Regulating transfer pricing mechanism for improved tax collection in Nigeria: A synoptic exposure

Yusuf Attahir Maiyaki[1], Mustapha Ibrahim[2] , Babangida Mohammed Auwal[3] , Yusuf Abdulsalam[4] and Baba Mohammed[5]

[1]*Federal Inland Revenue Service (FIRS) Abuja, Nigeria.*
[2]*Department of Taxation, Federal University Dutse, Jigawa State, Nigeria.*
[3]*Department of Accounting, Usmanu Danfodiyo Sokoto, Sokoto State, Nigeria.*
[4&5]*Department of Accountancy, Mai Idris Alooma Polytechnic, P.M.B. 1020, Geidam, Yobe State*
Email: ibraheem.moosty@gmail.com

Abstract

Nigerian government, in its quest to adopt and implement international best practice on transfer pricing, aimed at enhancing tax disclosure rules and tackling tax evasion, which largely arose from the base erosion and profit shifting, the Federal Inland Revenue Services (FIRS) introduced the new Income Tax (Transfer Pricing) Regulations, 2018. This study, therefore, examines and syntheses the regulation of Transfer Pricing (TP) for improved tax collection as well as its implication on taxpayers. The methodology adopted was a content analysis drawn from the literature and relevant regulations on the subject matter. The study concludes that the recent regulations released by the FIRS would impact positively on part of the government by creating more revenue as it blocks leakages. More interestingly, it would help in improving tax collection as a result of the stiff penalty imposed on defaulters, which may equally encourage prompts returns and increased government revenue. As a follow-up, the paper recommends that companies should establish a TP policy and align it with the regulations to make it effective. In addition, on the part of the government, the study recommends a strong institution, that is, by strengthening the FIRS with a sound vision and institutional mechanism to implement and impose the relevant provisions as deemed appropriate, devoid of corruption and window dressing.

Keywords: Transfer Pricing, Federal Inland Revenue Services, Multi-National Companies.

1.0 Introduction

Price is the rate of exchange agreed between two or more parties in a transaction. In Essential Price Theory by Elser and Schwardt (2015), considered Price as microeconomic variable and is involved practically in covering costs of production and realization of profits. In an organization, pricing is independently a decision area that pervades other major management decision areas of strategic; operational and tactical decision levels. In larger organizations with segments, divisions, sections or departments, prices are attached to the value of goods and services supplied by one segment or division to another segment or division of the same company. This is referred to as Transfer Pricing. Transfer Pricing (TP) may emerge either from intra or intercompany transactions. This type of price can affect a company Operating Profit, Return on Investment (ROI), Residual income (RI) for the affected segments of the firm and resultantly the overall tax of the organization. For a company that is wishing to reduce its expenses, tax is explicitly a heavy cost to consider (Terauoi, Kaddour, Chichti & Ben Rejeb, 2011). The tax implication of such an act is that the tax authority would always want a fair share of tax revenue accruing to the government with the expectation that the entity sustains the going concern. Hence, transfer pricing directly impacts on the taxable income of Multi-national Companies (MNCs) in the host country.

As construes by Cebreiro (2007) that TP is a subject of international taxation, it specifically constitutes an aspect of the tax policy assessment framework across the national border. As further buttressed by Oyedele (2013), TP simply refers to how related (connected, associated, dependent, or controlled) parties price goods and services, assets, intellectual properties, loans, guarantee and other commercial transactions between them. Transfer pricing becomes a topical issue of discourse among different stakeholders with varying views, for example, the taxman because the price paid for goods or services delivered or received has a direct bearing on the profits of the seller and buyer and by extension on the tax itself. Where the transaction is carried out across the border, the taxman is bothered more because any mispricing would effectively mean a shift of tax base from one jurisdiction to another or worse still, to a tax haven (Oyedele 2013).

Zubairu (2014) affirms that in recent years, TP has gained some recognition, principally on account of globalization, specialization and merger and acquisition. This recognition is matched by academic interest globally and more specifically in Nigeria in very recent times. To this effect, the pursuit of TP is meant to achieve certain global and national objectives. These dual objectives, along with another treatise, will be unfolded in this paper to juxtapose the recent and emerging trend within the Nigeria context.

