



Transfer Pricing Forum

Transfer Pricing for the
International Practitioner

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• **Bloomberg Tax**

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1. In your jurisdiction, how do the tax authorities select taxpayers for audits for transfer pricing cases and what are their focus areas that could lead to transfer pricing audits? And what measures and technology do the tax authorities have available to capture the essential information?

The Federal Inland Revenue Service (FIRS) in its *Frequently Asked Questions on Transfer Pricing*,¹ listed as *Question Number 24*, the following Q & A: “Will there be TP audits?” “Yes. The FIRS may carry out TP examinations in order to verify that prices adopted by a company with respect to controlled transactions comply with the arm’s length principle.” According to the FIRS, a “Tax Audit is an examination of underlying records to determine whether a taxpayer has correctly reported its tax liabilities. Tax audits are more detailed and extensive than other types of examinations such as desk examination, compliance monitoring/reviews.”²

Essentially, the FIRS may pick taxpayers for audits due to the volume or size and/or terms of controlled transactions *vis-a-vis* turnover and potential impact of such transactions on the taxable profits of the relevant taxpayers, especially if the vendor or service provider is a nonresident. Since the FIRS cannot conduct TP audits on all eligible taxpayers, there are materiality thresholds; in reality, MNEs are more likely to be subject to TP audits than their wholly Nigerian owned/resident group peers. Part of the rationale is that MNEs are required to file Country-by-Country Reports, unlike peers with only Nigerian resident affiliates.³

The TP Documentation submitted by the taxpayers (such as TP Policy, TP Declaration, TP Annual Returns, and TP Disclosure) will disclose information that the FIRS may deem worthy of further investigation by way of TP audit. “Unique” controlled transactions may also attract attention for more detailed scrutiny, and an audit may afford the taxpayer the opportunity to further explain such transactions to the FIRS.

The focus of a TP audit is to explore whether there is opportunity to adjust subject transactions (TP Adjustment) to result in higher taxable profits than reported, if the arm’s length principle is applied to them. Generally, the “FIRS selects taxpayer for tax audit using multifaceted approach including risk profiling, intelligent information, request for refund, etc.”⁴

The FIRS has an online portal for TP filing, and has since 2021 ceased to accept manual filings, although a

¹ <https://firs.gov.ng/wp-content/uploads/2022/03/TP-FAQ-2021.pdf> (accessed September 5, 2023).

² See FIRS, ‘Tax Audit Process’: <https://www.firs.gov.ng/tax-audit-process/> (accessed September 5, 2023).

³ See FIRS, Country by Country Reporting page: <https://www.firs.gov.ng/country-by-country-reporting/> (accessed September 5, 2023).

⁴ See FIRS, ‘Tax Audit Process’: <https://www.firs.gov.ng/tax-audit-process/> (accessed September 5, 2023).

related publication on the FIRS website suggests otherwise.⁵

2. Which approaches are followed by the tax authorities during transfer pricing audits and what are the key elements considered by courts when deciding on transfer pricing related disputes? Please describe a few recent cases or rulings as examples to help illustrate your explanation.

The first leg of the above question can be considered answered with these Q&A Numbers 25-27 from the FIRS' *Frequently Asked Questions on Transfer Pricing*:

25. How far back will TP audits go?: TP audits shall apply to accounting years commencing from 2nd August 2012. To this end, relevant taxable persons must maintain TP documentation from this date onward and for a minimum period of 6 (six) years for each successive accounting period. In the event of wilful default or fraud, there may be no limit to how far back the tax authority can go in order to deal with such criminal tendencies.

26. Is TP audit replacing regular tax audit?: No. Regular tax audit will continue to hold in order for the Service to satisfy itself that taxable income sources have been fully and properly disclosed and that deductions allowed are wholly, reasonable, exclusively and necessarily incurred for the purposes of earning the income.

