BREAKING THE GROUND FOR THE TRANSFER PRICING JURISPRUDENCE IN THE NIGERIAN TAX LAW: PRIME PLASTICHEM V. FEDERAL INLAND REVENUE SERVICE

Introduction

Transfer Pricing (**TP**) in Nigeria entered a new phase of its development when the Tax Appeal Tribunal (**TAT**) on the 19th February 2020 (**TAT**) delivered its judgment in the case of Prime Plastichem Nigeria Limited v. Federal Inland Revenue Service[1] (the **PPNL case**); making it the first and the only decided case on TP in Nigeria. This decision confirms that globalization has forced development and changes in the world's trading system which has led to the predominance of cross-border transactions and complex business structures. Given this, multinationals constantly devise new means to enhance their profits and adopt methods such as TP to reduce tax costs.

TP is by itself not illegal, however, it becomes abusive or illegal when the related parties distort the price of a transaction to reduce their taxable income.[2] The focus on TP by the tax authorities in Nigeria is relatively new, and in like manner, estimates vary as to how much tax revenue is lost by governments due to transfer mispricing.[3]

This paper will examine the state of the TP jurisprudence in Nigeria particularly in relation to the ground-breaking decision of the TAT in the PPNL case. It also considers the role the TAT has to play in the development of Nigeria's TP jurisprudence and concludes by urging the key stakeholders (TAT, Companies, and the FIRS) to display expertise and understanding of TP to develop Nigeria's TP jurisprudence.

Background: Transfer Pricing Framework in Nigeria

In simple terms, TP is the value attached to the sale of goods and services between related parties. There is TP when two or more entities that are part of the same multinational company trade the supply of tangibles and intangibles.[4] It is not unusual for the prices at which transactions are carried out between related parties to be comparatively lower than the prices at which they are carried out

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1 Unreported Appeal No. TAT/LZ/CIT/015/2017

2 Transfer Pricing in the Mining Sector: Preventing the Loss of Income Tax Revenue, 2016 (Natural Resource Governance Institute)

3 Transfer Pricing, 'Tax Justice Network' available at < https://www.taxjustice.net/topics/corporate-tax/transfer-pricing/> accessed on 19/08/20.

4 Ibid.

with non-related parties. The price of the transaction with the non-related party is the arm's length price and this forms the basis of the TP system because it is expected that the transaction between related parties should be completed at the arm's length price. To ensure conformity with this arm's length principle, different countries, Nigeria inclusive, enact laws that would regulate the TP regime.

The Nigerian TP Regime

TP system in Nigeria is regulated by the Companies Income Tax Act[5] (**CITA**), and the Income Tax (Transfer Pricing) Regulations[6] (The **TP Regulations**) which was made pursuant to the Federal Inland Revenue Service (Establishment) Act[7] (The **FIRSEA**). One of the purposes of the TP Regulation is to provide taxable persons with the certainty of transfer pricing treatment in Nigeria.[8] The TP Regulations require that the transactions to which the Regulations apply must be consistent with the arm's length principle.[9] Additionally, the TP Regulations provide that a controlled transaction is at arm's length if the conditions of the transaction do not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances.[10]

In other to ensure that transactions between related parties are priced at arm's length, the TP Regulations requires a connected taxable person to record in writing, sufficient information, with an analysis of the data showing that controlled transactions between related parties are priced at arm's length. It further requires the TP documentation to be in place before the due date for filing tax returns for the year in which the documented transaction occurred, and the documentation is to be submitted to the Federal Inland Revenue Service (**FIRS**) within twenty-one (21) days of a request by the FIRS.

Additionally, the TP Regulations impose a disclosure requirement on companies such that they are to disclose their related party transaction at the point of filing its income tax returns as well as prepare and maintain TP documentation on an annual basis. Where any connected taxable person fails to make the required disclosure, such entity will be liable to an administrative penalty of Ten Million Naira (NGN10,000,000) or one (1) percent of the value of the undisclosed related party transaction.

