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Matters arising from the FIRS' increased request for documents in respect of transfer pricing

"The FIRS has intensified its TP audit activity. While the most significant issues are likely to come from the TP audit itself, the preliminary phase of responding to FIRS' initial requests can also prove costly if the right steps are not taken."

Introduction

A lot has already been written about how difficult 2020 was for countries across the globe as a result of the ongoing pandemic. For Nigeria, in addition to slipping into a recession, inflation hit 15.57% in December 2020, unemployment closed at 27.1%, and there is a budget deficit of ₦5.6trillion in 2021. This suggests that 2021 will be a year where government will make aggressive moves to raise revenues and close tax leakages.

From a TP perspective, an early indication of the FIRS' intentions came towards the end of 2020 when the International Tax Department (ITD) sent out requests for taxpayers, across different industries, to submit their TP documentation (TPD) and other documents (e.g. general ledgers, contracts, invoices etc.) or risk facing penalties (usually a minimum of ₦10million). From my experience, this typically signals the ITD's intention to start a TP audit. I expect the ITD to send out more letters and schedule more taxpayers for TP audits in 2021.

This article will discuss some of the issues that taxpayers need to be aware of regarding these FIRS' requests.

Background

Nigeria's TP regulations require taxpayers to prepare annual TPDs that demonstrate that their related party transactions are arm's length. While the TPD is to be prepared within 6 months of the financial year end (FY), it only needs to be submitted upon a request from the FIRS. However, the submission must happen within 21 days of such a request.

Based on the above, the FIRS would expect a company with a 31 December year-end to have prepared its FY2013 TPD by 30 June 2014; its FY 2014 TPD by 30 June 2015; and so on for subsequent years. Similarly, the FIRS would also expect that the other documents supporting the intercompany transactions for these years are in place.

FIRS' recent requests

Many of the FIRS' recent requests have been for TPD and information covering the 2013 to 2019 financial years. Below, I discuss the implications of the above and share some of my recent experiences.

1) Years covered and statute of limitation

Some of the questions that always come up are whether the FIRS should be asking for information for some of the earlier years e.g. 2013 (since they may be statute barred) and whether the FIRS can raise a valid assessment for those years if the audit is concluded in 2021 or sometime after.

To answer these questions, we will consider section 66 of the Companies Income Tax Act (CITA) and Regulation 25 of the Income Tax (Transfer Pricing) Regulations, 2018 (2018 TP Regulations).

Section 66 of CITA provides that the FIRS must issue an assessment for additional tax to a taxpayer within a 6 year period, except on grounds of fraud, willful default or neglect. This means that if a taxpayer is undergoing a TP audit and the FIRS fails to issue an assessment relating to a particular year within 6 years, that assessment is null and void.

This position was affirmed by the Tax Appeal Tribunal (TAT) in *Polaris Bank v. Abia State Board of Internal Revenue*. In the same case, the TAT ruled that tax authorities are required to demonstrate the existence of sufficient grounds in order to commence an investigation which goes beyond the 6 year period.

This suggests that, other than in exceptional circumstances, the FIRS cannot issue an assessment once the 6 year period has expired. This position is also consistent with Section 34(2) of the FIRS Establishment Act which suggests a lower time threshold of 5 years.

Further, Regulation 25 of the 2018 TP Regulations (also see Regulation 18 of the 2012 TP Regulations) provides that all records and details which a taxpayer relied on in preparing its TP returns are to be retained for a period of 6 years from the date in which the return was made. This suggests that if a taxpayer filed its 2013 TP returns in June 2014, it is only required to maintain those documents (including the TPD which it would have prepared at the time that the intercompany transactions occurred) until June 2020. This view has also been formally communicated by the FIRS in its FAQs on TP which is published on its website.

Based on the above, a taxpayer should have a basis to push back on a request for documents that comes after the 6 year period since, arguably, the year(s) have become time barred.

2) Strict rules for granting extensions and rapid rejections

The FIRS has been known to almost instantly reject requests to extend submission deadlines where taxpayers are not able to meet certain strict conditions. Based on the FIRS' circular no. 2018/03 (Guidelines on TP Documentation), the conditions for granting an extension include death or illness of a key personnel of the company or a close relative; a natural disaster or civil unrest; a public holiday; where the information required to be submitted (except the TPD) is not available in Nigeria; or any other genuine reason preventing the taxpayer from complying.

While taxpayers may be able to demonstrate "other genuine reasons" that may prevent them from submitting other categories of documents, it is relatively difficult to obtain an extension of the time to submit TPDs. This is because the FIRS has taken the position that the TPDs should have been prepared in prior years (i.e. within 6 months of the relevant FY), and as such the FIRS tends to judge such requests based on a higher standard. This however does not mean that the FIRS will not grant an extension if a taxpayer is able to show good cause.

3) Risk of penalties / rapid assessments

Many of the letters are quick to remind taxpayers that failure to submit documents will result in the imposition of penalties.

Although I am yet to see the FIRS impose penalties for late submission of the documents, my experience from the rapid assessments issued in relation to the late filing of TP returns and country-by-country reporting reports and notifications suggests that the FIRS will not hesitate to impose penalties where necessary. The potential penalties can be significant and can run into hundreds of millions of naira.

What you need to do now

In order to reduce the risk that you are exposed to penalties when the FIRS makes a request for your TPD and other information, you should consider the following:

1) Regularise your compliance status.

You need to ensure that all your TPDs and supporting analyses (i.e. benchmarks, pricing calculations etc.) are up-to-date and readily available in anticipation of the FIRS' request. This is crucial as 21 days is generally not sufficient to put together a TPD that can withstand scrutiny from the FIRS. This will also minimise your exposure to penalties for late submission of TPDs.

You also need to ensure that transaction specific documents such as invoices, contracts, correspondence, pricing policies etc. are collated and stored in readiness for a request.

2) Perform a risk assessment / audit readiness review.

You need to perform a risk assessment of your intercompany transactions in order to identify key risks inherent in your transactions and to determine the strategy required to mitigate them.

3) Take all FIRS correspondence and notices seriously.

Since failure to respond to FIRS notices can be expensive, you need to ensure that persons within your organisation are aware of the importance of such notices and are able to quickly pass on all correspondence to the relevant teams with responsibility over tax / TP.

I have seen several instances where companies failed to meet the deadline because the FIRS' correspondence got stuck at the "wrong desk" in the company's premises. This is an expensive mistake that can be avoided.

Conclusion

The FIRS has intensified its TP audit activity. While the most significant issues are likely to come from the TP audit itself, the preliminary phase of responding to FIRS' initial requests can also prove costly if the right steps are not taken. You can reduce the risk of unnecessary penalties by getting your compliance up to date and taking steps to ensure that you are able to respond to the FIRS' requests within the time required by law.

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