing arrangement; and any transaction which may affect profit and loss or any other matter incidental to, connected with, or pertaining to the transactions referred to above. ⁶⁶

3.5.3 Compliance with the arm's length principle

As mentioned above, the principle of arm's length is very sacrosanct in taxation that every FDI is compelled to ensure that both tract and commercial transaction of the head office, subsidiaries and associates are separately treated and are viewed as separate legal personalities competing with other business entities that are not in the group for tax purposes. Thus, where a connected taxable person has entered into a transaction or a series of transactions, the person shall ensure that the taxable profits resulting from the transaction or transactions is in a manner that is consistent with the arm's length principle. And failure of a connected taxable person to comply will avail the authority the power to make adjustments where necessary if it considers that the conditions imposed by connected taxable persons in controlled transactions are not in accordance or consistent with the arm's length principle. ⁶⁷

⁶⁶ TejuTax Reference Book.

⁶⁷ Hunfrey Onyeukwu on "Transfer Pricing in the Nigerian Context".

3.5.4 Transfer pricing methods and calculation

The Regulations permit the use of any of the following methods in determining whether transactions between parties are consistent with the arm's length principle: (a) comparable uncontrollable price method; (b) resale price method; (c) cost plus method; (d) transactional net margin method; (e) transactional profit split method; and (f) any other method which may be prescribed by regulations made by the FIRS from time to time. It is expected that in making the choice of any particular transfer pricing methods, it must have regard to the nature of the controlled transaction determined, in particular, through an analysis of the functions performed, assets employed and risks assumed by each person that is a party to the controlled transaction. The following are the financial indicators and methods of calculating transfer pricing for the need of the Regulation.⁶⁸

i. Comparable Uncontrolled Price (CUP)

The comparable uncontrolled price method compares the price charged for transactions between associate enterprises (related parties) in comparable transaction between independent enterprises (unrelated parties) in comparable circumstances. If there is any difference between the two prices, this might be an indication that the transactions between the associated enterprises are not made at arm's length. For example, X Ltd and Y Ltd are members of the same group. If X Ltd sells a particular product to independent parties as well as to Y Ltd under similar circumstances, the prices charged for X Ltd.'s sales to independent parties can be compared with price charged for X Ltd.'s sales to Y Ltd (internal comparable). Similarly, if an independent party (ABC Ltd) sells to another independent party (XYZ Ltd), the same product sold to A Ltd, the prices charged by ABC Ltd can also be used as the basis for comparison (external comparable). For tax purposes, the tax authority may reject the prices for transaction between independent enterprises.⁶⁹

The method is appropriate where there are no material differences between the transactions being compared or where such differences exist, reasonably accurate adjustments can be made to

⁶⁸ FIRS Transfer Pricing Regulations 2012.

⁶⁹ Management Accounting Mastery 'Guiding You Personally to CIMA Exam Success'.

eliminate the effects of such material differences. There is need to consider other methods if material differences cannot be adjusted to give a reliable measure of an arm's length price.⁷⁰

ii. Cost Plus (CP)

Under this approach, the costs incurred by the supplier in making the product transferred or service provided to an associated enterprise are ascertained and a mark-up is then added to these costs. An appropriate mark-up may be determined by reference to the mark-up that the same supplier earns in comparable transaction with independent enterprises (internal comparable), or by reference to the mark-up earned in comparable transactions by independent enterprises (external comparable). As noted by Deloitte (2012), the method is suitable in comparable transactions and comparable cost bases but unreliable when it offers a strong incentive to inflate an entity's cost base.⁷¹

iii. Resale Price (RP)

The resale price method begins with the resale price to an independent enterprise and a gross margin is then deducted from this resale price. For example, OB Ltd and BY Ltd are related companies. OB Ltd usually transfers goods to BY Ltd which BY Ltd sells to independent parties. Under the resale price method, the arm's length price of the product acquired by BY Ltd in a non-arm's length transaction is determined by reducing the price realized on the resale of the product by BY Ltd to independent parties by an appropriate gross margin (resale price margin). BY Ltd.'s gross margin may be determined by reference to the gross margin that BY Ltd usually earns in comparable transactions with independent parties (internal comparable), or by reference to the gross margin earned by independent enterprises in comparable transactions (external comparable).⁷²

iv. Profit Split (PS)

The first step is to determine the combination profit that arises from a business transaction in which the associated enterprises are engaged. This profit is then split between the associated

⁷⁰ Zubairu A. D. "Understanding Nigerian Taxation".

⁷¹ Igbo, Andy and Others on "Nigerian Taxation Principle and Practice".

⁷² Igbo, Andy and Others on "Nigerian Taxation Principle and Practice".

enterprises in a manner that reflects the division of profit that would have been expected between independent enterprises. The combined profit or loss attributable to the transactions in which the associated enterprises participated is allocated to the enterprises in proportion to their respective contributions to that combined profit or loss, which should reflect the function performed, risk assumed and assets employed by each enterprise in the related party transactions.⁷³

v. Transactional Net Margin (TNM)

Under this method, the net profit margin that an enterprise earns from transactions with an associated enterprise is compared with the net profit margin earned in comparable transactions with an independent enterprise. An appropriate net margin may be determined by reference to the net margin that the enterprise earn in comparable transactions with independent enterprises (internal comparable), or by reference to the net margin earned in comparable transactions by independent enterprises (external comparable). The transactional net margin method operates in a manner similar to the cost plus and resale its price methods. However, the transactional net margin examines the net profit in relation to an appropriate base such as cost, sales or assets.⁷⁴

3.5.5 Documentation

Under the Regulations, taxpayers are required to prepare transfer pricing documentation prior to the due date for filing the income tax returns for the year in which the documented transactions occurred. They should make available information and data, additional information on request, financial and accounting books and records, specific information on request, tax returns and declaration forms so that in the event of an audit by FIRS.

Though the Regulation does not specify the form for this documentation but taxpayers are best advised to include in their documentation both qualitative information on the CTPs group structure and business activities, detailed descriptions of the transactions between the CTP. And with

⁷³ Management Accounting Mastery 'Guiding You Personally to CIMA Exam Success'.

⁷⁴ FIRS Regulation 2012.

reference to the OECD Guidelines and the UN Manual in the Regulations suggest that FIRS will respect documentation prepared in accordance with that guidance.

Some additional documents such as training manuals, internal correspondence and memoranda, and travel logs of senior personnel to combat the disallowance by FIRS of otherwise appropriate inbound charges, may be especially necessary in the absence of a tax treaty.⁷⁵

3.5.6 Advance pricing agreements

It is an agreement between a taxpayer and a tax authority of the State in which the former is resident which determines, in advance, an appropriate set of criteria for the purpose of determining the taxpayer's transfer prices for a fixed period of time (the maximum period under the Regulations is 3 years).

It could also be unilateral, that is, involving a taxpayer and one tax authority, usually the tax authority of the State in which the taxpayer is resident; bilateral, that is, involving a taxpayer and two tax authorities and multilateral involving more than two tax authorities.⁷⁶ Strictly speaking, it is not a dispute resolution mechanism; it is more of a dispute preventive measure as parties can agree beforehand on appropriate set of criteria which gives some certainty to tax liability. This is the level of certainty that has always been the expectation of FDI players to plan and make enough provisions in their budgets for the accounting period in both medium and long runs.

It is arguable that advance pricing agreements are contractual in nature therefore; the question may arise as to whether common law contractual rules would apply. Interestingly, this question came up before the US Courts in the case of *Eaton Corporation v Commissioner*.⁷⁷ In that case, the Inland Revenue Services (IRS) cancelled two advance pricing agreements with Eaton by reason of which additional income was assessed in excess of USD 400 million. IRS claimed that the cancellation was because Eaton breached a fundamental term of the advance pricing agreements

⁷⁵ Taiwo Oyedele, Anthony Curtis, Elizabeth Sweigart and Robert Smallwood on The Impact of Nigeria's New Transfer Pricing Rules on Multinational Enterprises

⁷⁷ *Eaton Corporation v Commissioner*

while Eaton argued that the common law rules of contract would apply, therefore, since IRS alleged a breach of a fundamental term of the advance pricing agreements, the burden of proving same rested on IRS. In response, the IRS argued that the cancellations were administrative determinations which it has the discretion to make and which could only be overturned if it abused its discretion. In other words, Eaton bore the burden of proving that IRS abused its discretion.

The court agreed with the IRS. Although Nigerian courts are not bound by the decisions of US courts, the decision may provide some guidance as the conditions for cancellation of an Advance pricing agreements under both United States of America's law and the Regulations are similar. Currently, the IRS is not entertaining any requests for advance pricing agreements. However, when it does, will be able to cancel an advance pricing agreements for an alleged breach of a fundamental term without proving actual breach given that under Nigerian law, 'he who asserts must prove'. Until FIRS engages taxpayers on advance pricing agreements, we will have to keep our fingers crossed.