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5 Chapter 21 Laws of the Federation of Nigeria
6 The Income Tax (Transfer Pricing) Regulations 2018.
7 2007
8 Reg. 2(e)
9 Reg.4(1)
10 Reg. 4(2)

In terms of the shape and form of documentation, the TP Regulations enumerate the methods that may be adopted in determining whether a transaction is consistent with the arm's length principle. These methods are the Comparable Uncontrolled Price (**CUP**) method; the Resale Price Method; the Cost Plus Method; the Transactional Net Margin Method (**TNMM**); the Transactional Profit Split Method;[11] or any other method which may be prescribed by Regulations made by the FIRS from time to time.[12] The FIRS is also empowered to make adjustments to a TP Documentation where a connected person fails to comply with the provisions of the TP Regulations.[13]

The TP Regulations provides that its provisions shall be applied in a manner consistent with the United Nations Practical Manual on Transfer Pricing ('**The UN Manual**')[14] and the Organisation of Economic Corporation and Development (Transfer Pricing) Guidelines as, 2017 (the **OECD Guideline**). This applicability is however subject to the supremacy of relevant tax laws provision in section 19 of the TP Regulations. It provides that where any inconsistency exists between the provisions of any applicable law, rules, regulations, the UN Manual, and the OECD Guideline, the provisions of the relevant tax laws shall prevail. The TP Regulations shall also prevail in the event of inconsistency with other regulatory authorities' approval.[15] Also, the FIRS has the power to set up a Decision Review Panel ('**DRP**') to resolve any dispute or controversy arising from the application of the provisions of the TP Regulations.[16] In other words, taxpayers can apply to the DRP for the review of TP adjustments made by the FIRS. The decision of the DRP on any adjustment or assessment represents the final position of the FIRS without limiting the taxpayer's right of appeal contained in the relevant tax legislation.[17]

The PPNL Case: The Ground-breaking Transfer Pricing Judgment:

Summary of Facts

PPNL is a private limited liability company which engages in the business of trading in imported plastics and petrochemicals. In the 2013 Financial Year (FY), PPNL adopted the CUP[18] Transfer

11 Reg. 5 (1) (i-v)
12 Reg. 5 (2).
13 Regulation 4(3)
14 2013; now 2017
15 Reg. 19 (2)
16 Reg. 21
17 Reg. 21 (8).
18 The CUP method sets out to compare the price charged for transactions or services transferred in the transaction between related parties with a similar transaction between unrelated parties.

Pricing Method in determining whether the pricing of its transaction with a related company, Vinmar Overseas Limited **(VOL)** was at arm's length. In 2014 however, the PPNL adopted the TNMM[19] and not the CUP due to lack of comparable data since VOL did not transact with any third party in Nigeria.

Upon assessing the TP Documentation filed by the FIRS, and the request for additional documents which PPNL supplied, FIRS disregarded the CUP method and applied the TNMM to both 2013 and 2014 FYs. In applying the TNMM, FIRS used the Gross Profit Margin ('GPM') as its base for calculating the Profit Level Indicator ('PLI') rather than the Net Profit Margin/EBIT ('NPM')[20] applied by PPNL. Consequent to this, FIRS served PPNL with an additional assessment of NGN1.74 billion[21] which PPNL objected to. The FIRS subsequently issued a Notice of Refusal to Amend ('NORA') on PPNL and dissatisfied with the NORA, PPNL appealed to the TAT.

The TAT, after hearing both parties' arguments resolved all issues in favour of the FIRS and dismissed the appeal of PPNL in its entirety. An analysis of some of the core issues before the TAT in arriving at its decision is carried out below.

Analysis

The review under this heading will be based on three (3) focal areas which will be discussed in seriatim.

