

# Transfer Pricing

## *Frequently-asked questions (FAQ)*

1. **Q: What is Transfer Pricing?**

**A:** Simply put, the term Transfer Pricing (usually referred to as TP) refers to how related parties price goods, services, intangible assets, loans and other transactions between them. TP Rules/Regulations are established in various countries to ensure that related party prices are reasonable and fair.

2. **Q: Does Nigeria have TP Regulations now?**

**A:** Yes, TP Regulations were released in October 2012 and applicable to basis (accounting) periods commencing after August 2012. For example, a company with an accounting year end date of 31st December 2012 will be required to have its TP documentation in place for the accounting year commencing 1st January 2013 for returns to be filed by June 2014. However, the time to act is now to ensure that the appropriate transfer prices are reflected from the first day of the new accounting year. It is important to start to collate the correct supporting documentation now rather than making year-end adjustments which may be difficult to defend.

3. **Q: What are the documentation requirements in the TP regulations?**

**A:** The TP Regulations require that annual

declarations on related party transactions must be made at the time of filing the annual tax returns including specific statements on whether or not documentation exists. Such documentation must be kept and made available to the FIRS within 21 days of a request from the FIRS after filing the annual tax returns.

4. **Q: Are all taxpayers required to apply the TP regulations?**

**A:** No, the TP Regulations apply only to transactions between connected taxable persons. Connected taxable persons generally include individuals and entities who share common control, management or shareholders; or individuals and entities who participate directly or indirectly in the management, control or capital of one another.

The definition of connected taxable persons under the TP regulations is wide. The regulations do not also define control. There may be connected taxable persons even where there is no shareholding.

5. **Q: How do I know if my transaction is expected to comply with the TP Regulations?**

**A:** Transactions covered include sale and purchase of goods and services; sales, purchase or lease of tangible assets; transfer,

purchase, licensing or use of intangible assets; provision of services; lending or borrowing of money; manufacturing arrangement; transactions between head office and permanent establishments (“PEs”); and any transaction which affects profit and loss of a company whether domestic or cross-border.

6. **Q: Are there any materiality thresholds in the regulations?**

**A:** There are no materiality thresholds in the TP Regulations.

7. **Q: What do the regulations say regarding safe harbour provisions?**

**A:** A taxpayer may be exempted from the documentation requirements on an application to the FIRS where the controlled transactions are priced in line with the requirements of Nigerian statutory provisions or where the prices of controlled transactions have been approved by the regulatory authorities and the FIRS. These will include approvals of fees by the National Office for Technology Acquisition and Promotion (NOTAP), Nigerian Customs Service, Central Bank of Nigeria and so on. The FIRS reserves the right to refuse an application even though the fees are approved by a regulatory agency.

8. **Q: Can I agree pricing in advance with the FIRS?**

**A:** Taxpayers can enter into an advance pricing agreements (APAs) with the FIRS in which both parties agree to the method and manner in which related party transactions will be priced for a specified future period. An APA may be entered into with the FIRS only or jointly with the competent authority of the connected taxable person. The threshold is an annual transaction value not less than N250 million (approximately USD 1.6 million). APAs will cover transactions for a maximum of 3 years subject to cancellation by either the taxpayer or the FIRS. There is no application or processing fee payable to the FIRS for APAs.

9. **Q: How will companies select the most appropriate TP methods to determine whether transactions with their related parties satisfy the arm's length principle?**

**A:** The TP Regulations do not specify any preferred method for compliance with the arms-length principle. The Regulations lists

the Comparable Uncontrolled Price method (CUP), the Resale Price Minus method (RPM), the Cost plus method (CPM), the Profit Split Method and the Transaction Net Margin Method as the methods that may be adopted by taxpayers in complying with the arms-length principle. If a company determines that all of these methods are not appropriate, it can use any other method so far as he can demonstrate that it achieves an arms-length result.

10. **Q: What if there is a group policy in place already, do we need to carry out a TP study again?**

**A:** YES. A local policy should be developed to ensure that the local company complies with the local TP requirements. As much as possible, this should be consistent with the global group policy.

11. **Q: How often should a TP document be updated?**

**A:** A TP document will usually be prepared for several years and should only be updated where there is significant change in the conditions used in the comparability analysis. However, companies should carry out a check on their TP documentation every 2 to 3 years.