3.5.7 Corresponding adjustments

As it has been previously stated, the reason for signing bilateral tax treaties on double taxation is to shield most foreign investments from the 'tragedy' of double taxation. Taxation as we know is not a friend to the investors because of its encroachment on the profits and returns on investment. The regulation has given preference to corresponding adjustment of the tax liability if the entities were within the double taxation jurisdictions and even goes ahead to determine the arm's length compliant status. This is the reason why the Regulation shows, *inter alia*, that the an adjustment is made to the taxation of a transaction or transactions of a connected taxable person by a competent authority of another country with which Nigeria has a Double Taxation Treaty.⁷⁸

3.5.8 Comparability of transactions

For the purpose of determining a reasonable transfer pricing with strict observance of the arm's length principle, it is within the contemplation of the Regulation to compare the transactions of

both the holding company, subsidiaries and associates to ascertain level of similarity of transaction under a given comparable conditions. Some of these transactions include sale or leasing of tangible goods, loans and financing, licensing and sale of intellectual property, and services, as all these are covered by the World Trade Organisation's agreements.⁷⁹ These conditions are regarded as the economic factors that are objectively considered as they include the items of transaction in question, nature of assets employed, that is, fixed assets and variable assets and the risk involved for there cannot be any investment without some risk undertaken⁸⁰, terms of the contract, business environment and business strategies deployed by the business entities. Usually, there might be manifest differences in the comparable transactions but it is to the credit of the Regulation that such differentials are managed given the discretionary powers conferred on the Federal Inland Revenue Services Act, 2007.⁸¹

3.5.9 Connected taxable person

Technically, the intendment of the Transfer Pricing Regulation is to enlarge, stretch, and expand the tax net to cover all legal personalities both natural and artificial who are involved in one form of FDI and domestic enterprises for the purposes of taxation even as provided by the various international tax treaties and tax laws in Nigeria such as the Companies Income Tax Act, Petroleum Profit Tax Act, Personal Income Tax Act, Organisation for Economic Corporation and Development Model Tax Convention, Organization for Economic Corporation and Development Guidelines respectively.⁸²

3.5.10 Application of UN and OECD Documents

This is a reflection of the fact that disclosure of the source of every piece of legislation facilitates the development of the legal system for ease of application and reference. Nigeria is a signatory to

⁷⁹ Taiwo Oyedele, Anthony Curtis, Elizabeth Sweigart and Robert Smallwood on The Impact of Nigeria's New Transfer Pricing Rules on Multinational Enterprises.

⁸⁰ Salini Case on Investment.

⁸¹ Section 9 FIRS Regulation, 2012.

⁸² Igbo, Andy and Others on "Nigerian Taxation Principle and Practice".

the United Nations Model Tax Convention and equally adopted the Organization for Economic Corporation and Development Model Tax Convention and Guidelines.

3.6 Conclusion

Above in this chapter, the meaning, nature and context of transfer pricing globally and in the Nigerian context are investigated. In addition, the international treaties, and the domestic laws and regulations that govern transfer pricing are also analyzed. From the discussion, it is obvious that the TP Regulations in Nigeria contains the key provisions of the OECD Guidelines and complies with most of its requirements. The implication of this is that Nigeria has a robust TP regulatory framework comparable with other African counties.

CHAPTER 4

CRITIQUE OF THE TRANSFER PRICING REGULATION

4.1 Introduction

In the previous chapter, the meaning, nature and context of transfer pricing globally and in the Nigerian context were investigated. In addition, the international treaties, and the domestic laws and regulations that govern transfer pricing are also analyzed. From the discussion, it was obvious that the TP Regulations in Nigeria contains the key provisions of the OECD Guidelines and complies with most of its requirements. The implication of this is that Nigeria has a robust TP regulatory framework comparable with other African counties.

Here in this chapter, the research agenda is to critique certain aspects of the provisions of the Nigerian Transfer Pricing Regulation.

4.2 Critique of the regulatory framework

Though the regulatory framework could be said to be very robust, some of the provisions of the extant laws and regulations are either conflicting or deficient in some respects.

These are explored below.

4.2.1 Purpose (Section 1)

The intendment of this Regulation was to give impetus to the provisions other statutes including the Company Income Tax Act (Law of Federation of Nigeria 2017). There is a risk inherent in the tax statute to the fact that it confers much discretionary power to the Board of the Tax Authority to exercise opinion on almost every transfer pricing issues. For elucidation, Section 13(2b) on Company Income Tax Act (Law of Federation of Nigeria 2017) requirement on Full Disclosure states that “ 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.”⁸⁴ Besides, Section 22 Company Income Tax Act (Law of Federation of Nigeria 2017 requirement on Artificial Transactions and others states that “**Where the Board is of opinion** that any disposition is not in fact given effect to or that 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.”

4.2.2 Documentation (Section 6)

The essence of documentation requirement has a lot of burden on the foreign investment in an environment where statistical data and information management is not prioritised. The lack of statistics cut across almost all governmental institutions including the regulatory apparatus of the tax management in Nigeria. For instance, the Bureau of statistics which is a governmental agency for statistical collation and dissemination has been so inefficient and devoid of the privilege of giving accurate and effective statistics. Another issue on documentation is the fact that Accounting books and records must be in place that records business transactions for transfer pricing purposes but the nature and type of the accounting standards to be adopted is another issue for the sake of harmonization of accounting standard and practice. This is borne out of the fact that the International Financial Reporting Standard and total unification of cash concept to accrual treatment in being adopted. Besides, lack of internet and low broad band penetration has placed a burden on the foreign direct investment located in the rural area of Nigeria thereby making it impossible for them to upload the information and data required by tax authority for transfer pricing purposes. And to aggravate the documentation issue is the fact that most of the tax returns and declaration forms are too complex in content and context.

4.3.3 Advance Pricing Agreement (Section 7)

⁸⁴ Section 13(2b) CITA, LFN 2017.

The rationale for the provision is more of a dispute preventive measure as parties can agree beforehand on appropriate set of criteria which gives some certainty of tax liability. However, some of the criteria adopted and are quite unrealistic and had made the practically not exploited. For instance the abridged period of three (3 Years) is unrealistic as it could not afford the foreign investors enough certainty for planning. Besides, the threshold of sales volume of N250, 000,000 (Two Hundred and Fifty Million Naira Only) was adopted when the exchange rate was N170 to \$1 and retaining the sane figure at the present exchange of N400 to \$1 is grossly inadequate and very unrealistic.

Besides, it was provided that the Advance Pricing Agreement could be cancelled in the event of a breach of a fundamental term of the contract. However, the issue is that of burden of proof. In the Nigerian Law the burden of proof the rest with the prosecutor the state and its agencies however in other climes like the United States of America the burden of proof is always shifted to the Tax payer petitioner. For instance, the case of Eaton Corporation v Commissioner (Internal Revenue Service) is a locus classicus. In that case, the IRS cancelled two APAs with Eaton by reason of which additional income was assessed in excess of USD 400 million. IRS claimed that the cancellation was because Eaton breached a fundamental term of the APA while Eaton argued that the common law rules of contract would apply, therefore, since IRS alleged a breach of a fundamental term of the APA, the burden of proving same rested on IRS. In response, the IRS argued that the cancellations were administrative determinations which it has the discretion to make and which could only be overturned if it abused its discretion. In other words, Eaton bore the burden of proving that IRS abused its discretion. The court agreed with the IRS.⁸⁵ Currently, the FIRS is not entertaining any requests for APAs. However when it does, will it be able to cancel an APA for an alleged breach of a fundamental term without proving actual breach given that under Nigerian law⁸⁶ Although Nigerian courts are not bound by the decisions of US courts the decision may provide some guidance as the conditions for cancellation of an APA under both US law⁵ and the Regulations are similar.⁸⁷

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⁸⁶ Folajimi Olamide Akinla on resolution under the Nigerian transfer pricing regime.

⁸⁷ Folajimi Olamide Akinla on resolution under the Nigerian transfer pricing regime.