Issue 1: The appropriate TP Methodology

PPNL argued that it adopted the CUP method in 2013 due to the availability of comparable internal data of VOL who engaged in a similar transaction with third parties in Nigeria. PPNL argued further that the company opted for the TNMM in the 2014 FY because of the unavailability of such comparable data. The FIRS, on the other hand, argued that PPNL failed to supply sufficient documentation to justify the use of CUP methodology in 2013. Also, that, PPNL's attempt at using different methods to similar transactions runs contrary to the consistency principle[22]. The TAT, for no other reason than those espoused by the Respondent, held that the action taken by the FIRS was in line with the Transfer Pricing Regulations and the OECD Guidelines.

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19 The TNMM on the other hand sets out to examine the net profit margin relative to an appropriate base like costs, sales and assets that a taxpayer realises from a controlled transaction.

20 Earnings before interest and tax.

21 ₦1, 738,481,875.33.

22 It connotes an expectation that a taxpayer would not use different pricing methods to similar transactions carried out with the same related party on similar terms.

My Take: The TAT seems to have agreed with the argument of the FIRS that the TNMM is in line with the OECD Guidelines without proper scrutiny of the said Guidelines.

While the OECD Guidelines are relevant under the TP Regulations and can be relied upon by the FIRS, it is however not the case that the FIRS properly applied the OECD Guidelines. According to the OECD Guidelines which for the most, formed the fulcrum of the FIRS' argument, the Traditional transaction methods[23] such as the CUP are regarded as the most direct methods[24] of establishing whether commercial and financial relations are at arm's length.[25] The OECD Guidelines provide that where the CUP method and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred. This is the more proper argument for PPNL which casts doubt on the approach of the FIRS in using the TNMM. Although PPNL argued that it supplied FIRS all the required documents to show that there was a reliable comparable data for the use of the CUP method in 2013, FIRS still based its review of the 2013 FY on the TNMM. The FIRS also failed to consider the provision of the TP Regulations that provides that the FIRS shall when examining whether a taxpayer's controlled transaction is at arm's length, base its review on the transfer pricing method used by the taxpayer if such method is appropriate to the transaction.[26] Given that the CUP was prima facie appropriate, it is difficult to see what the FIRS and indeed the TAT took a different view and relief on the TNMM where there was sufficient data to make the CUP method the most appropriate.

The FIRS also argued in rejecting the CUP method for the 2013 FY that there was a lack of consistency in the methods used. It took the view that TP methods should be consistent in the absence of change in functional analysis. This view is jaundiced because the facts clearly show that whilst there was a comparable uncontrolled transaction in 2013, no such transaction existed in 2014. The functional analysis had changed, and thus, not giving way to the requirement of consistency. Additionally, the FIRS failed to consider the provision of the TP Regulations which provides that the most appropriate TP method shall be used while taking into account the respective strengths and weaknesses of the transfer pricing method in the circumstances of the case. In the circumstances of the 2013 transaction, the CUP method was the most appropriate given the availability of comparable data. The consistency principle argument canvassed by the FIRS is faulty given that the circumstances

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23 Comparable Uncontrolled Price Method, Resale Price Method, Cost Plus Method.

24 As it compares the price in an RPT (transfer price) against the price obtainable among independent parties (market price) under similar circumstances, with adjustments carried out to increase the reliability of the comparable where necessary.

25 Para. 2.3.

26 Regulation 5(3).

of the transaction in 2013 and 2014 must be considered before a method will be applied.

Issue 2: The appropriate Profit Level Indicator (PLI) for the TNMM

The TAT held that the only point of divergence between PPNL and FIRS was the appropriateness of using Net Profit Margin (**NPM**) or Gross Profit Margin (**GPM**) as the PLI. PPNL averred that the use of GPM by the FIRS as its PLI is not supported by any law or prevailing practice. The FIRS contended however that, the use of the GPM instead of the NPM was to eliminate factors that may introduce distortions arising from different incomes and costs. Further, the FIRS argued that the use of the GPM is in line with best practice. Unfortunately, the Tribunal was persuaded by the argument of the FIRS on GPM being in line with best practices.

My Take: in this regard, it is apparent that the TAT lacked a proper appreciation of the use of GPM as PLI.

