

# **TRANSFER PRICING IN NIGERIA: THE UTILITY OF ADVANCE PRICING AGREEMENTS<sup>1</sup> (APAs)<sup>2</sup>**

## **INTRODUCTION**

Nigeria introduced Transfer Pricing Regulations in August 2012. One of the innovations of the Regulations is the introduction of Advance Pricing Agreements (APAs). This discourse would, *inter alia*, examine what an APA is, the types of APAs, their relevance to both taxpayers and tax administrations, the provisions of the Nigerian Transfer Pricing Regulations relating to APAs and recommendations for best practices. However, before discussing APA, it would be necessary to succinctly define 'transfer pricing'. So, what then is 'transfer pricing'?

Different definitions have been put forward by different authors and international bodies. An apt definition would be that of Transfer Pricing Analytics which defines the concept as follows, "'transfer price' is the price at which one company buys and sells goods or services or shares resources with a related affiliate in its supply chain"<sup>3</sup>. From that definition, it is clear that transfer pricing is not a concept exclusive to taxation, however, when used in the context of international tax it connotes the artificial manipulation of internal prices within a multinational group with the intention of creating a tax advantage.<sup>4</sup> That it connotes the artificial manipulation of prices does not, without more, mean that whenever used in the context of international law transfer pricing always seeks a tax advantage. According to Tax Justice

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<sup>1</sup> The Nigerian Regulations employ the term 'Advance Pricing Agreement' as opposed to the language of the OCED Transfer Pricing Guidelines which uses the term 'Advance Pricing Arrangements'. Difference in terminology notwithstanding, the objectives of both the Advance Pricing Agreement and the Advance Pricing Arrangement are indistinguishable.

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<sup>3</sup> *What is Transfer Pricing?* < <http://www.tpanalytics.com/tp-reference/learning-resources/what-is-transfer-pricing/> > accessed on 24<sup>th</sup> March 2013

<sup>4</sup> A. Miller and L. Oats, *Principles of International Taxation* 2<sup>nd</sup> Edition, Tottel Publishing p. 303

Network, what is harmful is not transfer pricing in itself but ‘transfer mispricing’ which is ‘illegal and abusive’<sup>5</sup>.

Having defined what transfer pricing is, we return to the primary focus of this discourse. We begin by looking at the legal framework of APA, followed by APA within the Nigerian context, the benefits of APA, the definition of some technical terminologies, the roles of both the taxpayer and administration and best practices to be adopted.

## **LEGAL FRAMEWORK**

On the 2<sup>nd</sup> of August 2012, Nigeria introduced the Income Tax (Transfer Pricing) Regulations No. 1, 2012 (the Regulations).<sup>6</sup> The primary objective of the Regulations is to ensure that all related party transactions by connected taxable persons<sup>7</sup> are at arm’s length. It follows, therefore, that the Regulations adopt the arm’s length principle as expounded in Article 9 of the UN<sup>8</sup> and OECD<sup>9</sup> Model Tax Conventions on Income and Capital (OECD MTC) as well as the provisions of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Transfer Pricing Guidelines).<sup>10</sup> Therefore, in this discourse, references would frequently be made to both the OECD MTC and OCED Transfer Pricing Guidelines. What is the arm’s length principle?

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<sup>5</sup> *Transfer Pricing* [http://www.taxjustice.net/cms/front\\_content.php?idcat=139](http://www.taxjustice.net/cms/front_content.php?idcat=139) accessed on 24<sup>th</sup> March 2013. The Tax Justice Network also refers to transfer mispricing as ‘transfer pricing manipulation’ and ‘abusive transfer pricing’

<sup>6</sup> The author, in his article *Transfer in Nigeria: An Overview of the Draft Regulations* published in International Tax Report September 2012 issue examined the Draft Regulations issued by the Federal Inland Revenue Service of Nigeria (FIRS) in April 2012 and made recommendations to the FIRS on the Regulations. His recommendations were largely adopted by the FIRS in the extant Regulations however, regrettably, certain recommendations proposed by the author on Documentation in Foreign Jurisdictions and Advance Pricing Agreements were not adopted.