4.3.4 Supremacy (Section 12)

In a situation where a given legislative instrument has manifest contradictions in its provision, the risk of uncertainty could be a herculean task for the foreign direct investors. For instance, whereas the Section 11 on the applicability of international treaties and guidelines of the United Nations and Organisation for Economic Corporation and Development Model Tax Laws are being claimed to one of the sources of the Nigerian Transfer Pricing Regulation, the same Regulation is claiming supremacy over an adopted international best practices as provide in respective International Model Tax Law. For instance, The German Federal Tax Court rejected the position of the local tax office (and the German Federal Ministry of Finance), and noted that Article 6 Section 1 of the 1959 Double Tax Convention between the Netherlands and Germany concerning associated enterprises corresponds largely to Article 9 of the OECD Model Tax Agreement. As such both the OECD and the Double Tax treaty take precedence over German domestic tax law. Because the transaction in question satisfied the arm's length principles, the local laws could not trump the OECD principles.⁸⁸

4.3.5 Dispute Resolution (Section 14)

It must be appreciated that the interest of an investor is the desire to get justice as seemed to be done through access to seamless dispute resolution mechanism. This is the reason why an international Arbitration arrangement is usually preferred by the foreign investors. The inability of the Nigerian Transfer Pricing Regulation includes arbitration mechanism as a real albatross on it. For instance the section on dispute resolution provides the transfer pricing matters could only be resolved through panel arrangement and the court adversarial platform. The crux of the matter is that it is time consuming, costly, and lacks investors' confidence. The provision states inter alia that "(1) The Service shall set up a Decision Review Panel (—the Panell) for the purpose of resolving any dispute or controversy arising from the application of the provisions of these Regulations. (2) The Panel, referred to in sub-regulation (1) of this regulation, shall comprise of – (a) the Head of the Transfer Pricing Department of the Service; and (b) two other employees of

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the Service who shall be at least of the rank of Deputy Director. (3) A taxable person may, within thirty days of the receipt of the assessment on the adjustment refer the assessment to the Panel.

(4) The Panel shall in rendering a decision on a matter presented before it take into consideration – (i) the adjustment or assessment issued; (ii) the basis on which the adjustment or assessment was issued; (iii) the taxable person’s objection; and (iv) the evidence presented to it by the parties. (5) The Panel shall issue a formal adjustment or assessment – (a) based on the decision rendered by it on a matter presented by the parties; or (b) where taxable person fails to communicate its decision to refer the assessment or adjustment to the Panel within thirty days of the receipt by the taxable person of the assessment or adjustment. (6) The decision of the Panel on any adjustment or assessment before it shall be final and conclusive without limiting the right of a taxpayer to refer the matter, where dissatisfied with the decision of the Panel to a court of competent jurisdiction.”⁸⁹

There is no provision in the Nigerian Domestic Tax Law and Treaty Policy of the government for arbitration. Besides, in there is no obligation for the Tax Authorities to make public the outcomes of dispute resolutions such as penalties and remedies both administrative and judicial and as such everything is shrewd in secrecy. Even during implementation of some of the decisions reached such as additional tax burden and refunds of tax, it is not in the public purview and as the issue of transparency is in question.

4.3.6 Safe Harbour (Section 15)

The principle of Safe Harbour was to give some exemptions to some of the arm’s length requirement of as provided in the OECD Guidelines on Transfer Pricing as it globally practices. However, the by virtue of the FIRS Transfer Pricing Regulation such exemptions must be done in accordance and approval of the Government Regulatory Agencies.

- A connected taxable person may be exempted from the requirements of regulation 6 of these Regulations where – (a) the controlled transactions are priced in accordance with the requirement of Nigerian statutory provisions; or (b) the prices of connected transactions have been approved by other Government regulatory agencies or authorities established under Nigerian law and satisfactory to the Service to be at arm’s length.⁹⁰

⁸⁹ Section 14 FIRS Transfer Pricing Regulations, 2012.

⁹⁰ Section 15 FIRS Transfer Pricing Regulation, 2012 .

The risk in this arrangement is that most of the Government Agencies are more of public servants that lack the requisite capacity and knowledge to exercise sound judgment in this technical area of taxation. This could reverberate a lot of uncertainty and impose a rather heavy administrative burden on the taxpayers and tax administrations that can exacerbate both legislative and compliance complexities both in the short and long runs.

It is important to note that the Nigerian Transfer Pricing Regulations did not specify the categories of tax payers or the types of transactions to be covered by the Safe Harbour provisions. This is contrary to the OECD Transfer Pricing Guidelines which states that “ A Safe Harbour may have two variances regarding the taxpayer ‘s conditions of controlled transactions: certain transactions are excluded from the scope of application of transfer pricing provisions or the rules applying to them are simplified.”⁹¹

4.3.7 Documentation retention (Section 18)

This section provides that all documents relation to the entire Transfer Pricing transactions could be retrained by the Tax Authority for a maximum period of six (6) years. The position of the Regulation on this is that it is oblivion of the fact that information technology has come to stay thereby making it possible for data to be held in perpetuity. Besides, the Nigerian Evidence Law has been reformed to the extent that by virtue of Section 84 of the Evidence Act 2014, the Computer Generated evidence admissibility in the court has come to stay.

4.4 Conclusion

In this chapter, the certain aspects of the provisions of the Nigerian Transfer Pricing Regulation are critiqued. The findings are that though the regulatory framework could be said to be very robust, some of the provisions of the extant laws and regulations are either conflicting or deficient in some respects. For an instance, in the aspect of dispute resolution, there are no provisions in the Nigerian domestic tax law and treaty policy of the government for arbitration. Besides, there is no obligation for the tax authorities to make public the outcomes of dispute resolutions such as penalties and remedies, both administrative and judicial and as such, everything is shredded in

⁹¹ Victor Adegbite on “Nigerian Transfer Pricing Regulations”.

secrecy. Even during implementation of some of the decisions reached such as additional tax burden and refunds of tax; it is not in the public purview and as the issue of transparency is in question.

Having done a critique of the extant regulatory framework, the next chapter interrogates the problems of implementation of these laws and regulations.

CHAPTER 5

CHALLENGES CONFRONTING THE TRANSFER PRICING IMPLEMENTATION

5.1 Introduction

In the previous chapter, certain aspects of the provisions of the Nigerian Transfer Pricing Regulation were critiqued and it was found that though the regulatory framework could be said to be very robust, some of the provisions of the extant laws and regulations are either conflicting or deficient in some respects. For an instance, in the aspect of dispute resolution, there are no provisions in the Nigerian domestic tax law and in the extant treaties for arbitration. Besides, there is no obligation for the tax authorities to make public the outcomes of dispute resolutions such as penalties and remedies, both administrative and judicial and as such, everything is shredded in secrecy. Even during implementation of some of the decisions reached such as additional tax burden and refunds of tax, it is not in the public purview and therefore, there is the issue of lack transparency.

In this chapter, the problems of implementation of these laws and regulations will be explored. Although the Transfer Pricing Regulation of Nigeria has only been in force for five years, it has faced a lot of challenges in its implementation. The stakeholders which are the businesses, investors, tax regulators (Federal Inland Revenue Services) and the government of the Federal Republic of the (the State),⁹² all have their respective peculiarities that pose both remote and proximate challenges in the implementation of transfer pricing regulation.

These challenges will now be examined.

5.2 Investors challenges

5.2.1 Rising overheads

⁹² FIRS Bulletin, 2014.

Generally, the apathy of business entities to the arm's length principle is predicated on the fact that they want to maximize profits to pay dividends to their shareholders and make enough sustainable returns to their investors both in the short and long runs. In order to achieve the profit motive, firms and business entities are expected to operate at production and business cost of input that could be low because when average cost of production is low there is always the tendency that the profit will be on the high side. However, financial records and statements show that the cost of doing business in Nigeria has been astronomically high, thereby pushing the cost of production high as well. For example, fixed cost of production such as land acquisition is high as a result of the rigid process in the public sector approvals and authorization and the ingenious Land Use Act, 1998⁹³ that vest all land on the government and requires the consent of the State Governors who are political personnel.

The bureaucratic bottleneck and corruption tendencies are a curse to land acquisition process which is why land is usually a capitalized asset. Secondly, capital assets i.e. the machineries and equipment imported for production processes are procured at exorbitant exchange rates and high import tariffs and do not qualify for capital gains tax. Thirdly, low level of infrastructural development; electricity, portable water, transportation networks and others have transferred the burden to investors and the resultant effect is an increase in the cost of production and concomitant reduction in profit.⁹⁴

5.2.2 Volatility of business environment

Put simply, the business environment consists of factors that affect the business operations of a business entity. There can be internal and external factors that affect the business; the latter consisting of legal, religion, economic, political, indigenous people and communities and so on. It must be noted that Nigeria is a heterogeneous, complex and volatile environment. The management of this volatility remains a challenge to the country and the investment climate. Obviously, foreign investment thrives where the internal business environment is conducive and convivial with little or no political turmoil. Volatility in the internal business environment threatens an investor as to the direction of the policy thrust any of the regimes.

⁹³ Land Use Act 1978.

⁹⁴ Manufacturers Association of Nigeria, 2016.