27. Is TP audit not a duplication of the regular tax audit? No, TP audit is not a duplication of regular tax audit. While regular tax audit is to verify whether or not a taxable person complied with statutory provisions with respect to proper disclosure of income and business expenses, TP audit is concerned with the pricing of transactions occurring between connected taxable persons. In other words, regular tax audit is checking to ensure full compliance with legal provisions on income and expenses, whereas TP audit is checking to ensure full compliance with arm's length prices for all transactions occurring with persons connected with the taxable person.

Nigeria considers a more robust TP regulatory enforcement approach as one of the ways to stem the flow of "illicit cash" out of the country and to improve Nigeria's current unimpressive tax to GDP ratio. This has underpinned many of the FIRS' TP related initiatives and actions, including the documentation on the TP page of the FIRS website.⁶

If the courts find the position of the FIRS on potential TP related adjustments more in line with the regulatory prescriptions, then they are likely to find in the FIRS' favor, as was the outcome in Nigeria's first ever TP case, *Prime Plastichem Nigeria Limited v. FIRS*.⁷ Essentially, the courts will be interested in seeing that connected

⁵ See <https://www.firs.gov.ng/wp-content/uploads/2021/06/Guidelines-for-Filing-TP>Returns-1.pdf> (accessed September 5, 2023).

⁶ See FIRS TP page: <https://www.firs.gov.ng/transfer-pricing/> (accessed September 5, 2023).

⁷ (2020) 51 TLRN 1. See discussion of the *Plastichem* case at pp. 5-6 of the Nigerian Chapter contribution (by Afolabi Elebiju, et al.) to *Bloomberg Tax's Winter 2020/Spring 2021: Transfer Pricing Forum*, available at: <https://lelawlegal.com/add111pdfs/Nigeria.pdf> (accessed October 8, 2023).

transactions do not translate into tax revenue leakages to the detriment of the *public fisc* through any profit shifting arrangements, when compared with arm's length transactions with unrelated parties.

There have not been many reported transfer pricing cases in Nigeria. However, recently a momentous TP decision was rendered in August 2023 in favor of the taxpayer by the Lagos Zone of the Tax Appeal Tribunal (TAT) in *Check Point Software Technologies B.V. Nigeria Limited v. FIRS*.⁸ The facts of the case were as follows.

The Appellant had been served with two Notices of Administrative Penalties respectively for late filing of its 2019 and 2020 Country-by-Country Notifications under the CBC Regulations 2018 (CBC Regs). The Appellant duly objected to them on the basis that they were *ultra vires* null and void since the CBC Regs imposed a penalty that exceeded statutory penalties in the enabling legislation,⁹ which the CBC Regs sought to enforce. Following the FIRS' refusal to discharge the Notices (after considering the objections), the Appellant appealed to the TAT.

At the TAT, the Appellant also argued successfully that although the CBC Regs were issued by the FIRS following ratification of the OECD Country-by-Country Multilateral Competent Authority Agreement (CBC MCAA) by the Federal Executive Council (FEC), the same was null as a treaty obligation because it had not been domesticated by the National Assembly as required by Section 12 of the Constitution of the Federal Republic of Nigeria (as amended).¹⁰ Finally, because Section 61 of the FIRSEA contemplated delegated legislative authority to the Board of the FIRS, such powers could only be validly exercised by the Board.¹¹ Therefore the FIRS' purported issuance of the CBC Regs in 2018, when it had no Board in place, was fatal: *delegatus non potest delegare*. Furthermore, Section 61 of the FIRSEA did not delegate power to impose the penalties being challenged on the FIRS. This is more so that late filing is a contravention unrelated to tax liability, hence the applicable penalty is as enshrined in the FIRSEA.¹² As a result, the TAT upheld the Appeal and found against the FIRS.

⁸ Appeal No. TAT/LZ/CIT/121/2022 of 17th August 2023. A soft copy of the judgment is also available at TAT's website: <https://tat.gov.ng/judgement/details.php?id=237> (accessed October 8, 2023).

⁹ FIRS (Establishment) Act, Cap. F36 Laws of the Federation of Nigeria (LFN) 2004 (FIRSEA).

