

# Transfer Pricing Compliance in Nigeria and Common Pitfalls that Businesses should Avoid

## Background

Transfer Pricing (TP) in Nigeria is governed by the Income Tax (Transfer Pricing) Regulations, 2018 (TPR). The TPR provides that Related Party Transactions (RPTs) should be conducted in line with the arm's length principle and provides compliance obligations for taxpayers. The annual compliance obligations include the filing of TP returns and the preparation of contemporaneous TP documentation.

The TP documentation is a report articulating the approach and methodology undertaken by taxpayers to ensure that the RPTs carried out in that specific Financial Year (FY) satisfy the arm's length requirements. The report is expected to be prepared in line with the guidance provided in the TPR and other guidance documents.

Where the RPTs do not meet the arm's length requirements, taxpayers may be faced with additional tax assessments, penalties and interest, which can be material and affect the going concern of the business. In addition, where the compliance requirements are unmet, taxpayers are exposed to a minimum administrative penalty of N10m based on the TPR. This has resulted in TP ranking as a high-risk area for businesses in Nigeria.

In this article, we have summarized the TP compliance requirements in Nigeria and highlighted some common TP pitfalls businesses typically encounter and suggested mitigating measures.

## Transfer Pricing Compliance Obligations

- **Arm's Length Requirement:** Regulation (4) of the TPR provides that when taxpayers transact with their related parties, they must ensure that such transactions are conducted in a manner consistent with the arm's length principle. This implies that the terms of a RPT should be comparable to the terms applicable between independent parties

conducting comparable transactions under similar circumstances.

- **Filing of Annual TP Returns:** Regulation (13) and (14) of the TPR requires taxpayers to file annual TP returns with the Federal Inland Revenue Service (FIRS). This filing involves the submission of a declaration form, a disclosure form and other financial/tax information relating to the year of filing.

The declaration form contains details of the ownership, management and nature of relationship of a company and its related parties. The disclosure form discloses details of the RPTs carried out by the taxpayer in the FY. It also indicates the value and TP methodology adopted in analysing the RPTs.

The TPR stipulates administrative penalty for not filing TP returns and/or inadequate returns.

- **Contemporaneous TP Documentation:** Regulation (16) of the TPR requires taxpayers to have in place a TP documentation at most six (6) months after the end of the FY. The documentation gives an in-depth analysis of the RPTs disclosed in the TP returns, showing the functions performed, assets utilized and risk assumed by the parties. It also includes the economic analysis, which demonstrates that the RPTs were carried out in a manner similar to comparable independent companies operating under comparable circumstances.

Where a taxpayer's total value of RPTs in a FY is less than N300m, they may choose not to prepare a documentation contemporaneously. However, upon receipt of a request by the FIRS, the taxpayer has 90 days to prepare and submit it to the FIRS.

Due to the nature of the TP documentation and the information contained therein, it is the first line of defense for the taxpayer during a TP audit exercise.

- **Record Keeping:** The TPR requires taxpayers to keep the TP documentation and supporting documents which should be sufficient to demonstrate compliance of the RPTs with the TPR. These documents should be kept for a minimum of six fiscal year.

### Common TP Pitfalls and Mitigating Measures

- **Misalignments of substance and form:** The general accounting principle of substance over form applies to TP. Where there is an RPT, there is the need for the substance of the transaction to align with the form of that transaction. Where substance and form are different, the substance will take precedence over the form.

This is most important in the event of a TP audit where taxpayers are faced with the risk of total disallowance of the transaction where there is no substance to them, or the risk of additional liability where the substance materially differs from the form.

Thus, measures should be taken to ensure that the substance and form of the RPT agree. The TP documentation should be prepared by giving more weight to the substance of the transaction rather than the form. A detailed functional analysis interview with key process owners, specific to the RPTs can help in achieving this.