There could be policy inconsistency and business stifling laws and rules that would make the entire business planning and decision making process of the going concern a very uncertain endeavor. Secondly, the hostility and aggressive conduct of the host communities could arise when there is so much demand for corporate responsibility on the investors is subjectively unbearable, thus, creating a very frosty relationship between the business entities and the host communities. This could ostensibly hinder the operational smoothness of the investors because most of their resources are wasted through series and elongated community negotiations and engagements. Thirdly, the legal environment in Nigeria is the sort that has sharia, customary and common law components; sometimes and depending on the location of the foreign direct investment, the impact of the these complex legal jurisdiction could be very over bearing. For instance, while the investors in the Northern Nigeria are being dominated by the Muslim must be acclimatized with the Penal Code while the ones in the Southern Nigeria must be mindful of the Criminal Code. It must be noted that internal business environment could be controlled and managed through a well-articulated and purposeful leadership and commitment of the peoples and citizens.

On the other hand, the external business environment are quite outside the control of the Federal Republic of Nigeria because they are situations triggered by world events such as globalization impact, climatic and environmental phenomena, global financial meltdown, slump in oil price and so on. Under these conditions, the business entities could not possibly control them because they are more exogenic in nature.

5.2.3 Dearth of data bank

Looking at the possible challenges of the transfer pricing issue, the arm's length principle may appear simple but applying it could be a herculean task. For instance, there might be some difficulties in finding information on similar transactions between related entities in an environment where local data are not available. And even where the information on the related business is available, there is no guarantee that the conditions and circumstances of the transactions will be sufficiently similar. Besides, the existence of a global transfer policy may not necessarily eliminate the requirement for additional works as there may be some Nigerian specific issues that have to be addressed and which create a need to localize the global policy. Now the issue of data

management requires huge investment in Internet and Computer Technology (ICT) in the area of computer acquisition, maintenance and replacement, training and manpower development and so on.⁹⁵ Besides, is the issue of low internet penetration and local telephony that has made data gathering from investments in localities almost a near impossibility. And since proper transfer pricing monitoring is predicated on availability of information, lack of reliable data base becomes a dis-incentive to the compliance to the arm's length principle.

5.3 Multiple taxation

“Multiple” refers to anything that is more than one or once while 'taxation' refers to imposition, assessment and collection of compulsory levy, fees, rates, fines, charges or taxes by any sovereign authority. 'Threat' refers to a declaration of an intention to inflict injury or pains.

The precise origin of multiplicity of taxes in Nigeria may not be easily traceable but it became widespread from the late 80s when revenue accruable and disburseable from the federal authority by each tier of government dipped. The situation led some state governments and many local governments in the country to seek for alternative sources of revenue internally. Paradoxically, the operatives in charge of these alternative sources of funding, rather than remitting collected taxes to government coffers found it more convenient to embezzle such funds, either under-declaring the amount collected or manipulating the system to their personal advantage. The abuses were further compounded with the emergence of "Tax Contractors" who then became fashionable while the manufacturers became the easy victims of the heretical methods adopted by such contractors in extorting money. Such methods include mounting of road blocks, sale of stickers, use of motor park touts for extortion, use of Joint Revenue Association (JORA) and Joint Accelerators Association (JAAS) especially at local government levels for illegal taxes and levies collection and arbitrary assessment and collection of extra constitutional taxes and levies.

The myriad of taxes and levies imposed on companies in various states across the country continues to be a major bane of the spirited efforts aimed at transforming the manufacturing sector.

⁹⁵ Lagos Chambers of Commerce and Industry.

As at today and abuse all logical norms, the states and local governments, different taxes and levies sprung up though backed by Edicts. Researches indicate that as many as over 500 different taxes and levies are being imposed by the various tiers of government as against 39 approved by Taxes and Levies (Approved List for Collection) Act.

Multiple taxation is as a result of perceived unfair revenue formula, lack of political will-power on the part of the executive arm of the relevant governments to finance and properly equipped their revenue agencies, perhaps for greed purpose and political reasons; technically inefficient manpower at the revenue agencies and greed on the part of some tax officials.

5.4 Regulatory authority challenges

The Federal Inland Revenue Services (FIRS) as a regulatory authority is facing some challenges in the area of implementation of the Transfer Pricing Regulation, thereby resulting to ineffective and effective taxation administration in Nigeria.

5.4.1 Lack of administrative facilities

Firstly, there are constraints to the availability of tools for the tax authorities in Nigeria to work. For instance, the available tax offices are not enough to cover the entire nation because of the geographical territory and demography. The tax offices are not located in the rural area and hinterlands for ease of accessibility to the rurally located similar and related enterprises. And since they are located only in the city centers then the prevailing dis-connect between the tax authority i.e. the regulator and the related businesses creates a real challenge to the implementation of the transfer pricing in Nigeria. It was even observed that even where the tax offices are available the requisite administrative structures are insufficient in term of befitting building structures, state-of-the-art office furniture and equipment and compliance to decent work environment and so on.

5.4.2 Lack of professionalism

Secondly, the implementation of the Transfer Pricing Regulation in Nigeria is most often hampered as a result of lack of professional to drive the tax administration. Taxation is a profession of its own in Nigeria as was indicated by the Supreme Court of Nigeria Judgment in the case of

the Institute of Chartered Accountants of Nigeria (ICAN) V. Chartered Institute of Taxation of Nigeria (CITN)⁹⁶. In the case, it was decided that taxation is a separate discipline from and accountancy profession, thus, the accountancy association could not regulate the practice of taxation profession. Though Chartered Institute of Taxation of Nigeria (CITN) was established the 1992 Act but on March 12, 2007, Justice Lateefat Okunnu of the Lagos High Court, gave a ruling granting the independence and autonomy to the CITN to regulate taxation profession in Nigeria. The issue is that most of the staff and management of the Federal Inland Revenue Services (FIRS) are not professional as most of them are political appointees and civil servants who are not really trained in law, accounting and even tax and fiscal matters.

Now the capacity to exercise professional judgment and knowledge in tax computation, tax laws and regulations, methodology of computation and assessment, adjustment and so on is lacking. The rather situation was as a result of wrongful recruitment and selection process that are based on primordial and subjective considerations, corrupt practices, nepotism, political party loyalty and affiliation and others. The enthronement of non-professionals has been a bane in the proper administration of effective and efficient transfer pricing regime in the entire gamut of Nigerian taxation and fiscal milieu.

5.4.3 Lack of capacity building and training

Thirdly, lack of capacity building has been a real challenge to the Federal Inland Revenue Services (FIRS). It must be appreciated that taxation and transfer pricing system is a global practice and the need for study and gain of experience from other tax jurisdictions of the world cannot be over-emphasized in the light of globalization. As can be demonstrated, the various taxation treaties, model tax laws and conventions and guidelines of the Organisation for Economic Cooperation and Development, United Nations, Double Taxation Treaties depicts the global dimension of taxation.

However, the requisite training and re-training of the tax administrators mostly in the area of transfer pricing has not been seamless both for domestic and foreign training because of foreign exchange controls and restrictions, inchoate training scheme and curricular, insufficient local

⁹⁶ CITN V. ICAN 2007.

trainers and tax experts and so on.⁹⁷ The resultant effect has been an enthronement of tax officers who are deficient in tax matters creating un-necessary clog in the whole enforcement process through analysis by paralysis and wrong adjustments giving rise to dispute.

5.5 Government-instigated challenges

In the Transfer Pricing system, the government is usually deemed to be the sole beneficiary of an effective and efficient taxation system because, it is the main source of government revenue with which to render services and deliver her mandate and democracy dividend to the citizenry. Unfortunately, the government has become an accomplice in the under-development of the taxation system and renders the transfer pricing implementation ineffectual through a number of ways.

5.5.1 Political instability

Firstly, political instability orchestrated by political upheavals, lack of democratic governance, and anomalies in the electoral processes do often times create a tendency for apprehension in the corporate and investment community. The frequent change in government has the tenacity to cancellation of taxation arrangement hitherto in place and introduce new one because of the incoming of another political party to power. Such discontinuity breeds uncertainty in the taxation policy and systems and its concomitant effect on the foreign direct investors. It must be noted that no foreign investment could thrive in a risky and uncertain business climate of political insecurity.

5.5.2 Inchoate tax treaties policy

Secondly, the government of Nigeria has been having faulty tax policy treaties. This is manifested in the incomplete adoption of the Organization for Economic Cooperation and Development (OECD) Model Tax Conventions and Guidelines provisions. For instance, the Federal Inland Revenue Services Transfer Pricing Regulation 2012 enjoys supremacy over the provision of the extant International Model Tax Laws.⁹⁸ This position itself is a misnomer because our taxation

⁹⁷ CITN Tax Guide, 2002.

