PwC's Transfer Pricing Series

What do the Nigerian Safe harbour rules have in common with the movie "Safe house"?

When it comes to the exemption for transactions that have been approved by a regulatory authority, the rules have a roundabout way of taking back whatever small gifts they seem to offer.

By Seun Adu

In the movie, "*Safe house*", Denzel Washington plays "Tobin Frost", an ex-CIA agent who surrenders himself to the American consulate in Cape Town, South Africa while being chased by mercenaries bent on harming him. The CIA quickly transfers him to a safe house for interrogation. A safe house, as the name implies, is a place where you are assured of safety and protection from hostile forces. In the movie, the Safe house comes under attack from the mercenaries and Tobin Frost is lucky to escape alive. The Safe house, it turns out, was not safe at all.

The notion of an "unsafe" safe house reminds me of the Safe harbour provisions of the Nigerian Transfer Pricing regulations.

What are safe harbour rules in Transfer Pricing (TP)?

Taxpayers who are doing it for the first time are often surprised at the rigour that goes into putting together a defendable TP policy and documentation report. It can be a complex, time consuming, and expensive exercise. These taxpayers are even more surprised when they realise that, in spite of all that effort, the Federal Inland Revenue Service (FIRS) could still review their work and come up with a totally different conclusion which will require them to pay more taxes. Compared to other tax areas, the level of uncertainty that comes with TP compliance can be relatively high.

Safe harbours rules help to solve this problem. Safe harbours rules are a set of simple rules which, if followed by a taxpayer, would allow the taxpayer some certainty about how its transfer prices will be perceived by the tax authorities. For example, a safe harbour rule could set a range of prices that are considered to be arm's length such that when a taxpayer applies a price that is within that range, the tax authorities are bound to automatically accept that the transfer price is an arm's length price.

Safe harbour rules are usually prescribed by law or regulation and apply to specific categories of transactions.

TP Safe harbour rules are meant to keep you safe

If you have ever dealt with the complexities of setting a transfer price and having to defend it under an audit, you can appreciate how useful safe harbour rules can be especially when they have been set in a reasonable manner.

The major advantages of having safe harbour rules include: (1) minimising the cost of compliance for taxpayers as they do not have to undertake any complex and resource consuming analysis to set up their TP policies and justify their transfer prices; (2) providing certainty to the taxpayer that its transfer prices will be accepted if it applies the rules; and (3) reducing the amount of work that tax administrators need to do in assessing the arm's length nature of transactions that have been priced in line with the safe harbour rules.

Nigeria has safe harbour rules but what are they good for?

The big question is whether the Nigerian safe harbour rules offer any type of safety. I will get to that in a bit.

Nigeria's safe harbour rules can be found in Regulation 15 of the Nigerian TP regulations. The rules cover two categories of transactions.

The first category is transactions that have been priced in line with an existing law. An example is the price of crude oil disposed by an oil producing company. For this, the Petroleum Profit Tax Act (PPTA) provides rules on how the value is to be determined for tax purposes.

The second category is transactions where the prices have been approved by a Government regulatory agency. The most popular example of this is the approval from the National Office for Technology Acquisition and Promotion (NOTAP).

The Nigerian rules suggest that taxpayers who undertake these categories of transactions are entitled to certain exemptions; but there is a twist.

Even if you think you should, you "may" not get any exemptions

Regulation 15 starts by saying: "A connected taxable person ***may*** be exempted…". At the most basic level, the use of the word "may" in this phrase suggests that the exemption is discretionary. One interpretation is that the FIRS gets to decide whether or not you get the exemption even if you meet the requirements.

Some lawyers will argue differently and say that this is one of those instances in legal interpretation when "may" really means "shall" such that, in substance, the FIRS has an obligation to grant the exemption to any taxpayer that meets the requirements.

The fact that the provision can be interpreted in different ways creates some uncertainty. For a rule that is designed to reduce uncertainty; this is not good.

Even if we conclude that "may" really means "shall", there is also the question of whether a formal application needs to be made to the FIRS such that a formal approval (even if routine) must be received before a taxpayer can enjoy the exemption. Again, more uncertainty.

Assume you manage to resolve the approval hurdle, the next question is: why go through the trouble?

The Nigerian safe harbour rules do not give a lot of protection

What exactly can you get from the Nigerian safe harbour rules? What is the eligibility worth?

Taxpayers that qualify under the safe harbour rules in Nigeria are exempt from preparing annual TP documentation. That is where it stops. The Nigerian rules are missing an important ingredient of many safe harbour rules.

Taxpayers want safe harbours that give certainty on the treatment of the inter-company transactions covered by the rules. They want to know that once they follow the rules, there will be no surprises several years down the line. They want to know that their transfer prices will not be adjusted if they follow the safe harbour rules.

In many countries, the safe harbour rules exempt taxpayers from preparing detailed TP documentation and also protect them from TP adjustments provided that they are eligible and have followed the rules. Audits from the tax authorities are limited to confirming eligibility.

The Nigerian safe harbour rules do not provide any express guarantee that the transactions covered by the rules will not be audited and that TP adjustments will not be passed. In theory therefore, even if you are clearly eligible to apply the safe habour rules in Nigeria, you can still get audited like any other taxpayer that is not eligible under the rules.

This defeats the purpose of having safe harbours in the first place.

Even if you get the exemption, you still don't get it

When it comes to the exemption for transactions that have been approved by a regulatory authority, the rules have a roundabout way of taking back whatever small gifts they seem to offer.

The rules state that the exemption for this category of transactions will only apply if the FIRS is satisfied that the transaction is arm's length.

The obvious question that will follow is: how does one satisfy the FIRS that the transaction is arm's length? The answer is likely to be: by doing the exact thing that the safe harbour is supposed to exempt you from i.e. by preparing TP documentation!

This makes you wonder what the safe harbours rules are good for.

Now is a good time to make the Nigerian safe harbour rules safe

The Nigerian TP regulations are currently being revised and this provides a good opportunity to fix the safe harbour rules.

First the safe harbour rules should be reworked to give real relief. The rules should make it clear that taxpayers who are eligible will not be required to undergo detailed TP enquiries relating to those transactions. Any enquiries from the FIRS should be limited to confirming the eligibility of the taxpayers for the safe harbour. This is the approach taken in many countries.

Second, the concern that having an approval from another regulatory authority will not guarantee that a taxpayer's transfer price will be accepted by the FIRS needs to be addressed. The FIRS and the other regulatory authorities should agree on what constitutes an arm's length price range for the relevant transactions. This should then be used as the basis for the approvals to be granted by the relevant agencies.

The eligibility criteria should also be reviewed and expanded. For example, transactions which carry low TP risks such as those between two Nigerian companies who are under the same tax regime should be included.

The federal government has stated its commitment to improving the ease of doing business and paying taxes in Nigeria. Fixing the safe harbour rules will be in line with this goal and a quick win for the government.

Seun Adu is an Associate Director and Transfer Pricing Leader at PwC Nigeria. He is a regular writer and public speaker on tax and transfer pricing matters.