2. Literature Review

The literature on TP can be viewed from two major areas of accounting. Thus, Management Accounting and Taxation. Management accounting literature has long viewed TP as an instrument for coordinating the production and sales decisions of different business segments. In essence, TP is meant to provide divisional managers with relevant information about the cost and profitability of intra-company transactions. Since performance measures for divisional managers are frequently based on the profits of the segments they manage, TP has a key resource allocation function in facilitating and incentivizing the transfer of goods and services across divisions.

The tax-oriented literature on TP views TP as how a firm can minimize its world-wide tax liability within the confines of the arms-length standard that is applicable in most countries. Although, the management accounting acknowledges the crucial tax dimension of TP, the various computation methods, namely cost-based, market based and negotiated TP ignore tax consideration.

In view of the above, since the view of the tax-oriented literature on TP is how to minimize worldwide tax liability, it is on record that the category of companies that make use of TP most extensively are the MNCs. For instance, in a Global Survey on TP carried out by Ernest & Young in 2007-2008, of 850 MNCs in 24 countries, 40 percent of the respondents identified TP as their most significant tax issue (Jonathan & Kargi, 2009).

In addition, the world trade takes place within multinational companies, TP, as suggested by the global trade index, is estimated at between $300 billion and $500 billion, and that between $100 billion and $ 150 billion of this amount are outflows from developing and emerging economies. This is quite a significant portion, considering the global trade figure that is recorded in trillions of dollars in recent years. In 2011 for instance, the global trade, according to the World Trade Organization (WTO), amounted to US Dollar 22.4 trillion.

According to Garrison & Noreen (1997), the major aim of this global engagement is, among others, minimization of taxes. However, TP strategies engaged in by these MNCs are often the exaggerated or the creative types, in their bids to minimize cost and maximize profit (Jonathan & Kargi, 2009). TP becomes exaggerated or creative when it is susceptible to abuse and manipulations. In such a scenario, TP usually results in the shifting of accounting profit by companies from high tax to low tax or above all, the tax haven environment.

Accordingly, James (2009), argues that the Creative TP strategy is also a popular avenue of misusing tax incentive. That is, by divesting the company’s profit or sales through an entity that qualifies for a tax incentive. For instance, there is a discovery in India of a company with two subsidiaries, one of which benefits from tax incentive and often record higher profit, while the other did not and often report a lower profit, indicating a diversion of profit for purpose of the incentive. Similar accounts were given recently of the activities of companies such as Starbucks, Facebook, Amazon, and Google, in the UK. (Oyedele, 2013). As a result of these trends and several others, MNCs are being pressurized worldwide by tax authorities to justify the size of their tax payments, hence the need for the Federal Inland Revenue Service (FIRS) to effectively make regulations on TP in Nigeria which motivates and forms the basis of this research as well.

2.1. **FIRS Regulations on TP in Nigeria**

In contrast to the old Regulations, which were enacted to give effect to anti-avoidance provisions contained in the existing income tax laws including; Companies Income Tax Act (CITA), Petroleum Profits Tax Act (PPTA) and Personal Income Tax Act (PITA). The new Regulations have been expanded to give effect to similar provisions in the Capital Gains Tax Act (CGTA) and the Value Added Tax Act (VATA). Generally, the Regulations empower FIRS to adjust the profits resulting from related party transactions (e.g. sale or transfer of assets, provision of services, financial arrangements, etc.) to reflect market price. The expansion in the scope of the Regulations suggests that where adjustments are made to taxpayers' profits, FIRS may consider the CGT and VAT impact of such adjustments. It is worth noting that the VAT Act does not have an express arm's length provision. However, another notable changed in the new provisions is the introduction of stiff penalty of ten million Naira (N10, 000, 000) for non-compliance by taxpayer and between ten to twenty five thousand naira (N10, 000 –N25, 000) daily as failure persist, depending on the gravity of the offenses and the number of days involved (Adu & Alabi, 2018).

Issues covered in the regulation include procurement, sales to related parties, management, and technical fees, trademark and royalty, shared cost and Loans.