⁹⁸ The National Tax Policy.

system is not as developed as the one of the advanced countries whose major sources of revenue is derived from taxation. Another area of policy default is that of the limited number of Double Taxation Treaties; Nigeria needs to have as many double taxation treaties with a lot of countries both within the continent and other economic blocks of the world spanning from the Americas to Europe, Asia and Far East. It must be noted that insufficient double taxation treaties has brought about loss of enormous tax revenues to the government of Nigeria and a dis-incentive to foreign direct investment model.

5.6 Conclusion

In this chapter, the problems of implementation of these laws and regulations governing transfer pricing have been explored. The conclusion is that although the Transfer Pricing Regulation in Nigeria has only been in force for five years, it has faced a lot of challenges in its implementation. The stakeholders which are the businesses, investors, tax regulators (Federal Inland Revenue Services) and the government of the Federal Republic of the (the State),⁹⁹ all have their respective peculiarities that pose both remote and proximate challenges in the implementation of transfer pricing regulation.

The next chapter discusses the measures to solve the myriad of problems facing regulation of transfer pricing in Nigeria.

⁹⁹ FIRS Bulletin, 2014.

CHAPTER 6

SOLVING THE TRANSFER PRICING PROBLEMS

6.1 Introduction

In chapter 5, the problems of implementation with regard to the laws and regulations governing transfer pricing have been explored. The conclusion was that although the Transfer Pricing Regulation in Nigeria has only been in force for five years, it has faced a lot of challenges in its implementation. The stakeholders which are the businesses, investors, tax regulators (Federal Inland Revenue Services) and the government of the Federal Republic of the (the State),¹⁰⁰ all have their respective peculiarities that pose both remote and proximate challenges in the implementation of transfer pricing regulation.

In this chapter, the research objective is to explore the measures for solving the myriad of problems facing regulation of transfer pricing in Nigeria.

6.2 Measure for solving the transfer pricing problems

From the previous chapters, one could not be left in doubt that the transfer pricing regulation in Nigeria has some challenges that could be addressed through a concerted effort of the tripartite stakeholders that consist of the Government, the Federal Inland Revenue Service and the foreign direct investors respectively.

The Federal Government of Nigeria depends on taxation as her major source of revenue to enable her provides the required infrastructure that would drive both the economy and wealth needs of the citizen. Therefore, the government strives to plug any leakages that might result to non-compliance with the arm's length principle of group related companies and ensure an effective

¹⁰⁰ FIRS Bulletin, 2014.

transfer pricing regime¹⁰¹. The government could do so through so many and some of these ways are examined in the following paragraphs.

6.2.1 Tax treaty expansion and adoption

It is believed that taxation has international dimension in as much as direct foreign investors came to the country to invest in productive ventures. Therefore, it behooves on the government to adopt good tax policies that would be investment friendly such as engaging in tax treaties and adoption of international tax models and guide line and provision of tax incentives. They should engage in double taxation treaties with more countries of the world because as it is today it has limited number of such treaties.¹⁰² The double taxation treaty is to ensure that the tax net is spread across more jurisdictions for effective tax management.

6.2.2 State policy on TP

The federal government of Nigeria shall direct its policy towards ensuring transfer pricing taxation compliance, thus, transfer pricing system shall reflect the international taxation principles and practice. The Government of the Federation shall ensure a periodic review of the transfer pricing regulation and administration in Nigeria. It shall be the duty of Government is to ensure that Federal Inland Revenue Services is granted autonomy and adequate funding to meet operational transaction. The rights of all foreign investors must be recognized and double taxation in all forms must minimize.

6.2.3 Special arrangements

¹⁰¹ The Chartered Institute of Taxation of Nigeria (2004) Examinations February 2004, CITN, Lagos.

¹⁰² OECD (2012) Dealing Effectively with the Challenges of Transfer Pricing, OECD Publishing 2013.

In furtherance of the role of taxation in the creation of wealth and employment, it is recognized that there is room for certain special arrangements within the system for the purpose of attracting and retaining investment within the economy; examples of such special arrangements includes:

i. Tax-free zones

In creating such zones, the paramount consideration must be the expected benefits to the entire economy and not just a particular sector or class of persons. In addition the purpose for which they are set up must clear specific and directed at identifiable sectors, entities or persons.

Where tax free zones are created, they must be administered in line with the enabling legislation and persons, entities and activities carried out in such zones must be in compliance with the law. The executive and legislature should work closely to identify new areas, where such special arrangements are required and pass necessary legislation to create them. The status of such tax free zone sand the benefits accruing there from must be subject to periodic review and a system put in contrast to the tax revenue not being collected. Government must however, retain the right at all times to terminate any such arrangement, or the right of any person, entity or activity to take benefit of such arrangement, should it determine that such arrangement is no longer beneficial to the Nigerian economy.

ii. Tax incentives

In addition to the above, government may provide tax incentives to specific sectors or for such specific activities in order to stimulate or retain investment in the sectors.

Tax incentives should however be carefully considered before they are granted in view of the argument that they may be viewed as violating some principles of good taxation. For example, it is generally perceived that incentives: discriminate in favour of a particular sector; require imposition of a heavier tax burden on other sectors to cover the tax shortfall arising from the grant of incentives to the favoured sector; complicate the tax system due to the additional cost and the time required to monitor the beneficiaries of such incentives in order to avoid possible abuse and

may not be beneficial to the economy especially where the tax forgone exceeds the anticipated benefits from granting the incentives.

Government may streamline the number of tax incentives in order to restrict them to those that will benefit the entire economy. The process of granting and renewing incentives, waivers or concessions must be transparent and sector focused and not arbitrary or only granted to specific companies or individuals only. The government may also seek input from relevant sectors of the Nigerian economy and populace in the determination of the desirability or otherwise of such incentives. The process of granting incentives must comply strictly with legislative provisions for granting such incentives, waivers or concessions. In addition, even if not stated in the law, incentives that will result in a reduction in income distributable to all tiers of government should advisedly require the involvement of the arms of government affected or impacted.

iii. Multiple taxation control

To curb the menace of multiple taxation, the respective States Houses of Assemblies should pass the relevant provisions of Act no. 21 of 1998 into Laws without delay. Such laws must however be in line with the provisions of 1999 Constitution of Nigeria. Such Laws should provide for assessment, collection, objection and appeal procedure. The executive arms of governments must muster the courage to implement the provisions of such laws to the letter. Also, all structures needed for effective tax administration should be put in place. Such include State Joint Revenue Committee, Body of Appeal Commissioners, etc.

State governments should work with law enforcement agencies to sanction all local government councils engaged in illegal tax activities such as mounting road blocks to collect taxes which is outlawed by Taxes and Levies (Approved list for collection) Act.

State-governments-should publish the list of authorized taxes within their States and local governments to educate the public while stakeholders retreat should be organized by the Joint Tax Board (JTB) on multiple taxation to get all related issues on the table and work towards reducing this incidence of multiple taxation.

iv. Waivers and concessions

They are part of special incentives given the investors all over the world whether manufacturing or any other investment form. Some incentive as the Export Expansion Grant and the Economic Communities of West African States (ECOWAS) Trade Liberalization Scheme (ETLS) which is even a regional trade policy and protocol scheme.

The Trade Liberalization Scheme (ETLS) used to be about 40% of the manufacturing cost of the product before it was slashed down to 20%. It was granted to manufacturing exporters as a measure to cushion the high cost of production and thereby make the products competitive in terms of pricing at the international market, especially the West Africa market. The ETLS was a policy agreement by the Economic Communities of West African States (ECOWAS) countries, stipulating that products and firms covered by the scheme would have an easy passage and unrestricted entry into and out of fellow sub-regional countries.

6.3 Transfer pricing compliance

There is the need to test the validity of the pricing adopted by the Multinational. The simplistic example given above would not be sufficient to carry out an audit exercise. It is there crucial to know how to evaluate the arm's length character of prices charged by related parties. OECD/United Nations Guidelines on transfer pricing, and the Income Tax (Transfer Pricing) Regulation No 1 2012 are useful materials for study to gain a better understanding of transfer pricing;

- Ensure that Nigeria is able to tax on appropriate taxable basis economic activities by persons inclusive of associated enterprises' transactions.
- Provide tax authorities tools to fight tax evasion through over and underpricing of controlled transactions between associates.
- Reduce the risk of economic double taxation
- Provide a level playing ground between multinationals and enterprises doing business in Nigeria.

- Provide certainty of transfer pricing treatment on Nigeria.

