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What the definition of connected taxable persons can teach us about definitional fallacies

“The attempt to make the concept of connected taxable persons as broad as possible unfortunately created a new problem; it makes the definition illogical. The reality is that TP legislation is not a tool to tackle all possible forms of tax avoidance or evasion just as a nail and hammer should not be used to fix all items of broken furniture.”

Imagine you have no clue what the term “Married person” means; and I am to help you out. If I said to you: “a Married person means a person that is married”; have I been helpful? This is an example of a circular definition. It is a definition that contains the term that it intends to define. It is a bad definition; it is a definitional fallacy. I can also commit a fallacy of definition if my definition is too narrow, is too broad, is self-contradicting, or is just too difficult to understand.

The definition of connected taxable persons in the Nigerian TP Regulations contains several definitional fallacies. As a result of these fallacies, I have seen people make a case (rather incorrectly) for subjecting a transaction between two independent parties to the TP Regulations.

We do not yet know all the problems that this definition can create for both taxpayers and tax administrators; and we should not wait to find out. We should fix it.

Connected persons and TP legislation

The concept of “connected persons” (or “associated persons”) is used to explain the type of relationship that must exist between two persons for TP obligations to apply. This concept is very critical in defining the scope of TP legislation. It therefore needs to be as clear as possible.

I have summarised below how the Nigerian TP Regulations define connected persons.

“... a 'connected taxable person' includes persons, individuals, entities, companies, partnerships, joint ventures, trusts or associations (collectively referred to as 'connected taxable persons') and includes the persons referred to in (i) Sections 13(2)(d), 18(2)(b) and 22(2)(b) of the Companies Income Tax Act, 2004 (as amended);...”

Did you notice anything amiss? You must have spotted that the definition is circular. This is however the least important of all that is wrong with it. I will tell you more; but this time you will need to really pay attention.

There are three concepts that need to be clearly defined in any TP legislation

A TP legislation will usually define (1) the type of entities or persons it applies to (e.g. corporate entities and individuals); (2) the type of relationship that must exist between entities or persons for the legislation to apply; and (3) the type of transactions such entities or persons must undertake with one another for the legislation to apply. These three concepts of “entities covered”, “relationships covered” and “transactions covered” define the scope of any TP legislation.

The Nigerian TP regulations use a single term to define two of these concepts

One of the problems with the definition of connected taxable persons in the Nigerian TP regulations is that it attempts to define the first two concepts highlighted above (i.e. entities and relationships) using the same term. You did not notice this, did you? Have another look at the definition.

The first part of the definition includes a list of types of entities i.e. individuals, companies etc. The second part includes an additional list which comprises persons with a specific relationship with one another; for example the persons referred to in Section 22(d) of CITA are persons who either control each other, or are controlled by a third person.

When you really look at it; the term “connected taxable persons” is used to define two concepts.

The result is that the definition can be interpreted to be really broad

While individuals and companies (as listed in the first part of the definition) can very well be connected taxable persons, the definition does not state the fundamental attribute which such must possess to be seen as a connected taxable person, instead it labels them connected taxable persons and then includes another list of entities (with specific attributes) who, in addition to this first list, should also be considered connected taxable persons.

By this definition, every corporate entity and individual is a connected taxable person and any transaction they have with any other corporate entity or individual is a controlled transaction.

I didn't say it; it is what the Regulations say.

If in providing you with examples of quadrilaterals I say quadrilaterals include: shapes, two dimensional shapes etc. you may be right to conclude that a circle is also a quadrilateral wouldn't you?

There is also a more practical problem of ambiguity

If we assume that everyone would be reasonable and not take such a broad interpretation of the definition, we are still left with the problem of ambiguity.

Since the term connected taxable persons is used to define the concept of “entities” and “relationships” at the same time, it can be hard to determine which concept is intended when a particular item on the list is considered. The most common instance of this confusion happens when the listed item is one that represents a collection of entities e.g. with Joint Ventures (JVs).

What should we make of the inclusion of entities such as JVs in the definition?

If you take the “entity view”, you will conclude that JVs are

included as a type of entity that could be subject to the TP regulations. This will mean that a JV will only be subject to the TP regulations if it has a transaction with another entity that it is connected with e.g. through common control.

If you take the “relationship view” you will conclude that JVs are included on the list in order for the relationship that exists between JV members to be covered by the Regulations. This will mean that JV members are seen as being connected to one another.

By this second definition, all parties to an oil and gas joint venture are related to one another as well as the NNPC. I will leave you to chew on the implications of that.

The Regulations also makes a reference to legislation that does not exist

The problems do not end with ambiguity. In the TP regulations, connected taxable persons are also defined to include: “persons referred to in Section 18(2)(b) of the Companies Income Tax Act (CITA)”.

There is no Section 18(2)(b) in the CITA (at least not in any of the recent versions).

Conclusion

A nail and hammer can be effective tools for fixing broken furniture, but would you use them to fix broken ceramic?

The attempt to make the concept of connected taxable persons as broad as possible unfortunately created a new problem; it makes the definition illogical. The reality is that TP legislation is not a tool to tackle all possible forms of tax avoidance or evasion just as a nail and hammer should not be used to fix all items of broken furniture. Broadness at all costs should not be the goal, clarity and effectiveness are better goals.

In all fairness to the drafters, it is not always possible to avoid errors or ambiguities in legislation; particularly when the legislation relates to new areas where experience is still limited. That said, we now have a chance to do better.

The definition of connected taxable persons under the Regulations needs to be revised. There are many examples of more appropriate and effective definitions that we can borrow from. These are available globally, and even in other parts of Africa.

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