12. **Q: How easily can we obtain information on comparable transactions or companies in order to benchmark our TP with related parties?**

**A:** Obtaining comparables from a local database will be quite tasking in Nigeria especially where traditional methods such as the Comparable Uncontrolled Price will be used. In reality, there may be no local database. It might be necessary to search for internal comparables or rely on foreign databases and make country specific adjustments.

The ultimate objective should be that the taxpayer can demonstrate that it has applied its best efforts in carrying out the analysis. Where traditional methods do not work, reliance can be placed on other methods such as the profit based methods.

13. **Q: How far back can the tax authorities go in requesting a TP document or assessing a TP adjustment?**

**A:** The obligation to prepare TP documentation should only apply to

transactions in the accounting period commencing after 2nd August 2012. However, the requirement to apply the arm's length principle in related party transactions has always existed in the tax laws and as such any TP adjustments may be based on this provision. When a TP adjustment is based on this provision, the tax authorities can go as far back as 6 years.

14. **Q: What is the relevance of OECD TP guidelines and UN TP manual?**

**A:** In preparing a TP document, a taxpayer may rely on the OECD TP guidelines or the UN TP manual. The TP Regulations will be applied in a manner consistent with the arm's length principle in Article 9 of the UN and OECD Model Tax Convention on Income and Capital; and the OECD Transfer Pricing Guidelines for Multi-national Enterprises and Tax Administrations. The TP regulations will override where there are inconsistencies.

15. **Q: Is there a limit to the level of fees, such as technology and trademarks that a Nigerian subsidiary can pay to its parent company abroad?**

**A:** Some of these issues are currently being addressed by certain regulatory authorities e.g. NOTAP, in respect of management fees, technical fees, royalties etc. While NOTAP thresholds may be considered as a safe harbor the approval does not guarantee acceptance for TP purposes. A matter that remains unresolved is the risk faced by those seeking to obtain foreign exchange to make payments for technical and management services based on NOTAP approval. For instance, if NOTAP approves an amount less than the approved transfer price then the shortfall could effectively be trapped in Nigeria.

16. **Q: What happens in the case of disparities between Customs import values and TP documentation?**

**A:** This has been a lingering and prevalent issue particularly in developing countries and where custom duties are handled by separate authorities. However, there are instances where reliance has been placed by the courts on customs valuations. In our experience customs do not give refunds due to a TP adjustment done by the income tax authorities. For example, a recent ruling by the tax tribunal of Korea said companies that make transfer pricing adjustments after reporting importation to customs will not be

refunded. It is important for multinationals to enter into pre-importation arrangements with the customs and tax authorities where possible to ensure they do not lose out both ways.

17. **Q: How does a multinational go about staff recharges in compliance with TP regulations?**

**A:** Where recharges represent reimbursement of cost with appropriate documentation, there is unlikely to be a TP issue. Where the recharge represents services rendered by one entity to another (with or without a mark-up) the entities will need to justify the basis for the mark-up or no mark-up.

18. **Q: Will a TP policy be useful in defending allocation of profits to a Permanent establishment (PE) and taxation on actual rather than deemed profit basis?**

**A:** Currently the FIRS taxes the PE of non residents on a deemed profit basis of 20% of income taxable at 30%. In principle, it should be possible to use a TP policy to defend the allocation of profits within an entity to an identifiable PE to support tax on actual profit basis. This should be more appropriate than the 20% deemed profit basis which is only a best of judgment estimate.

19. **Q: Does the existence of TP documentation override the need to review Uncertain Tax positions associated with those transactions?**

**A:** No. TP documents will typically reflect standards of reasonableness with respect to transfer pricing and not necessarily the likelihood of sustaining a position taken on uncertain tax issues.

20. **Q: Why is it necessary to apply the TP regulations to related parties who are both resident in Nigeria?**

**A:** Generally TP regulations are designed to address cross border related parties transactions. However, there are many instances where it will be necessary for local entities to apply the rules e.g. where one entity is under pioneer status, or a loss making entity within a profitable group, or related parties subject to tax at different rates and so on. As a result, there is merit in local groups preparing their TP policy and documentation.

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