The FIRS having adopted the TNMM ought to have applied the method appropriately. Just as the name connotes, TNMM examines the net profit relative to an appropriate base such as costs, sales, or assets that a taxpayer realizes from a controlled transaction. The OECD Guidelines and the UN Manual heavily relied on by the FIRS clearly provide that the TNMM involves a comparison of NPM rather than the GPM. It, however, seems unclear how the FIRS and by extension the TAT arrived at the GPM as the PLI for the TNMM and it is even more questionable how the FIRS took the view that the use of GPM as the PLI for TNMM is in line with best practices.

Issue 3: The Validity of FIRS' Imposed Penalty and Interest

PPNL argued that it had observed full compliance and had filed its returns in time and accurately such that the imposition of interest and penalty was moot. The Respondent on the other hand contended that PPNL having failed woefully in paying its tax liability which had become due, may be issued with an administrative assessment. This administrative assessment, according to the FIRS, includes penalties and interests imposed for failure to pay accurately and which begins to count from the time the tax returns became due. The FIRS relied on Section 55 and 77 of CITA[27], Regulation 4(2) of the TP Regulations[28],

and Section 32 of the FIRSEA[29]. The TAT held that the import of these provisions

[27] Companies Income Tax Act, 2007
[28] The Income Tax (Transfer Pricing) Regulations 2012.
[29] Federal Inland Revenue Services Establishment Act, 2007.

is that the FIRS has the power to disregard the TP method adopted by the taxpayer provided due regard is made to Regulation 5(2) of the TP Regulations and impose penalties enshrined in the relevant tax laws for failure to file their returns and pay as at when due.

My Take: This decision runs contrary to several earlier decisions[30]by the TAT and casts further uncertainty as to what the true position is as regards when interest and penalties begin to count where there is a default in compliance with tax obligation.

While I agree with the Tribunal that the FIRS can disregard the TP method adopted by the company provided it complies with Regulation 5(2), it is unclear what the Tribunal's rationale when it held that the FIRS could impose penalties and interest upon the assessment in this case.

The TAT did not make any pronouncement on when interest and penalties would begin to accrue after an assessment is made by the FIRS. It referred to Regulation 4(2) of the TP Regulations allows the FIRS to make the necessary adjustments where a person fails to comply with the provisions of the TP Regulations, and section 32 of the FIRSEA prescribes the penalties and interest on tax not paid when due; Section 77 (2) of CITA specifies that a tax charged by an assessment which is not a subject of an objection or an appeal shall be payable within two months after service of such notice on the company, and interest and penalties accrue after payment is not made within that period.[31] The proper conclusion flowing from these provisions ought to be that interest and penalties accrue when tax is not paid in line with section 32 of the FIRSEA or when after an assessment by the FIRS, no objection is raised within 30 days or no payment made within 2 months of the service of the Notice of Assessment. In any of these cases, the assessment will be deemed to be final and conclusive.

The TAT in Weatherford v. FIRS[32] gave credence to this provision and held that interest and penalties on overdue tax start to run when the taxpayer does not object within the stipulated period or appeal within two months.[33] PPNL, in this case, objected to the assessment within the time limit and thus should not have incurred any liability for interest and penalty.

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30 Weatherford v FIRS and Tetrapark v. FIRS.

31 See section 77(2) of CITA.

32 Appeal No: TAT/LZ/013/2014

33 Similarly in Tetrapark West Africa Limited v. FIRS[33] where one of the issues before the Court relates to the computation of penalties and interests when additional assessments or demand notices have been raised on a taxpayer. The TAT referred to Section 13 of the 5th Schedule [33] and held that the computation of penalties and interests only arise when the assessment or demand notices have become final and conclusive.

Thus, in the absence of an objection/appeal by PPNL, the Company would have had two months within which to pay the additional tax. However, since an objection was raised and an appeal was filed appropriately, penalties and interests cannot accrue until the final determination of the appeal. In other words, collection of the tax due and any penalty or interest that should accrue would be in abeyance until the appeal is determined.