The objectives of TP regulation are thus:

I. To ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activity deployed by MNCs in Nigeria, including in their transactions and dealings with the associated enterprise;

II. To provide the Nigerian authorities the tools to fight tax evasion through over and underpricing of controlled transactions between associated enterprises.

The category of persons covered in the TP regulations, tagged as "Connected Taxable Persons" are defined as individuals, permanent establishments, created head offices, subsidiaries, associates, partnerships, joint ventures, and trusts. The extent is as they participate directly or indirectly in the management, control or capital of another; or both of which have common control, management or shareholders.

Taxpayers are to prepare documentation and analysis justifying the pricing of their related party transactions within 21days of a request from the FIRS. Documentation includes details of related party transactions, pricing method, reasons for selection of TP, information on comparable, etcetera. Annual declaration on the transaction must be made on a standard form at the time of filing the annual tax returns including specific statements on whether or no documentation exists. The applicable TP methods are Comparable Uncontrolled Price Method (CUP); Resale Price Minus Method (RPM); Cost Plus Method (CPM); Profit Split Method; Transaction Net Margin Method; Any other method as prescribed by the FIRS.

All records (accounting and others) as well as data relating to any trade carried out by the taxpayer, inclusive of recorded details from which the taxpayer's returns were prepared for assessment of taxes, are to be retained for a period of 6 years from the date on which the return relevant to the last entry was made. To this end, it is sufficient to say that the TP regulation will not apply in retrospect. However, since the arm's length principle has been existing in the tax law prior to the regulation, the FIRS may have to establish that transactions undertaken by the taxpayer before the emergence of the TP regulation have been carried out at arm's length, as such conduct a back-duty audit to as far back as 6 years.

2.2 Transfer Pricing Operations in FIRS Tax Offices

i. TP Declaration Form (Initial submission and then updated as and when necessary)
ii. TP Disclosure Form (to be submitted annually)
iii. Copy of Audited Financial Statement
iv. Copy of Self-Assessment Form
v. Copy of Income Tax Schedules which contains: Tax Computation;

Capital Allowance Computation; and all Relevant Schedules.

vi. Write a covering letter for the TP returns

Note that the due date of filing TP is the same as the due date of filing annual income tax returns as provided for in the relevant tax laws.

How To File:- package all these documents together and label them "TP Returns"

Deliver them to the tax office (where CIT/PPT Returns are rendered) at the same time that the company is filing its annual income tax returns. Note that annual income tax returns shall be deemed incomplete if the TP Returns are not submitted, by connected entities, along with its interest and penalty for late returns apply.

FIRS Tax Office- Obtain acknowledgment of submission of TP Returns at the tax office. Receive returns from the taxpayer and forward to TP Division.

FIRS Transfer Pricing Division (TPD):- Receive TP returns from tax offices for processing.

Tax Offices Handling of TP Returns
From Desk:

i. Shall request for TP returns when income tax returns are presented for filling.
ii. Upon presentation of the TP returns: he/she shall take a blank "Checklist "and print the company's name, TIN and the YOA in the spaces provided.
iii. Open the package, check the contents submitted against the items on the "Checklist Form".
iv. Put a tick under "Yes", for item submitted and "No" for documents that were not submitted.
v. The officer shall print his/her name, signature, and date in the spaces provided on the checklist.
vi. The officer shall then: - stamp the documents with the "Received Stamp", append his signature and date.
vii. Acknowledge the taxpayer's copy by stamping and endorsing the copy of the letter.
viii. Take a blank file jacket and print the company's name, TIN and the relevant YOA on the front page.
ix. Staple the duly completed checklist form to the inside cover (left-hand side) of the file opened.
x. Properly insert the documents received in the file jacket
xi. Update the TP Returns Register.
xii. Forward the register of TP returns and files of TP returns that were received to TC for his attention.
xiii. The TC will: receive the files containing TP returns from the relevant officer and sign-off the TP Returns Register.
xiv. Cross-check the content of returns and counter-sign the "check-list Form"
xv. Forward the files containing the returns to the "TP Liaison Officer" who is responsible for forwarding them to the TPD.

The TCs are kindly requested to designate an officer as TP Liaison Officer.

