

Transfer Pricing Newsletter

FIRS publishes revised Transfer Pricing Regulations

KPMG in Nigeria

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The Federal Inland Revenue Service (FIRS) has released the revised Income Tax (Transfer Pricing) Regulations, 2018 (the new Regulations). The new Regulations repealed the Income Tax (Transfer Pricing) Regulations, 2012 (the old Regulations) which took effect on 2 August 2012. The new Regulations have a commencement date of 12 March 2018 and will apply to basis periods of taxpayers beginning after that date.

The significant changes in the new Regulations are as follows:

1. Penalties

The new Regulations stipulate exorbitant penalties for non-compliance. These are as follows:

Default	Penalty
Failure to submit Declaration Form within statutory deadline	₦10 million plus ₦10,000 for every day in which the failure continues.
Failure to submit updated Declaration Form to notify FIRS of changes in structure, arrangement or circumstances considered to influence connected person	₦25,000 for every day in which the failure continues
Failure to appropriately disclose controlled transactions	Higher of ₦10 million or 1% of the value of the incorrectly disclosed controlled transactions.
Incorrect disclosure of controlled transactions	₦10 million or 1% of the value of the controlled transactions incorrectly disclosed
Failure to provide Transfer Pricing (TP) documentation within the stipulated period	Higher of ₦10 million or 1% of the total value of all controlled transactions plus ₦10,000 for every day in which the failure continues.

Failure to provide other information required by the FIRS within the stipulated period

1% of the value of each controlled transactions for which information is required plus ₦10,000 for every day in which the failure continues.

2. Procurement arrangement

The new Regulations require companies to include supporting documents in respect of goods, assets, services or other item procured from unrelated parties, through a connected person, in the contemporaneous documentation. The documents include *“contracts, invoices, bills or similar documents issued by the unrelated person from whom the items originated”*.

3. Safe harbour

The new Regulations have expunged the safe harbour arrangement applicable under the old Regulations. The only pricing arrangement that can now be considered for safe harbour is in respect of those *“priced in accordance with specific guidelines that may be published by the Service for that purpose from time to time”*.

4. Connected persons

The new Regulations replace the term *“connected taxable persons”* (in the old Regulations) with *“connected persons”*. Persons are now deemed to be connected where *“one person has the ability to control or influence the other person in making financial, commercial or operational decisions, or there is a third person who has the ability to control or influence both persons in making financial, commercial or operational decisions”*.

5. Capital-rich-low-function companies

The new Regulations define a capital-rich-low function company as one which has huge equity capital but limited capacity to carry out risk management functions. Based on the new Regulations, such companies would be entitled to only risk-free returns where they do not control the financial risks associated with their funding activities. The profits or losses associated with the actual risks would be allocated to the entity(ies) carrying out the risk management functions.

6. Intra-group services and Intangibles

The new Regulations adopted the modalities provided in the Organization for Economic Cooperation and Development TP Guidelines for determining the existence of intra-group services and intangibles, and compliance with the arm's length principle.

The Regulations further specify the maximum amount that will be allowable for tax purposes in respect of "transfer of rights in an intangible, other than the alienation of an intangible". This is 5% of direct earnings before interest, tax, depreciation and amortisation (EBITDA) derived from the commercial activity in which the right was exploited.

7. TP documentation

Connected persons whose total value of controlled transactions is less than N300 million are exempt from maintaining contemporaneous documentation under the new Regulations.

8. Filing of updated TP declaration

The new Regulations specify certain trigger events for the filing of updated declaration by connected persons. These include merger and acquisition transactions involving the connected person or its parent company, and *"any other change in the structure, arrangement or circumstances of the person ... which influences whether it will be considered to be connected or not connected to another person"*. The updated declaration is to be submitted to the FIRS within six months of the end of the accounting year in which the event occurred.

Furthermore, a connected person is required to make a notification to the FIRS as part of its TP declaration, where there is a change in its directorship by way of an appointment or retirement of a director.

9. Dispute resolution

The dispute resolution mechanism has been changed under the new Regulations. Previously, a taxpayer dissatisfied with the decision of the FIRS could appeal directly to the Decision Review Panel (DRP).

However, under the new Regulations, only the Head of the TP Function (within the FIRS) has the right to refer a taxpayer's objection to the DRP.

Conclusion

As expected, the new Regulations incorporate a number of learning points from the implementation of TP in Nigeria since the issuance of the old Regulations. The tax authority has also tried to reduce the level of subjectivity in the application of the Regulations in the country.

Although the legality of the penalties stipulated by the new Regulations could be a subject of debate, the potential exposure to the penalties is expected to significantly increase the level of TP compliance in the country.

Another potentially contentious provision is the restriction of royalties that are deductible for tax purposes to 5% of EBITDA, as this is inconsistent with the provisions of the Companies Income Tax Act.

We expect to see, in the coming months, practice notes/guidelines to supplement the new Regulations and provide clarification on the implementation of different provisions.

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