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PRACTITIONERS' CORNER

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Johnson Ngila Mutuku is a manager with Tax, Regulatory and People Services for KPMG Advisory Services in Lagos. E-mail: johnson.mutuku@ng.kpmg.com

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Safe harbors are music to the ears of many tax practitioners and taxpayers in the transfer pricing world. When Nigeria's Federal Inland Revenue Service (FIRS) published the transfer pricing regulations, taxpayers celebrated the inclusion of safe harbor provisions. Unfortunately, those celebrations were premature. The safe harbor in the transfer pricing regulations might not be as safe as many thought.

A safe harbor is a statutory provision that applies to a given category of taxpayers or transactions and that relieves them from specific obligations otherwise imposed by the tax legislation by substituting for those obligations exceptional — and usually simpler — options.

The Nigerian Safe Harbor Provisions

The Nigerian transfer pricing regulations provide for a safe harbor under Regulation 15. The regulation provides that a connected taxable person would be exempt from the requirements of Regulation 6 (transfer pricing documentation) if the controlled transactions (those with related entities) are priced in accordance with the requirements of Nigerian statutory provisions, or the prices of connected transactions have been approved by other government regulatory agencies or authorities established under Nigerian law, and deemed by the FIRS to be at arm's length.

Other necessary and valid regulatory approvals in the transfer pricing regulations are those issued by the National Office for Technology Acquisition and Promotion (NOTAP), the Department of Petroleum Resources (DPR), the Nigerian National Petroleum Corp. (NNPC), and any other such regulatory authorities or bodies.

The Benefits of Safe Harbors

Ideally, the major benefits of safe harbor provisions are administrative simplicity for the tax authorities, and relief from onerous documentation requirements and certainty in pricing intercompany transactions for the taxpayer.

It is commendable that the FIRS implemented a safe harbor to ease transfer pricing administrative burdens. That is uncommon in other African tax jurisdictions. While the FIRS understands the spirit of the safe harbor provisions in the transfer pricing regulations, a critical analysis of the letter of the provisions reveals otherwise. Taxpayers may not be safe from transfer pricing risks under a safe harbor arrangement. Therefore, any celebrations are short-lived.

Critical Analysis

Section 15(a) of the transfer pricing regulations provides for exemption from the documentation requirements if the controlled transactions are priced in accordance with Nigerian statutory provisions. What exactly are these provisions, and are there any taxpayers who will qualify for the safe harbor? The answers will depend on the taxpayers' specific circumstances. Some of the statutory provisions that will be relevant are the DPR's directives on the minimum prices of oil products. (The DPR is in charge of the statutory supervision and control duties in the oil industry.) The directives would relieve oil marketers from justifying that the pricing of oil products is at arm's length and hence provide a safe harbor. However, the Nigerian safe harbor provisions are unilateral and thus not binding on other tax jurisdictions. Therefore, entities that are part of an international group and that purchase the oil products are still required to prove that the minimum price set by the DPR is at arm's length. The transfer pricing risk is not eliminated at the group level; hence, a safe harbor in the current form is not a prudent tool for managing group transfer pricing risks or eliminating double taxation arising from transfer pricing adjustments.

Another likely use of the safe harbor by taxpayers in Nigeria is for NOTAP approval for technical and management services. There is a convergence of objectives of the FIRS and NOTAP — in that they both want to ensure that charges to Nigerian entities are not excessive. However, there is a likely conflict in the methods used by the two agencies to arrive at the reasonable charges. Again, the taxpayer will be forced to use the accepted transfer pricing methods to prove to the FIRS that NOTAP-approved charges are at arm's length.

Part B of the safe harbor provisions states that approvals by government regulatory authorities must comply with the arm's-length rule. This makes the arm's-length principle superior to government approvals. So the question is how do you satisfy the FIRS that an intercompany transaction is at arm's length? The answer is simple: Conduct a transfer pricing study. That entails a nine-step comparability process and, as outlined in the OECD guidelines, includes:

- identification of the years to be covered;
- a broad-based analysis of the company's environment;
- an understanding of the intercompany transactions;
- a review of available internal comparables;
- the sourcing of external comparables;
- the selection of the most appropriate method;
- the identification of potential comparables;
- comparability adjustments; and
- interpretation and use of the data collected.

Unfortunately, the benefit envisaged by the safe harbor provisions has not been realized. The safe harbor should resolve the difficulty the taxpayer faces in ascertaining the arm's-length range. However, in Nigeria, the onus is still on the taxpayers to demonstrate that their safe harbor arrangement is at arm's length.

It is a case of giving with the right hand and taking with the left. There is no relief given to the taxpayer by the safe harbor provisions. This might lead taxpayers to incorrectly assume that transactions that are approved by the relevant government regulatory agencies or authorities should not be part of their transfer pricing studies and will not be subject to transfer pricing scrutiny.

The Issues of Uncertainty

I think the following are the fundamental questions that must be answered by the FIRS to avert potential transfer pricing risks and reduce the challenges facing taxpayers that rely on safe harbors:

- Should companies conduct transfer pricing studies even if they have obtained government approval, just as a double-check?
- If there is conflict in the terms approved by different government agencies relative to the transfer pricing study (under the arm's-length principle), should companies proactively make an adjustment?
- Since government approvals are used for purposes other than tax, do we envisage a situation in which different figures will be used for the same issue for different purposes?
- What is the recourse for the taxpayer when the safe harbor has been subject to adjustment in other tax jurisdictions?

The Way Forward

There could be a twofold solution. The FIRS could amend the transfer pricing regulations to remove the requirement that a safe harbor arrangement be satisfactory to the agency under the arm's-length rule. Approvals for related-party expenditures or revenue allocation by other regulatory agencies or authorities listed in the regulations (such as NOTAP, NNPC, and DPR) would thus be considered to be at arm's length and not subject to any further scrutiny by the FIRS. Alternatively, the FIRS could issue official directives answering the four fundamental questions.

The OECD recently issued revised guidelines for the formulation and implementation of safe harbors. The revisions were necessitated by some of the challenges highlighted here. It will be imperative for the FIRS to borrow from these guidelines to foster international acceptance of the Nigerian safe harbor.

Conclusion

It is the responsibility of the FIRS to ensure that the benefits envisaged at the time of the inclusion of the safe harbor provisions in the Nigerian transfer pricing regulations are realized. Therefore, the FIRS should reduce the transfer pricing compliance costs for taxpayers while also reducing its own administrative burden. Watertight safe harbor provisions will also ease the strain on the FIRS's transfer pricing resources, as the workload will be shared with other regulatory agencies or authorities. ◆