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The safe harbour provision in the 2018 TP Regulations: what can be done to make it effective?

Despite the new TP Regulations, it is safe to say that there is still some work to be done on the safe harbour regime. The FIRS needs to engage key stakeholders before the anticipated guidelines are released to ensure that all relevant views are carefully considered.

Introduction

In the last few years, tax administrations around the world have made changes to their transfer pricing (TP) laws to reflect new developments. Nigeria is not left behind. The Federal Inland Revenue Service ("FIRS"), recently introduced the Income Tax (Transfer Pricing) Regulations, 2018 which replace the 2012 TP Regulations. One of the changes in the 2018 TP Regulations is the complete overhaul of the safe harbour provision. In this article, we examine these changes and provide recommendations for dealing with some of the shortcomings we have identified.

What are safe harbour rules with respect to Transfer Pricing?

Undertaking a transfer pricing analysis is usually a complex, burdensome and time consuming process for both taxpayers and tax administrators. Even with all that time and effort, there is no guarantee that both parties will arrive at the same conclusion and there could still be a high level of uncertainty even with detailed analysis. In order to reduce the uncertainty and simplify compliance, tax administrators put in place safe harbour provisions where appropriate.

The OECD TP Guidelines specifically define safe harbour in a TP regime as "a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's general transfer pricing rules".

Safe harbour rules under the 2012 TP Regulations

Regulation 15 of the 2012 TP regulations exempts a taxable person from preparing TP documentation and filing TP returns under specified conditions. This includes where the transactions with related parties have been priced in accordance with the requirement of any of Nigeria's statutory provisions; or the transfer price has been approved by other government regulatory agencies established under the Nigerian law and is satisfactory to the FIRS to be arm's length.

The major criticism of the safe harbour provision under the 2012 Regulations is that it did not provide any real relief or safety in many instances. For example, even though Regulation 15 suggests that prices approved by other government agencies will be seen as "safe" for TP purposes, it qualifies the relief by including a condition that the prices must be "satisfactory to the Service as arm's length". This phrase seems to suggest that the Service (i.e. FIRS) can disregard, for income tax purposes, the use of prices approved by government agencies on the basis that it is not satisfied that the prices are arm's length.

We have seen this happen in practice. In a recent TP audit, the FIRS challenged the price and fees approved by the National Office for Technology Acquisition and Promotion ("NOTAP") on the basis that the approved fees were not at arm's length. The issues above meant that the safe harbour provision in the 2012 TP Regulations was ineffective as it could not give the certainty that such a provision is intended to provide to taxpayers.

Fast forward to 2018, out with the old and in with the new. What does the new safe harbour provision have to offer?

Safe harbour rules under the 2018 TP Regulations

Regulation 22 of the 2018 TP regulations provides that a taxpayer may be exempt from preparing TP documentation in respect of a related party transaction where the transactions is priced in accordance with the specific guidelines that may be published by the Service for that purpose from time to time.

The FIRS is yet to publish any specific guidelines on safe harbours and as such it is hard to tell the actual scope of the new safe harbour rules.
The above notwithstanding, there are a few things that are apparent when you compare the safe harbour rules under the 2012 TP Regulations to those under the 2018 TP Regulations.

The first is that if you qualify for a safe harbour under the 2018 TP Regulations, you will not be exempt from filing annual TP Returns; you only get an exemption from preparing TP documentation. Under the 2012 Regulations, the exemption covered the filing of TP returns and the preparation of TP documentation.

The second thing that one can deduce (at least until the FIRS publishes guidelines that show otherwise) is that the FIRS will no longer permit regulatory authority approvals to serve as a basis for justifying transfer prices. This conclusion comes from reading Regulation 19 (2) which states that the TP Regulations prevail in the event that there is any inconsistency with any other regulatory authority approvals. In addition, in its recently released information circular 2018/03, the FIRS has stated that taxpayers who have related party transactions that are priced in line with statutes will not be required to prepare TP documentation. The information circular is silent on what happens when the price is based on "other regulatory approvals".

Are there relative improvements in the "2018" safe harbour provision?

Pending when the specific safe harbour guidelines are issued, it would appear that compared to the 2012 TP Regulations, the 2018 TP Regulations have reduced the reliefs available to taxpayers as well as the scope of safe harbours.

We however note that the proposed approach (under the 2018 Regulations) of introducing specific safe harbour rules via FIRS guidelines has the potential to allow for flexibility and agility whenever changes are required to the safe harbour rules. Compared to Regulations, guidelines can be issued much quicker as the process is shorter. This means that, in the future, the FIRS should be able to update the scope of the safe harbour rules to reflect its understanding of low risk transactions including current developments and trends.

Recommendations

A safe harbour provision is supposed to provide the following: (1) Certainty of tax treatment; (2) Compliance relief; and (3) Administrative simplicity. Since the specific safe harbour rules have not been released, the FIRS still has an opportunity to get the above right.

The FIRS should ensure that the safe harbour guidelines provide eligible taxpayers with relief from TP audits. One of the key features of safe harbour rules in other jurisdictions is that they provide eligible taxpayers an exemption from the audit of the transactions in question or certainty that any audit is limited to ensuring that the eligibility criteria for the application of the provision has been met.

In addition, the guidelines should cover low risk transactions. A clear example is those domestic intercompany transactions that pose a low risk because income tax arbitrage using transfer pricing is of little or no effect.

The FIRS should consider following the OECD's recommendation on low value adding services (services such as accounting, legal, etc where these services are not the core business of the service provider). The OECD recommends a 5% mark-up on service costs as a reasonable fee which does not require extensive scrutiny and documentation. There is also an urgent need to resolve the conflicts that arise when other regulatory authorities set prices that taxpayers must follow. Taxpayers should not suffer double taxation and other commercial difficulties simply because two government agencies adopt different price setting approaches. The FIRS and the relevant agencies should work together to come up with a uniform approach for price determination.

Conclusion

Despite the new TP Regulations, it is safe to say that there is still some work to be done on the safe harbour regime. The FIRS needs to engage key stakeholders before the anticipated guidelines are released to ensure that all relevant views are carefully considered.

Tiwa Otufale

Tiwa is a Transfer Pricing Senior Manager at PwC Nigeria. She has made several media and conference presentations on transfer pricing matters.

Omolara Olaniyi

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