The Role of the Tax Appeal Tribunal in Nigeria's Transfer Pricing Jurisprudence

The TAT is primarily set up under section 59 of the FIRSEA to act as an administrative Court for disputes arising from the operations of the FIRSEA and other legislation administered by the Federal Inland Revenue Service (FIRS) as set out in the First Schedule to the Act. Under this provision, the TAT is empowered to settle disputes and controversies which may arise from Companies Income Tax Act, Petroleum Profits Tax Act, Personal Income Tax Act, Capital Gains Tax Act, Value Added Tax, Stamp Duties, and other taxes and levies provided in the Taxes and Levies (Approved List for Collection) Act, as well as regulations, proclamations, and notices issued by the government as they relate to the relevant legislations.[34] It is a settled position[35] of the law that the TAT serves as the first point of call for an aggrieved person to ventilate tax assessment issues.

Having been settled that the TAT has an important role to play in being the first point of contact on tax assessment disputes under the aforementioned laws, it only becomes imperative that the TAT is well equipped with the necessary knowledge in solving knotty issues such as TP matters. The TAT's decision in PPNL v. FIRS has shown that the TAT may not, at the moment, be able to demonstrate expertise in the methods of TP concerning the dynamics of different facts before them. The failure to do this may result in the TAT resolving disputes based on incorrect representations made to it by parties. This played out in the PPNL v FIRS case where the Court agreed, incorrectly, with the FIRS that the use of the GPM when applying the TNMM is in line with global best practice and the OECD TP Guidelines.

The TAT in reaching its decision in the case of PPNL v. FIRS relied heavily on the arguments put forward by FIRS which are substantially not the correct position of the law or which are highly questionable with little or no further examination of what the position is under the relevant extant

[34] See First Schedule to the FIRS Act as well as Sections 1 & 11 of the Fifth Schedule to the FIRS Act

[35] Esso Exploration and Production Nig. Ltd & SNEPCO v. NNPC (CA/A/507/2012 delivered on 22 July 2016) and SNEPCO & 3 Ors. v. NNPC; SNEPCO v. FIRS (CA/A/208/2012 delivered on 31 August 2016)

laws. It is expected that the TAT, being a special Court, would apply more expertise than a regular Court like the Federal High Court, the Court of Appeal and the Supreme Court would in determining a TP case. At this juncture, it is not unwise for the TAT to, apart from familiarising itself with the technical aspect of TP, invite TP specialists who will act as an amicus curia for the purpose of providing a correct representation to the TAT. This is needed for the development of Nigeria's TP jurisprudence.

Conclusion

The PPNL v. FIRS is a pioneer case on Nigeria's TP system and it has not only birthed the jurisprudence of Nigeria's TP system, but it has also raised the question of whether Nigeria, especially the TAT, is ready for this development in its Tax regime. The TAT, from its decision in the case of PPNL v. FIRS, did not demonstrate a proper understanding of the TP methods given that it simply agreed with all the arguments put forward by the FIRS without digging deep into the veracity or otherwise of the arguments.

Essentially, the pioneer case is a call to Companies, tax authorities, and the TAT to know their onions on the technical matters of TP. While the TAT has a huge role to play in the development of the TP jurisprudence in Nigeria, Companies may have to ensure they employ the service of experts when complying with the TP Regulations given the statutory burden on them to show that its transactions are at arm's lengths which the PPNL was held not to have satisfied. In all, we look forward to more TP matters determined by the TAT with a display of expertise and understanding of the TP methods.

About the Author

Feyisikemi Adeagbo is smart, proactive, and confident. She has over two years' experience in Commercial Dispute Resolution and Transactions. Feyisikemi is an astute reader and writer, has a keen interest in Energy & Natural Resources Law and Tax. She is presently an Associate in the law firm of Olajide Oyewole LLP and She is excited to take up the challenges that growth/development brings in law practice presents.