

Transfer Pricing Policy

Paving the way for the journey ahead



Transfer pricing policy generally provides guidelines on how prices are or will be set for related party transactions such as management and technical services, secondment of staff, shared services, intercompany loans and guarantees, royalty, sale of goods or transfer of assets and so on.

Because of the enduring nature, it is conventional wisdom that a transfer pricing policy should be meticulously done and diligently implemented.

You must have heard about transfer pricing by now and possibly have an idea of what it means. In case you haven't then you have a longer road to travel than many others, but the good news is you can start now and still make it to the finish line in time. You may also have received a letter from the Federal Inland Revenue Service (FIRS) requesting for your organisation's transfer pricing policy. If so, congratulations – at least it shows that you have records with the taxman and you have not been forgotten even if you wish so. If not, then your guess is as good as mine.

Transfer Pricing (TP) deals with the interaction between related parties, both corporate and natural persons, in terms of commercial transactions from one to another and ask the question "what is the basis of the price agreed for your related party transactions?" Make no mistakes; this is not just about having a written agreement in place – it is about being able

to justify to yourself and the taxman that the price (or fee) being paid is not arbitrary, and has not been manipulated to confer on you or your related party an undue advantage to the detriment of the taxman.

For instance, when dealing with unrelated persons, you do not just hire anyone and pay just any amount as salaries, and you do not just set the price of your goods or services based on impulse, but rather based on carefully considered parameters and market conditions. You must deal with your related parties in the same way and must be seen to be doing so by providing the basis and documented evidence. Now this is where your TP policy comes into play.

A policy is a framework, a statement of intent, a set of principles and procedures to guide decision making in order to achieve desired results or rational outcomes in a consistent manner.

Therefore, for TP purposes, there should be a policy to address dealings among group members and other related parties including key shareholders, technical partners and directors. The TP policy generally provides guidelines on how prices are or will be set for related party transactions such as management and technical services, secondment of staff, shared costs, intercompany loans and guarantees, royalty, sale of goods or transfer of assets and so on. The first step in establishing a TP policy is to gain an in-depth understanding of the business, the organisation structure, the market and economic circumstances, the industry where the group operates and so on. The next step is identifying all related parties and the relevant transactions between them. Then the core of the exercise is to gather all the relevant facts and circumstances surrounding each transaction. These facts can be summarised in three categories - functions, risks and assets.

1. **functions** - that is, the activities that each of the entities engaged in a particular transaction perform as a normal part of its operations;
2. **risks** - that is, a significant portion of the rate of return earned by any business should reflect the fact that the business is bearing risks of various kinds such as credit risk, market risk, inventory risk, product liability risk and warranty.
3. **assets** – that is, both tangible and intangible assets that are used in performing the transaction must be considered in setting the price.

Once the policy has been developed, it must be approved by the Board of Directors or other equivalent body within the organisation. Of course things can change and they often do, but in terms of policies, changes are expected to be less frequent so you should consider your TP policy a fairly static document that will last for some time, usually not less than three years before an update or a review becomes necessary. Because of the enduring nature, it is conventional wisdom that a TP policy should be meticulously done and diligently implemented.

The evidence of the TP policy implementation to achieve market driven prices when dealing with related parties together with the policy itself will make up the TP documentation.

Based on the TP Regulations issued by the FIRS in August 2012, affected companies are required to comply from their financial year commencing after the regulations became effective. Consequently taxpayers must submit, with their tax returns, appropriate TP declaration and disclosure forms. For businesses liable to tax under the Companies Income Tax Act, the due date is six months after the financial year end date, while for companies liable to tax under the Petroleum Profits Tax Act, it is five months.

Upon examination or desk review of the returns and disclosure forms, the FIRS may request for detailed TP documentation which must be provided within 21 days. Given that it is not practicable to prepare any meaningful TP documentation within 21 days, affected companies should prepare their documentation before filing their tax returns regardless of a request from the FIRS. All taxpayers may be asked to submit a TP declaration form whether they have related party transactions or not in order to enable the FIRS determine more easily non-compliant taxpayers.

The request for TP policies by the FIRS ahead of tax returns filing deadlines is a clear indication that they are keen to start the review of compliance with the TP regulations. Everyone should therefore brace up and pay close attention to their compliance in this regard and ensure all relevant documentation is ready before the due date.

Suffice to say that any organisation involved in related party transactions without a TP policy will be considered as being arbitrary in their pricing decisions. This also means such organisations will be regarded as high risk taxpayers in terms of potential tax avoidance or even evasion and should be prepared to entertain the taxman for TP audits more frequently than others. If you do not have a policy in place, you should request for more time from the FIRS within which to prepare and submit the TP policy. Doing nothing is not an option, but even if it is, you do not have to exercise it.

Watch out for our series on Transfer Pricing in subsequent editions of Tax Bites.

Blog with Taiwo for in-depth analyses, unique insight and superlative perspective on tax matters: www.pwc.com/nigeriataxblog. Subscription is free!

About PwC

PwC firms help organisations and individuals create the value they're looking for. We're a network of firms in 158 countries with close to 169,000 people who are committed to delivering quality in assurance, tax and advisory services. Tell us what matters to you and find out more by visiting us at www.pwc.com/ng