- **Not recognizing TP as a major business risk:** From our experience, the appreciation of TP risk among businesses in Nigeria is average. Taxpayers fail to recognize the inherent risk in not adhering to the provisions of the TP regulations.

Arguably, TP is one of the riskiest areas of taxation in Nigeria today. This is largely due to the issues with the application of the arm's length principle in pricing RPTs. The aggressiveness of the FIRS and the potential huge adjustment and assessments from TP audits. In addition, the introduction of TP administrative penalties means that taxpayers are now faced with huge potential payment for failure to comply with the TP provisions.

In view of this, taxpayers are advised to give much importance to the TP aspect of their businesses, these risks should be analysed from an advisory and compliance perspective. Where possible, TP risks should be included in the risk register of businesses, mitigating responses documented and tracked to ensure that the risks do not crystallize.

- **Not Engaging TP Expert:** With constant changes and update being made in the TP space globally, taxpayers are struggling to comprehend TP and the potential implications for their businesses. As such, there is need for taxpayers to engage consultants and practitioners who are more experienced and exposed to the field of TP and are better positioned to guide with TP strategy implementation and provide compliance support.

Failure to engage expert to provide adequate advice may result in future liability for the business stemming from inadequate application of TP concepts. TP experts are also better positioned to guide businesses on how to comply with the various TP obligations in a manner that will not expose the business to administrative penalties.

More important, is the role a TP expert will play in articulating and defending the TP position of the taxpayer during a TP audit exercise. The significance of this can be seen from the only TP judgement in Nigeria, Prime Plastichem Nigeria Limited Vs FIRS ruled by the Tax Appeal Tribunal (TAT). In this judgement, the absence of a TP

expert witness to articulate the TP issues clearly to the Judges resulted in huge additional liability to the taxpayer.

- **Insufficient or inadequate records/documentations to backup TP claim:**

When conducting RPTs, taxpayers often fail to ensure that proper documentary evidence needed to support the nature and conduct of the RPTs are kept.

In preparing the TP documentation, having carried out a robust TP analysis, it is important that taxpayers keep adequate information about comparable data used in the analysis of their RPTs.

The TP regime in Nigeria requires a contemporaneous analysis where RPTs are analysed with the relevant economic and business data at the instance of the RPTs. These information sources may change over time due to comparable companies marketing drive or change in business objects.

It is therefore important that sufficient evidence to demonstrate that the comparable data used for TP analysis where actually comparable contemporaneously. Where these evidences are not kept, FIRS might disallow the analysis in its entirety and rely on a new set of analysis giving a new set of result and as such, leading to TP liability in the event of an audit.

It is worthy of note that section 15 (6) of the FIRS establishment Act, 2007 (FIRSEA) and regulation 16(10) of the TPR place the burden of proof on the taxpayer. Thus, it is the duty and obligation of the taxpayers to provide adequate documentary evidence to back up the position taken in the TP documentation. In addition, the TPR stipulates a huge administrative penalty for failure to provide documents or information as requested by the FIRS. In the event that no sufficient documentary evidence is provided to support TP claims, the

FIRS will make adjustment based on reasonable assessment (Based-Of-Judgement) on each of the RPTs, which may result in a huge liability for the business.

## Conclusion

It is no more news that TP risks are real and in recent times, are crystallizing in Nigeria following drive for TP audit by the FIRS. As such, businesses are advised to be more proactive with addressing their TP issues, push as much as possible tax efficiency and in doing so, achieve full compliance with the TPR.

In the bid to maximise value for shareholders using TP, the act of mitigating the potential risks are embedded in the correct understanding of these common pitfalls and how to avoid them.

*For more enquiry, contact our tax team:*



**Aliu Yesufu**  
Partner, Tax

234 (0) 803 311 4535  
[aliu@nexianigeria.com](mailto:aliu@nexianigeria.com)



**Mathew Agada**  
Senior Manager, Tax

234 (0) 703 7419 350  
[mathew@nexianigeria.com](mailto:mathew@nexianigeria.com)