

Compliance-based Documentation

Demonstrating the proper implementation of your transfer pricing policy with verifiable evidence



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Our last discussion revolved around the need to have in place, a transfer pricing (TP) policy that could help to justify to the Federal Inland Revenue Service (FIRS) that the price being paid for your intra-group and other related party transactions is not arbitrary, and has not been manipulated to confer on you or your related party an undue advantage to the detriment of the Revenue.

In this publication, we will look at the requirements of the Nigeria TP regulations for taxpayers to demonstrate, where necessary, actual and proper implementation of what is contained in their TP policies.

It is pertinent to appreciate initially that while having a TP policy provides a valid framework for, and also signifies your organization's intention towards, achieving market driven prices when transacting business with a related party, the evidence that this policy is actually implemented lies with the availability of a proper 'compliance-based' documentation (it is possible that an organization have other forms of TP documentation for different objectives e.g., a planning documentation for business restructure purposes).

A compliance-based documentation is generally developed for submission to a tax authority to

support the arm's length nature of the chosen TP policy and practices. The objective of having such documentation in place is to support the arm's length nature of the taxpayer's transfer prices and comply with local legislative and regulatory TP requirements. Accordingly, the Nigeria TP regulations require taxpayers to keep necessary information which can be used to back their TP practices. This requirement is specifically spelt out under Regulations 6 (1) of the Nigeria TP rules. The language of the TP rules is such that the FIRS expects the relevant documentation to be in place prior to the due date for filing the income tax return for the year in which the documented transactions occurred.

Looking at this provision critically, this expectation partly provides a safeguard for taxpayers should any issue arise on their TP practices with the Revenue. The present TP regulations require taxpayers to submit, with their tax returns, appropriate TP declaration and disclosure forms. Upon examination of these forms, the FIRS may request for detailed TP documentation which must be provided by the taxpayer within 21 days (although conditions exist under which a 7-day extension can be made in this regard). Preparing proper TP documentation before filing tax returns, therefore, put the taxpayer in a relatively safer position should the FIRS subsequently make a request for such. It is even more pertinent that a taxpayer gives serious attention to this requirement because under the Nigeria TP regulations, the onus of showing that the conditions of the related party transactions are consistent with the arm's length principle rests with the taxpayer. This is regarded as the burden of proof. This element of the regulations reflects the significant responsibility borne by the taxpayer to prove the correctness of its transfer pricing methodology, at least in the first instance. The burden of proof is considered to have been satisfied only after the taxpayer provides documentation consistent with the requirements of the regulations. Otherwise, once the FIRS makes a *prima facie* showing that a taxpayer's pricing is inconsistent with the arm's length, the taxpayer acquires the burden of proof at that instance.

To a Nigeria corporate taxpayer therefore, having a proper and timely compliance-based documentation in place is a preventive measure to avoid a TP controversy with the FIRS and to manage a TP dispute should there be one.

Transfer pricing documentation should reflect the company and its relevant inter-company transactions at a certain moment in time. The documentation gathered should include the relevant facts and circumstances at that moment. For Nigerian taxpayers, the current documentation evidence should cover all related party transactions carried out by the entity in the financial year commencing after August 2 2012.

A good guide for taxpayers in this area is to refer to instructions contained in the 2010 TP Guidelines provided by the Organization for Economic Cooperation and Development (OECD). The Nigeria TP regulations state clearly that the TP provisions will be applied in a manner

consistent with OECD Guidelines. A Nigerian taxpayer can therefore obtain greater peace of mind by following the OECD provisions in this area.

According to the OECD 2010 TP Guidelines, a taxpayer, in putting together relevant documentation, is expected to prepare written materials or to refer to written materials, where the materials could serve as documentation of efforts undertaken. The written materials are to include information on which the taxpayer bases its transfer pricing, the factors the taxpayer has taken into account, and the method the taxpayer selects.

Generally, a taxpayer's documentation should cover the following, albeit non-exhaustive, useful information for determining its transfer pricing.

1. Information on the related parties controlled transactions – i.e., information on the nature and terms of the transaction, the economic condition affecting the transaction, the property involved in the transaction; also covered here is a description of transactions between the taxpayer and an independent party as a basis of identifying comparables etc.
- 2.
3. Information relating to each associated enterprises involved in the controlled transaction under review – i.e., an outline of the business, the structure of the organization, ownership entities within the multinational (MNE) group, sales and operating results, and the level of taxpayer's transactions, including services, rents, and intangible property.
- 4.
5. Pricing information – i.e., information about business strategies and special circumstances such as management strategies, increase in market share or where set-off transactions have been carried out between related parties.
- 6.
7. General commercial and economic conditions affecting transfer pricing – i.e., current business environment, forecasted changes pertaining to the business environment, market scale, competitive conditions, technological progress, and the foreign exchange market.
- 8.
9. Relevant facts and circumstances surrounding each transaction – i.e., functions performed by each of the related entity as a normal part of its operations, risk assumed in relation to the rate of return earned by the related party business, assets used by the related party in performing the transaction, information in the possession of the foreign associated enterprise such as research and development costs, financial information, documents that show the negotiation process, including forecast prices and the manner in which the taxpayer determines transfer prices.

It is important, however, to note that maintaining relevant TP documentation is subject to regular update for changes in facts and circumstances related to the TP transactions. If the relevant facts and circumstances change, maintenance

activities will need to be undertaken by the taxpayer. Such a change may, for example, be related to an update of the comparable search after two or three years. Such updates are very critical as they underlie the continuing validity of the assumptions and practices adopted by a taxpayer.

The current tendency in the global business environment where companies are increasingly required to adjust to changing business environment is something that tax authorities around the world (FIRS inclusive) appreciate and

pay careful attention to. Hence, giving the Revenue a basis for raising a TP query through the provision of outdated documentation should be a risk exposure that taxpayers should guard against right from the very start. At this stage of our TP tax regime in Nigeria, the possible penalty and associated inconveniences may not be a pleasant experience, no matter how improbable this may seem to you presently.

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