¹⁰ The CBC Regs mimic the CBC MCAA, which itself was signed by Nigeria on January 27, 2016, and ratified by FEC on August 3, 2016.

¹¹ Section 61 of the FIRSEA provides, "The Board may, with the approval of the Minister, make rules and regulations as in its opinion are necessary or expedient for giving full effect to the provisions of this Act and for the due administration of its provisions and may in particular, make regulations prescribing the - (a) forms for returns and other information required under this Act or any other enactment or law; and (b) procedure for obtaining any information required under this Act or any other enactment or law." (Emphasis added).

¹² Regulation 11 CBC Regs imposed a ₦10 million administrative penalty for the late filing of a CBC Report and ₦1 million for every subsequent month for such late filing. According to Regulation 9, the due date "is not later than 12 months after the Reporting Accounting Year of the MNE Group."

3. How can MNEs best prepare for potential disputes in light of the factors described in Questions 1 and 2, and what can they do to mitigate the risks of future disputes?

The most important preparation is to ensure that requisite, credible (easy to follow and consistent) documentation is in place (both contemporaneous and historic, the latter because of back year audits), that explains the MNE's position, and which are consistent with the prescribed regulatory requirements. Rigorous internal reviews cum examinations of such documentation with a view to correcting gaps ahead of disputes and/or to ensure that documentation to be filed are in the best possible shape, are also prescient. Sometimes, a "mock audit" can identify issues and lead to action items that optimize the MNE's TP compliance status.

Generally, the above illustrative quality assurance process speaks to the robustness of the tax governance system of the relevant MNE. On time (prompt) TP filings, and responses to queries/ requests for clarifications, or additional documentation are also important. Typically, the quality of the MNE's feedback could obviate a potential dispute or reduce the potential amounts that could be in issue in potential disputes. Pre-dispute engagement must be well managed so the MNE does not unwittingly fall victim to untoward happenstances—for example, failure to object to an assessment within 30 days as required by law could make such assessment "final and conclusive" against the MNE taxpayer, thereby potentially precluding any challenge of such assessment on the merits.

Another critical point is to monitor regulatory developments and constantly stay abreast of regulatory changes, in particular changes disseminated through FIRS Circulars and Guidelines, so the MNE can timeously craft its responsive strategy. Sometimes, the FIRS website may not keep pace with changes that have been introduced (by way of immediate uploads and/or removal of dated information).¹³

Expectedly, the MNE's Finance function will have professional relationships with FIRS officials, and the MNE's tax consultants and advisers also represent another (indirect) point of contact and engagement with the FIRS. Since MNEs are usually able to afford the services of the leading firms and hence presumably enjoy quality advisory services, they provide good leverage for MNEs to better prepare for disputes, nip disputes in the bud, or enhance prospects of successful dispute outcomes for the MNE.

On a final note, it is apposite to mention that Nigeria's future TP regulatory landscape may also be affected by the outcome of the changes that would be midwived by the recently established Presidential Committee on Fiscal Policy and Tax Reforms at the end of its one-year assignment.¹⁴

¹³ See the example of FIRS Guidelines on filing of TP Returns in footnote 2 above but which no longer represent the correct position, as manual filings is no longer allowed.

¹⁴ See for example James Agberebi, "Tinubu Inaugurates Presidential Committee on Fiscal Policy, Tax Reforms", *The Guardian* (August 8, 2023): <https://guardian.ng/news/tinubu-inaugurates-presidential-committee-on-fiscal-policy-tax-reforms/> (accessed October 8, 2023): *The Committee will be responsible for various aspects of tax law reforms, fiscal policy design and coordination, harmonization of taxes, and revenue administration. ...the President recognised how important a sound fiscal policy environment and an effective taxation system are for the functioning of the government and the economy. ...The Committee will not only advise the government on necessary reforms but will also drive the*

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implementation of such recommendations in support of the comprehensive fiscal policy and tax reform agenda of the current administration.



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