In applying the regulations, Permanent Establishments (PEs) are treated as separate entities, and any transaction between a Permanent Establishment ("PE") and its head office or other connected taxable persons shall be considered a controlled transaction. The need for economic efficiency and fairness, coupled with the pressure of international consensus - all point to the direction of seeking to tax the real profits derived by a multinational from economic activity derived in the state. Where a connected person has entered into transaction or series of transactions, the person should ensure that the taxable profits resulting thereof is consistent with the arm's length principle.¹⁰³

Where a connected taxable person fails to comply with the provisions of the regulation, the tax authority shall make adjustments where necessary if it considers that the conditions imposed by connected taxable persons in controlled transactions are not in accordance with the arm's length principle. Comparability is critical before any meaningful comparison can be made to test prices between related parties against prices between third parties.

The federal ministry of finance (or the state Ministry as applicable) and the federal Ministry of Justice (or the state ministry as applicable) should ensure that the applicable orders are issued and gazette in support of any incentives, waivers or concessions granted by the government and those incentives, waiver or concessions are for a specified period and subject to periodic review during the duration of the period.

6.4 Regional integration

With the elimination of all trade barriers amongst ECOWAS countries, business entities will, in the future have access to Nigeria's market without having to set up local entities in Nigeria.

There is a need to advocate that could be deepen through regional integration such as the Economic Community of West African States (ECOWAS) in order to encourage a common policy on tax incentives this will open the sub- region to infrastructural development and job creation. The

¹⁰³ Igho & Others "Nigerian Taxation, Policy/Principles & Practice".

harmonization of tax policies among the member nations of ECOWAS will help the sub – region to achieve a seamless economic integration, which will facilitate trade and infrastructural development.¹⁰⁴ It is believed that member nations can integrate the economies of the region, the quest for foreign investment and fair share of the investment benefits will be the achieved within a short time.

The harmonization in the ECOWAS sub region will help to improve the incentive structure in the region and also help member nations to benefit from reduced distortions imposed by existing tax systems on the private sector, in particular the elimination of tax competition and ensure uniformity of tax rates.¹⁰⁵ It will also help the increment in revenue mobilization, which will help in the correction of an imbalance in an imperfect market.

The development of a model double taxation treaty or multi-lateral treaty for members states for the avoidance of double taxation to complement the ECOWAS Treaty and support the implementation of transfer pricing rules across the sub region cannot be over-emphasised.¹⁰⁶

And the establishment of free- Trade zones and adoption of the common External Tariff Regime, business entities may choose to locate in any country within the ECOWAS sub-region, but will most likely favour the country that has a more conducive investment climate. Foreign Direct Investment (FDI) has many benefits when compared to benefits derived from international trade alone. Greater FDI will generate higher employment, transfer of knowledge and skills (which will further enhance economic growth) as well as various other positive multiplier effects.

Nigeria Transfer Pricing Regulation must strive to be competitive and therefore attractive for However, the larger proportion of this is likely to be linked to the oil and gas sector. Therefore, Nigeria needs to focus on being an attractive place for investment in the non-oil sectors.

For foreign companies investing in natural resource extraction, the location of the resources will be the deciding factor on where to establish a local entity irrespective of the absence of adequate infrastructure. However for foreign companies in the other sectors, the provision of suitable

¹⁰⁴ WAUTI president, Mike Koffi Afflu 3rd Annual International Tax Conference of the West African Union of Tax Institutes (WAUTI) in Accra, Ghana, which was held between February 26 and 27, 2014.

¹⁰⁵ Association of Tax Administrators (CATA), who doubles as the commissioners – General of Ghana revenue Authority, George Blankson.

¹⁰⁶ Mr Taiwo Oyedele, Partner and Head of Tax, PwC Nigeria.

infrastructure would influence an investor choice of Nigeria as a host country for investments compared with other ECOWAS countries. It is expected that government must try and counter this disadvantages and use its Transfer Pricing Regulation to make it more attractive for inward investment.

6.5 Tax holiday abuse policy

The study of the Organization for Economic Cooperation and Development (OECD) has revealed that tax holiday have proved to be ineffective in attracting long-term projects, being primarily attractive to quick –profit investments, while being subject to serious abuses. Tax holidays are deemed to perpetuate tax fraud and to shift profits to the pioneer company to minimize the overall tax of the group in the country. Therefore, the federal government of Nigeria must endeavor to make a comprehensive tax policy to address the various tax abuses such as:

Tax Shelter – it is a tax avoidance scheme whereby a parent company set up a subsidiary in Nigeria to take advantage of the tax holidays which includes the exemption from tax of the profit of the subsidiary and the dividends accruing to the parent company for the period of the tax holidays which may range from three to ten years. Prices are internally determined and structured to ensure that maximum profit accrues since these are exempted from tax. Then subsidiary stops the production of the pioneer product after the period of tax holidays and by which time it might have taken full advantage of the tax foregone by the government.

Tax Sharing - Nigerian Double Taxation Treaty/Agreement usually contains provisions for the tax sharing. It is intended to protect the incentives granted by the industrial production legislation of Nigeria. Normally, the contracting state would allow only tax paid by its resident company in Nigeria provided such tax has been spared in by the incentive legislation of Nigeria. It must be noted that without any provisions in the Agreement, the tax spared by the Nigerian legislation would be neutralized by the contracting state tax. It follows that with the tax sparing scheme the contracting state would regard the tax exempted as tax paid in Nigeria which would qualify as credit against the contracting country.

Profit Sharing – in this arrangement new companies are formed to produce the pioneer product and capital is transferred from the existing operation of the parent company to the pioneer companies. This is done with a view to minimize the tax burden of the holding parent company.

Thus, fictitious and artificial means are usually employed to transfer taxable income from the subsidiary/affiliate companies to the pioneer company and to shift expenses from the pioneer company to the affiliate/subsidiary as the case may be.¹⁰⁷

6.6 Export Processing Zones (EPZs)

In order to sustain the Government's policy directed at encouraging an export oriented industry, and to address some of the major administrative concerns that are associated with the export processing Zones (EPZs), the following recommendations are made:

Companies operating in these zones should continue to be exempt from income taxes provided that 100% of the goods produced in the zones is for exports. However, exports from these zones into Nigeria shall attract appropriate duty on the imported raw materials. The necessary legislative amendments to the relevant laws should reflect this position.

6.7 Straightening of the Federal Inland Revenue Service

6.7.1 Automation of processes

It shall be the duty of tax authorities to work towards the automation of all processes involved in transfer pricing to avoid uneven compliance with certain aspects of arm's length principles to the detriment of others.

Tax authorities shall therefore ensure uniform deployment of technology in the aid of all aspects of transfer pricing. It shall be the responsibilities of Government to provide the required funding and platform for the automation of transfer pricing processes, as this would aid effective and efficient transfer pricing in Nigeria. Automated processes would minimize or eliminate leakages in the system, which may be due to error or misconduct on the part of regulatory official or taxpayers, safe guard the integrity of the system and lead to great professionalism on the part of tax officials and greater confidence on the part of taxpayers. In addition automated systems would

¹⁰⁷ Nigerian Tax Guide and Statute.

lead to greater specialization and reduce the cost and time required in the transfer pricing administration process thereby leading to higher compliance by multi-national companies due to the ease with which processes starting from registration of the companies, filing of returns, audit and investigations. Compliance to transfer pricing and including correspondence where there are gaps in current regulation or where the laws do not support the use of such systems, necessary amendments shall be made to ensure that the use of the systems are in line with the law, Where electronic systems are already in use, they shall be standardized to ensure that there can be seamless interaction between all regulatory administrative processes.

Federal Inland Revenue Authority officials shall be trained in the use and maintenance of automated system and the general public and foreign investors encourage embracing the use of these systems so that Nigeria can have a transfer pricing system that is in line with global practices.

6.7.2 Staffing and capacity building

Tax authority would require adequate and proper staffing in order to effectively carry out their mandate. In this regard, the revenue authorities must have the proper quantity and quality of personnel. Proper recruitment and selection processes with emphasis on both skills and ethics, are critical skills and manpower gaps should be identified at all levels of revenue authorities and promptly addressed. Tax authorities shall also endeavor to attract and retain experienced and well trained personnel with the right code of conduct, within the tax system.

In addition to proper staffing, there is need for continuous capacity building by tax authorities at all level of Government. This can be achieved by:

- the establishment and funding of tax academies of training of tax authorities and continuous capacity building
- adequate exposure of tax authorities to international training (including attachment and monitoring) programmes on all aspects of taxation, revenue administration and practice is closely linked to the autonomy and funding of tax authorities and
- provision of a framework to fully acquaint tax official with global best practices in tax and revenue generation and administration.