<sup>7</sup> A ‘connected taxable person’ is defined in Regulation 10 to include ‘persons, individuals, entities, companies, partnerships, joint ventures, trusts or associations (collectively referred to as ‘connected taxable persons’) and includes the persons referred to in (i) sections 13(2)(b), 18(2)(b) and 22(2)(b) of the Companies Income Tax Act, 2004 ... (ii) section 15(2) of the Petroleum Profit Tax Act, CAP. P13, Laws of the Federation of Nigeria, 2004... (iii) section 17(3)(b) of the Personal Income Tax Act, CAP P8, Laws of the Federation of Nigeria, 2004; (iv) Article 9 of the OCED Model Tax Convention; (v) ‘associated enterprise’ referred to (sic) the OECD Guidelines.’

<sup>8</sup> United Nations

<sup>9</sup> Organisation for Economic Cooperation and Development.

<sup>10</sup> OECD Transfer Pricing Guidelines (July 2010)

Paragraph 1 of Article 9 of the OECD MTC is the statutory expression of the arm's length principle. It provides as follows:

*Where*

- a. an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or*
- b. the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,*  
*and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.*

The arm's length principle is the international standard adopted by the OECD Member States for determining the transfer prices of related party transactions for tax purposes. It is preferred to the Global Formulary Apportionment principle.<sup>11</sup> As noted earlier, the primary aim of the Regulations is to ensure that all related party transactions are carried out at arm's length. One of the mechanisms introduced by the Regulations in furtherance of this aim is the provision of APAs.

What, then, is an APA?

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<sup>11</sup> Also known as unitary taxation. It involves dividing the total profits of a multinational group using a predetermined formula and allocating the profits to each component of the group based on the formula.

## **WHAT IS AN ADVANCE PRICING AGREEMENT?**

In the Glossary of the OECD Transfer Pricing Guidelines an Advance Pricing Arrangement is defined as:

*An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An advance pricing arrangement may be unilateral involving one tax administration and a taxpayer or multilateral involving the agreement of two or more tax administrations.*

Simply put, an APA is a contract between a taxpayer and the competent authority<sup>12</sup> of the State<sup>13</sup> in which the former is resident. Where the APA involves a taxpayer and a single competent authority (usually the competent authority of the State in which the taxpayer is resident) it is referred to as a Unilateral APA. On the other hand, where the competent authorities of more than one State are involved, it is either a Bilateral (in the case of only 2 States) or Multilateral (more than 2 States) APA.

PricewaterhouseCoopers defines an advance pricing agreement as ‘...a contract, usually for multiple years, between a taxpayer and at least one tax authority specifying the pricing method that the taxpayer will apply to its related-company transactions.’<sup>14</sup>

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<sup>12</sup> A competent authority of a State, in this context, is the tax authority of a Country. In Nigeria, it is the Federal Inland Revenue Service (FIRS). Cf the revenue services of different States within Nigeria which adopts federalism as a system of government.

<sup>13</sup> Except stated otherwise, ‘State’ in this article refers to a Sovereign as opposed to a component unit within a federation.

<sup>14</sup> <http://www.pwc.com/gx/en/tax/transfer-pricing/advance-pricing-agreements.jhtml> <accessed on 21st April, 2013>

From the definitions, it is clear that, unlike an audit, an APA is futuristic in nature because it relates to future tax years. An audit, on the other hand, relates only to previous tax years. It is to be noted, however, that in practice, an APA may, in fulfilling its primary objective, also help in resolving issues from previous tax years.

As stated earlier, an APA may be unilateral, bilateral or multilateral. A bilateral or multilateral APA is usually in the form of a Mutual Agreement Procedure APA (MAP APA) which is governed by Article 25 of a Model Tax Convention. A MAP APA applies where States have entered into Double Tax Treaty (DTT) which contains the MAP. Once an APA is reached unilaterally in one State, a MAP is activated in order to bind the competent authorities of the other Contracting State(s) in which the taxpayer carries on related party transactions.

Now let us look at the APA under the Regulations.

