

PwC's Transfer Pricing Series

Intra-Group services under the 2018 Transfer Pricing Regulations

What would you do if you stopped receiving the service from your related party? Would you immediately look for an independent service provider? Or employ someone to do the work? If you will do neither of these things, then the service you are paying for is probably not beneficial to you and the FIRS may refuse to give you a tax deduction for the service fee.

Introduction

We now have additional rules you need to follow to obtain a tax deduction for intra-group service fees.

The Federal Inland Revenue Service (FIRS) updated the Income Tax (Transfer Pricing) Regulations, 2018 ("2018 TP Regulations") to include specific requirements taxpayers must meet before their intra group services will be considered to be arm's length. The requirements borrow from the OECD's Transfer Pricing (TP) guidelines.

If you are unable to show that your intragroup service fees are arm's length, you will not get a tax deduction for the amount that has been charged to you.

What are intra-group services?

Intragroup services are services provided by one or more entities within a group to other companies in

the group, or for the benefit of the group as a whole. Intra-group services include administrative, finance, human resources (HR), information technology (IT), management, marketing, procurement, research and development (R&D), and technical services amongst others.

Fees for intragroup services are sometimes described as head office charges, shared service charges etc. Groups have intra-group service arrangements for commercial reasons that include consistent quality, cost reduction and efficiency.

What must you do to get a tax deduction for Transfer Pricing (TP) purposes?

You will only obtain a deduction for a service fee paid to a related party if such a fee is "arm's length".

Regulation 6 of the 2018 TP Regulations provides the specific requirements you must meet for your

service fee to be considered to be “arm's length”. You must answer “yes” to the following three questions and in addition, determine an arm's length service fee to get a tax deduction.

Question 1: Did you receive the services?

For an intra-group service fee to be arm's length, you must be able to prove with verifiable evidence that you received the services for which you get a service charge. From experience, examples of evidence may include service deliverables such as reports, manuals, communication via letters and email, internal memoranda, etc.

You need to closely examine your existing service agreements for clarity, and retain documentary evidence that support the mode and place of service delivery (i.e. whether remotely or in Nigeria), the expected benefits, and the deliverables from the service transaction. For example, if your service agreement states that the service provider will pay monthly visits to your location to deliver the services, you should retain evidence of the monthly visits.

Question 2: Did you expect to, or currently enjoy any economic or commercial benefit?

Apart from demonstrating that you received the services, you also need to show that you entered the service agreement with the expectation of a clear economic or commercial benefit. Depending on the service, evidence of economic benefits such as an increase in sales, or a reduction in costs because of the services received will support your claim for a tax deduction. It may not be easy to do this in all instances.

At the minimum, you need to state the reason for purchasing the service, and be able to explain the expected benefits at the time you made the decision.

In some instances, it may suffice to be able to show that the services are of a type usually required by a business like yours under the circumstances.

If the services are continuous, you need to be able to explain the ongoing commercial benefits that you receive. You also need to consider if some of the services are similar to activities that your staff currently undertake in-house. If the services are similar, then you must be able to

make a clear distinction between the work that you do in-house and the services that you get from your related service provider.

Question 3: Would you be willing to pay an independent service provider or employ staff to perform the services?

What would you do if you stopped receiving the service from your related party? Would you immediately look for an independent service provider? or employ someone to do the work? If you will do neither of these, then the service you are paying for is probably not beneficial to you and the FIRS may refuse to give you a tax deduction for the service fee.

Shareholder costs are one category of costs that you will not get a tax deduction for. Shareholder costs are costs that your shareholder/parent company incurs: (i) solely in its status as a separate legal entity, (ii) solely because of its position as a shareholder, and (iii) solely for its own benefit. You will not obtain a tax deduction for service fees that are costs of activities your shareholder(s) performs to protect its interest in your business, expand its business interest, or comply with its own regulatory obligations. These activities are “shareholder services” and are solely for the benefit of your shareholders.

Some examples of shareholder services or activities specified in the 2018 TP Regulations include the costs for the shareholders' financial reporting i.e. consolidation of accounts and issue of shares in the parent company.

How do you determine an arm's length service fee?

The final step to ensuring you get a tax deduction for intragroup service fees is to determine what an independent party in similar circumstances will pay for the services i.e. an arm's length service fee. The 2018 TP Regulations highlight some considerations when doing this.

Fees for services where you are the sole recipient
Imagine going out to dinner with two friends and one orders grilled chicken, the other has roast fish and you have a sandwich. When the waiter presents the bill, each person would identify their meal and settle their respective bills. In a similar manner, where you can identify the specific services received from a related party as well as the cost or market price

for the specific services, the market price or specific costs should determine the fees that you should pay for the services. In many instances, you will only be able to determine a market price accurately if the related service provider also provides similar services to third parties.

Fees for services rendered jointly to various connected persons

You and three colleagues agree to purchase one cow from a mutual friend of yours for your consumption during the festive season. Ideally, you will determine each person's monetary contribution based on the relative share of the cow that each person will get.

Similarly, where a related party service provider provides services to you and other related parties, and you cannot identify and separate the specific services provided to each recipient, then the service charge should be allocated among the service recipients using a basis that

reflects the relative benefits derived by each person.

The basis for allocating the service fee should be reasonable, and suitable to the circumstances of the services.

The take away

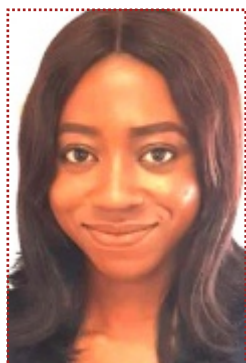
Going forward, you need to do more than analyse the price of the Intra-group services you receive for you to get a tax deduction for the fees. You need to be able to prove that you received the services and show the benefits you obtained.

The changes to the 2018 TP Regulations show clearly that your ability to obtain a tax deduction for intra-group service charges will depend largely on your ability to demonstrate the substance behind the services.



Gboluwaga Ige

Gboluwaga Ige is a Transfer Pricing specialist and a Manager in the Tax & Regulatory Services unit at PwC Nigeria.



Esther Ogunro

Esther Ogunro is a Senior Associate with PwC Nigeria's Transfer Pricing practice.

Visit our tax blog for in-depth analyses, unique insight and superlative perspective on tax matters:
www.pwcnigeria.typepad.com. *Subscription is free!*

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 158 countries with more than 250,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com