There is a need to recruit Transfer Pricing **Professionals**. The Transfer Pricing department of the Federal Inland Revenue Services should be staffed with well-qualified, experienced and motivated Transfer Pricing personnel who must be well paid with good condition of service. The tax personnel must be well trained in order to acquire Transfer Pricing skills and techniques. The Federal Inland Revenue Services can obtain technical assistance from tax authorities in other countries that are more experienced in Transfer Pricing are willing to offer such tax authorities for a certain number of years or month for on- the job training on Transfer Pricing¹⁰⁸. On other hand, Transfer Pricing expert could be seconded from more experienced tax authorities to the Federal Inland Revenue Services to train some staff of the Federal Inland Revenue Services and to provide on-the-ground additional support. The Federal Inland Revenue Services needs to develop detailed Transfer Pricing manual and guide that will serve as a reference material for the training of staff of the Transfer Pricing department.

6.7.3 Professional bodies

Nigeria Law provides a statutory role for professional bodies in the tax system. In the regard, the Chartered Institute of Taxation Act provides powers to the Chartered Institute of Taxation (CITN) to amongst other things determine standards of knowledge and skill to be attained by tax practitioners, the establishment and maintenance of a register of its members and regulation and control of tax practice. It is therefore expected that the CITN shall exercise its powers to enhance tax practice in Nigeria and for the overall benefit of the tax system.

Tax consultants and practitioners are also key stakeholders in the tax system, who are expected to use their skill and expertise to simplify the tax compliance process, properly advice foreign investors on compliance requirements and also provide necessary insight and assistance to tax authorities. It is expected that tax practitioners and consultants shall discharge their duties with integrity and patriotism at all times and shall not be party to willful or negligent non-compliance with transfer pricing regulation. They are also expected to partner with tax authorities and other stakeholders to enhance the effectiveness and efficiency of the transfer pricing system and ensure that they open and maintain effective communication lines with tax authorities at all times.

¹⁰⁸ FIRS (2012) The Income Tax (Transfer Pricing) Regulations No. 1, 2012, FIRS, Abuja.

6.7.4 Consultants

Consultants are recognised as useful allies in the development and administration of the transfer pricing mechanism. Their duties may include advising government, tax authorities, taxpayers and other third parties on the practice and administration of transfer pricing in Nigeria, They are also important in the dispute resolution process as they may be engaged by the corporate entities to interface with the tax authorities on their behalf. It is however important to note that the use of such consultants should be to enhance the system and not to act as a parallel authority in their own right.

Accordingly, such consultants may be engaged in various capacities by the tax authorities, including training of tax/revenue officials, capacity building, data gathering, strengthening tax processes and other ancillary functions. Consultants shall however not be involved in the assessment and collection of assessment or other functions, which only public servant engaged in tax administration, are empowered to carry out, challenges in the system should be addressed and fixed head on and shortcuts to revenue generation should be avoided. Thus, the way the regulatory authority is developed as a critical institution of government is important to ensuring certainty in the system.

There should be bilateral/multilateral cooperation between FIRS and tax authorities in other jurisdictions. Nigeria should enter into double taxation agreements with effective exchange of information provisions that will enable the FIRS to secure necessary information from the counterparties of local companies involved in related party transactions. Automation of Transfer Pricing processes. Developing and applying software to process TP related information that will be useful for exchange of information¹⁰⁹. The FIRS should make concerted efforts to develop database containing information on comparable on a local or pan-regional level.

¹⁰⁹ International Tax Compact (2011) Benefits of a computerized integrated system for taxation.

The FIRS may seek for support or assistance from more developed countries as well as international organizations such as World Bank, International Finance Corporation, International Monetary Fund, etc.¹¹⁰

Given the fact that the FIRS operates with limited resources at its disposal, it is impracticable to subject all the multinational companies operating in the country to a through transfer pricing audit every year. By properly conducting a transfer pricing risk assessment, the FIRS to identify multinationals and transactions should be subject to a through TP audit.¹¹¹ Once implemented, the FIRS should carry out a performance assessment of the effectiveness of the TP Regulations and, if necessary, make amendments to the Regulations. There may need to introduce additional documentation and disclosure requirements for multinational companies.

Investors' education is a critical in realizing and improving compliance such that proper education will obviously dissuades them from defaulting the arm's length principles. Thus, once they understand the concept, compliance becomes a secondary task. Consequently various medium provided opportunity for this but cost effectiveness as well as the investment environment should be the principal consideration. The forms of enlightenment programmes needed include: workshops, Seminars, Tax Luncheon/Dinner, Held desk at all the Tax officers, Radio and Television Discussion/programs, Private Practitioners encouragement, etc. Equally the following Publication Materials such as Flyers, Handout and Billboards in strategic position – all could be employed to sensitize the multinational companies on the Transfer Pricing Regulations and others.

6.8 Enforcement

6.8.1 Tax laws

Every tax imposed in Nigeria must be backed by legislation otherwise it becomes illegal to take steps to enforce collection of such tax. Tax imposed and collected in Nigeria is governed by Companies Income Tax Act which regulates the taxation of corporate bodies engaged in business

¹¹⁰ World Bank (2011) Transfer pricing technical assistance global tax simplification program, presentation given by Rajul Awashi in Brussels, 24 February.

¹¹¹ Gbonjubola, M O (2013) Transfer Pricing and Thin Capitalization.

other than petroleum operations. Petroleum Profits Tax Act which regulates the taxation of companies engaged in petroleum operations. Value Added Tax Act which regulates the taxation of supplies of goods and services. Education Tax Act imposes tax on the assessable profits of Nigerian Companies. Capital Gains Tax Act regulates the taxation of capital gains from disposal of capital assets. Stamp Duties Act which imposes duty on legal documents/instruments and others.¹¹² All the tax legislations specify the powers and duties of a tax authority which comprise such as Power to assess tax – raise assessment, Power to collect and account for tax. Power to receive representation from the tax payers and their agents and through this interaction a relationship is created between the tax authority and the tax payer.

Since the goal of every tax administration, is the collected taxes imposed under the various laws in force. Large delinquency in tax payment is a sure sign of ineffective tax administration. Therefore, it is essential to take steps to encourage voluntary compliance with the Tax Laws in matters of payment of tax. All the provision of the Law guiding the filing of returns, the issue of assessments, the payment of tax, and accounting for the tax collected, have to be enforced. The taxpayer has to be educated on the tax laws and government expenditure policy. Facts on the government education, health, road, and industrial projects might be valuable information the tax payer needs. Successful performances of this task might induce taxpayers pay their taxes. Collection and use of information in respect of tax payers is emphasized. If tax payers know that tax authority has information as to their income, the possibility of evasion of tax would be removed. Tax administrators are expected to make the best use of all information available on tax payers and induce them to obtain their correct incomes.¹¹³

6.8.2 Dispute resolution

Resolution of controversies resulting from tax liability under objection by the tax payer should be worked out in a firm and fair system to instill in the taxpayer confidence in the tax administration. This confidence will increase taxpayer's voluntary compliance and thus ensure a basic step forward in successful administration. Where the controversies are referred for judicial review, the

¹¹² CITA (LFN, 2004).

¹¹³ As above.

uniformity of judicial decisions and the speed in reaching these decisions are essential to effective tax administration. Controversies can however be reduced through administrative interpretation of the tax laws to tax payers. View on doubtful points of statutory interpretation should be made clear to the tax payers. The alternative dispute resolution must be encouraged in other stir investors' confidence.

It must be emphasized that whereas the Advanced Pricing Agreement (APA) tries to solve transfer pricing cases before they arise, arbitration tries to solve the problem when they have grown too complex for the tax authorities. Equally, Mutual Agreement Procedure (MAP) as provided in Article 24 of the Nigerian Double Treaty Agreement (DTA) and Article 25 of the Organization for Economic Cooperation and Development (OECD) Model gives the foreign direct investors an added advantage to seek redress. It provides that "where a resident of a contracting state considers that the action of one or both contracting state results or will result for him in taxation not in accordance with this Agreement, he may irrespective of the remedies provided by the domestic law of those State, present his cases to the competent authority of the Contracting State of which he is a residence".¹¹⁴ Also it states that "the competent authority shall endeavor, if the objection appears to it to be justifies and it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State....".¹¹⁵ And from all indications, both the Mutual Agreement Procedure (MAP) and Advanced Pricing Agreement (APA) have not been able to resolve problems the transfer pricing in view of their inherent deficiencies, thus, the need for an Alternative Dispute Resolution mechanism.

Arbitration applies only where treaty partners provide for the institution under a multilateral and bilateral arrangement. Arbitration involves the setting up of an independent body to express an independent opinion on a transfer pricing case. With arbitration, compliance with elimination of double taxation within six (6) months is mandatory. Besides, competent authorities must act in accordance with the opinion of the independent body, if they failed to find an alternative solution within six (6) months.

¹¹⁴ Article 24 Nigerian Double Taxation Agreement.

¹¹⁵ Article 2 OECD Model Tax Convention.