The TP Liaison Officer will:-

Receive TP Returns Files from the TC

Record the files received in a "TP Returns Dispatch Register" maintained for that purpose.

Deliver the files to an officer of the TPD assigned to collect the files or send them by courier to the TPD.

TPD officer, on receiving the returns, signs the dispatch register.

3. Research Methodology

The methodology adopted for the study is a content analysis drawn from the literature and relevant regulations on the subject matter. Such documents include the CBN statistical bulletin and IFRS guideline on transfer pricing regulation.

4. Discussion

It is quite evident from the foregoing that the institutional mechanism of a TP regime took a long time to be in Nigeria. Prior to this time, general anti-avoidance rules have been in the extant tax laws for many years. However, several statutory provisions that gave the Nigerian tax authorities the power to make the adjustment to tax returns if transactions between connected parties are not at arm's length were not also made clear. From the TP point of view, the findings of the study suggest that the recent regulations released by the government would impact positively by creating more revenue as it blocks leakages by companies. Another interesting positive impact could be sought from the stiff penalty imposed on defaulters. This may equally encourage prompts returns thereby increase government revenue.

5. Conclusion and Recommendations

In our concluding remark, it could be asserted that in view of this, companies should establish TP policy and align it with the regulations to make it effective. In addition, the requisite structure within organizations should be put in place to cater for TP policies, documentation and reporting system for controlled transactions. The policy implication for that may compel FIRS, the need for upgrading of the currently designated division for transfer pricing to a department because TP requires the use of specialized skills, specialized database, and other tools. So also, to mitigate TP audits that take a very long time to conclude and allows for uniform standard. However, since TP present exercise at division level is carried out in conjunction with Integrated Tax Offices (ITOs)' efforts, there is a need for more collaboration in a bid to maximize corporate tax yield. Finally, the adjustment template to be employed by FIRS tax officials for TP purpose should be transparently clear and concise with a specific guide to safeguard any unscrupulous acts by the officials.

The study, therefore, recommends a strong institution, strengthened by the FIRS with a sound vision and institutional mechanism to implement and impose the relevant provisions as deem appropriate, devoid of corruption and window dressing.

References

Cebreiro, A. (2007). Tax Incentives and FDI Performance. MENA-OECD Investment Programme. 19th – 20th June 2007, Cairo.

Federal Inland Revenue Service (FIRS, 2014). Handling Transfer Pricing Returns at Tax Offices, FIRS Ttransfer Pricing Division.

Garrison, R., H. and Noreen, E., W. (1997). Managerial Accounting. New York: McGraw Hill Irvin.

James, S. (2009). Incentives and Investments: Evidence and Policy Implications. (International Finance Corporation; World Bank Group Multilateral Investment Guarantee Agency) The World Bank.

Jonathan, O., A. and Kargi, H., S. (2009). Multinational Transfer Pricing Strategies: The Ethical and Legal Implications. *Nigerian Journal of Accounting Research.* Vol. 5, No. 2, PP. 63-72.

Levenson, A., M. and Solon, B., S. (1971). Essential Price Theory. New York: Hott, Rinehart and Winston, Inc.

Oyedele, T. (2013). Transfer Pricing Regulations: Issue, Opportunities, and Challenges. Institute of Chartered Accountants of Nigeria (ICAN) 2013 Mandatory Continuous Practice Education (MCPE) Programme –Tax Practice Sector.

Elsner, W., and Schwardi, H. (2015). Critique of the neoclassical " Perfect

Market" Economy and Alternatives Price Theories. International Encyclopedia of the Social and Behavioral Sciences p457-460.

Teraoui, H., K., Chichti, A., J. and Rejeb, J. (2011). Impacts of Tax Incentives on Corporate Financial Performance: The Case of the Mechanical and Electrical Industries Sector in Tunisia. *International Journal of Economics and Finance. Vol. 3, No. 6* (Available at www. Ccsenet.Org/ijef).

Zubairu, D., A. (2014). International Taxation-transfer pricing. The Chartered Institute of Taxation of Nigeria (CITN) Special Pre-Induction Training Programme. Monday 12th – Wednesday 14th May 2014. PP. 70-87.