6.8.3 Self-assessment filing

The laws have been restructured to enable tax payers perform their legal duty of paying voluntarily through the introduction of self-assessment filing and tax payment. The role of tax authorities has now shifted from the coercive enforcement of the law to giving the tax payer all the possible assistance for complying with the provision of the Tax Laws. The law expects the tax payers to file their returns themselves without being called upon by the revenue to do so at the right time. The returns are checked for correctness by the Revenue.

The preliminary checking is followed by periodic tax audit. If fraud or tax evasion is discovered, there will be full scale investigation of the tax payers to determine the extent of fraud and evasion. Penalty and interest are imposed on the amount of tax evaded. The law allows the tax payer to appeal if not in agreement with the Revenues additional tax and penalty, first to the Body of Appeal Commissioners and then to the courts up to the Supreme Court.¹¹⁶ It is general belief that loopholes in the law are exploited or manipulated to reduce tax liability – that is tax planning which is otherwise called tax avoidance and it is legitimate. Some companies deliberately delay filing tax returns with the aim of delaying payment of tax that the fund to be used in tax payment can be utilized as part of the working capital of the company. This view is faulted by the provisions of the tax law which imposes penalty and interest at commercial rate on late payment of tax, thus treating the amount of tax as a loan to the tax payer for business. But taxpayers still prefer to delay tax payment as the enforcement of payment by the Revenue Agency through the courts is a long litigation process which drags on for months to the advantage of the tax payer.

6.9 Foreign direct investors' role

6.9.1 Professional obligation

¹¹⁶ Nigerian Law Report, 2014 13 TLRN.

Multi-national companies are the single most important group of stakeholders in the entire transfer pricing system. Overall foreign investors shall see themselves as part and parcel of the Nigerian transfer pricing system and not outsiders and shall therefore carry out their Constitutional and civic roles as their contribution of National development and growth.

They are bedrock of the source of all revenue generated by tax authorities. Therefore, they must ensure the existence of the following:

- Strict compliance with tax laws at all times.
- Voluntary registration with tax authorities and make timely, correct and complete transfer pricing returns and payments as required under the law.
- Co-operation with tax authorities and all other stakeholders in the tax system to ensure effective and efficient transfer pricing administration in Nigeria.
- Act in an informal supervisory role, as they have the right to demand for transparency in assessment.
- Assist tax authorities in the discharge of their functions by providing necessary information and such other assistance as may be required by the tax authorities. There shall be effective linkages and co-operation between foreign investors and other stakeholders in the transfer pricing regime to enhance the overall quality of the Nigerian extant regulation
- To submit disputes with tax authorities to the Judiciary for adjudication when necessary in order to aid the development of Nigerian arm's length jurisprudence.
- To make necessary input to proposed transfer pricing regulations and suggest changes to existing tax legislation. In this regard, there should be frequent interaction between multi-national companies, tax authorities and other stakeholders in the transfer pricing system, in a forum where ideas may be freely exchanged and suggestions made for the improvement of transfer pricing practice and administration in Nigeria.

On the Foreign Direct investors, there is no doubt that fear of possible loss of profit is the driving motive for them to engage in noncompliance with the arm's length principle. However, they should look inwards to address the internal problems of their business entities such as mismanagement of organizational resources, bloated overheads resulting from directors' bills and incentives,

corporate corrupt practices, falsified financial statement and audited accounts of the companies and so on.

Thirdly, the investor business entities should adopt some scientific business models that would keep their investment as going concern, if there challenges facing their business operations. Some of the business model which they could adopt is mergers and acquisitions, public private partnership, business buy out, concession, build operate and transfer and others.

Fourthly, any foreign investors must endeavor to avail themselves of the opportunity of investing in the special economic zones such as the Lekki Free Trade Zone in Lagos, Anambra Free Trade Zone in Anambra State, and other so that they could avail themselves of the incentives and reduce their operating cost and maximize their business profit.¹¹⁷

Lastly, the need for foreign direct investors to comply with the extant tax laws and transfer pricing regulations cannot be over-emphasized because it is very obligatory for them to be seen to be good corporate citizen.

6.10 Conclusion

In this chapter, the measures for solving the myriad of problems facing regulation of transfer pricing in Nigeria are discussed. The conclusion is that the government must strive to plug any leakages that might arise as a result of non-compliance with the arm's length principle of group related companies and ensure an effective transfer pricing regime¹¹⁸. This, the government could

CHAPTER 7

CONCLUSIONS AND RECOMMENDATIONS

¹¹⁷ LFZ Investment Brochures.

¹¹⁸ The Chartered Institute of Taxation of Nigeria (2004) Examinations February 2004, CITN, Lagos.

7.1 Introduction

TP practice in Nigeria is still at the development stage and a lot of work needs to be done to grow the practice. It is very complex and dynamic even as direct investments are growing in the country. It must be emphasized that there are limited decided transfer pricing cases in Nigeria that can be cited as an authority. This is because both the business entities and Federal Inland Revenue Services are always reluctant to take their disputes to court for arbitration as a result of high cost of litigation and the length of time taken to conclude cases in court.¹¹⁹

Besides, it is envisaged that for the transfer pricing regulation in Nigeria to be effective all the stakeholders such as the investors, tax authorities and government must play their roles as required by the economic, business and political dynamics of the country.

7.2 Summary of Findings

In chapter 2, the historical perspectives to taxation was discussed, thereafter, the theories that underpin taxation and FDI were examined. It was found that taxation is an important fiscal instrument employed in every modern economy to promote economic activities and growth while ensuring that there is balance and fair play among the parties.

In chapter 3, the meaning, nature and context of transfer pricing globally and in the Nigerian context were investigated. In addition, the international treaties, and the domestic laws and regulations that govern transfer pricing were also analyzed. From the discussion, it was obvious that the TP Regulations in Nigeria contains the key provisions of the OECD Guidelines and complies with most of its requirements. The implication of this is that Nigeria has a robust TP regulatory framework comparable with other African counties.

¹¹⁹ Shell Producing Company V. Federal Inland Revenue Services

In chapter 4, certain aspects of the provisions of the Nigerian Transfer Pricing Regulation were critiqued and it was found that though the regulatory framework could be said to be very robust, some of the provisions of the extant laws and regulations are either conflicting or deficient in some respects. For an instance, in the aspect of dispute resolution, there are no provisions for arbitration in the Nigerian domestic tax law and in the extant treaties. Besides, there is no obligation for the tax authorities to make public the outcomes of dispute resolutions such as penalties and remedies, both administrative and judicial, and as such, everything is shredded in secrecy. Even during implementation of some of the decisions reached such as additional tax burden and refunds of tax, it is not in the public purview and therefore, there is the issue of lack transparency.

In chapter 5, the problems of implementation with regard to the laws and regulations governing transfer pricing were explored. The conclusion was that although the Transfer Pricing Regulation in Nigeria has only been in force for five years, it has faced a lot of challenges in its implementation. The stakeholders which are the businesses, investors, tax regulators (Federal Inland Revenue Services) and the government of the Federal Republic of the (the State),¹²⁰ all have their respective peculiarities that pose both remote and proximate challenges in the implementation of transfer pricing regulation.

In chapter 6, the measures for solving the myriad of problems facing regulation of transfer pricing in Nigeria were discussed. The conclusion is that the government must strive to plug any leakages that might arise as a result of non-compliance with the arm's length principle of group related companies and ensure an effective transfer pricing regime¹²¹.

5.3 Final conclusion

The TP Regulations in Nigeria contains the key provisions of the OECD Guidelines and complies with most of its requirements. Although the regulatory framework could be said

¹²⁰ FIRS Bulletin, 2014.

¹²¹ The Chartered Institute of Taxation of Nigeria (2004) Examinations February 2004, CITN, Lagos.

to be very robust, some of the provisions of the extant laws and regulations are either conflicting or deficient in some respects. In conclusion, the government must strive to plug any leakages that might arise as a result of non-compliance with the arm's length principle of group related companies and ensure an effective transfer pricing regime.

5.4 Recommendations:

Transfer Pricing practice in Nigeria is still at the development stage and a lot of work needs to be done to grow the practice. It is very complex and dynamic even as direct investments are growing in the country. It must be emphasized that there are limited decided transfer pricing cases in Nigeria that can be cited as an authority. This is because both the business entities and Federal Inland Revenue Services are always reluctant to take their disputes to court for arbitration as a result of high cost of litigation and the length of time taken to conclude cases in court.¹²²

¹²² Shell Producing Company V. Federal Inland Revenue Services

Besides, it is envisaged that for the transfer pricing regulation in Nigeria to be effective all the stakeholders such as the investors, tax authorities and government must play their roles as required by the economic, business and political dynamics of the country.

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