### **APA IN THE NIGERIAN CONTEXT**

Regulation 7 of the Nigerian Regulations provide for APAs. It is to be noted that the wording of Regulation 7 (1) raises the question as to whether the APA, as envisaged in the Nigerian context, is futuristic or retrospective. This observation is informed by the use of the phrase '*for determining whether the person has complied with the arm's length principle*'. A scrutiny of the said provision would help in elucidation. It provides thus:

*7-(1) A connected taxable person may request that the Service enter into an Advance Pricing Agreement (APA) to establish an appropriate set of criteria for determining whether the person has complied with the arm's length principle for certain future controlled transactions undertaken by the person over a fixed period of time provided*

*that such agreement shall be consistent with the requirements established by this regulation.<sup>15</sup>*

The underlined phrase, appears, at first glance, to mean that the taxpayer has already carried out a related party transaction. If this were the case, then the purpose of an APA is defeated. However, in order to give effect to the Regulations as a whole, regulation 7 should be read and interpreted in accordance with the OECD Transfer Pricing Guidelines. This is because regulation 11 (b) of the Regulations provides as follows:

*11. Subject to the provisions of regulation 12 of these Regulations, this regulation shall be applied in a manner consistent with-*

*(a)....*

*(b) the OECD Transfer Pricing Guidelines for Multi-National Enterprises and Tax Administrations approved by the Council of the OECD approved publication on 22 July, 2010 (otherwise referred to as 'Annex I to C (2010) 99') as may be supplemented and updated from time to time.*

It is for this reason that, despite the ambiguous phrase contained in regulation 7, the regulation should be read in a manner consistent with the OECD Transfer Pricing Guidelines. Therefore, since the APA as defined by the OECD is futuristic in nature, regulation 7 should also be interpreted as being futuristic. More so regulation 12 deals with inconsistency between the provisions of relevant tax laws<sup>16</sup> and other 'applicable laws, rules, regulations, the UN Practical Manual on Transfer Pricing, the OECD documents referred to in regulation 11' and not inconsistencies between the Regulations and the OECD Guidelines.

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<sup>15</sup> Underlining supplied for emphasis

<sup>16</sup> 'other relevant tax laws' as defined in regulation 19 includes 'Companies Income Tax Act, Petroleum Profit Tax Act, Capital Gains Act, Stamp Duties Act, Personal Income Act and Value Added Tax.'

## **WHAT ARE THE BENEFITS OF APAs?**

The benefits of APA hereunder listed are in contradistinction with other dispute resolution mechanisms. The list is inexhaustible.

- An APA, by predetermining the appropriate set of criteria to be applied to certain controlled transactions, ensures certainty of tax. This helps the taxpayer adequately plan its budget. When tax is certain, a company can allocate resources to other aspects of the business.<sup>17</sup>
- APA eliminates the risk of double taxation. In the case of bilateral or multilateral APAs, the acceptance, by the competent authorities, of one Contracting State(s), of a unilateral APA concluded by another Contracting State usually resolves the problem of double taxation.
- APA could be a supplement to other dispute resolution mechanisms.
- It also reduces the incidences of disputes which would otherwise have arisen in an audit. Because it is futuristic, potential disputes are quickly identified and promptly resolved during negotiations culminating the APA.
- APA reduces recourse to litigation. A taxpayer avoids all the shortcomings of litigation, to wit, the legal fees, drawn out litigation, and uncertainty of the result of litigation.
- Many jurisdictions do not impose any fee upon application for an APA, therefore, in terms of monetary cost, APAs could be relatively cheaper than other dispute resolution mechanisms.
- Once a request for APA is made and finalised, a taxpayer need not comply with onerous documentation requirements because during the

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<sup>17</sup> See [www.transferpricing.com](http://www.transferpricing.com) on the benefits of APA from a Canadian point of view.

negotiations resulting in an APA, certain documentation requirements are met and once an APA is agreed, all the taxpayer needs do is fill a compliance report, usually in a prescribed form. This satisfies documentation requirements in many jurisdictions.

- At the expiration of an APA, same can be renewed. This ensures cooperation, certainty of tax and trust on the part of both taxpayer and competent authority and reduced compliance cost for the taxpayer.
- As a result of the complexity of an APA, experts, to wit, economists, lawyers, auditors are, from the onset, involved in a case. Therefore as soon as a dispute arises such can be nipped in the bud hence providing a more efficient and effective mechanism of dealing with disputes.
- An APA, although generally forward looking can, at times, help to resolve disputes which had previously arisen in an audit.

These are but some of the benefits of an APA. Having highlighted some, we would look at some of the technical terms employed under an APA process.

### **SOME TECHNICAL TERMINOLOGIES**

#### **WHAT IS AN 'APPROPRIATE SET OF CRITERIA'?**

Regulation 7 provides that '*a connected taxable person may request that the Service enter into an Advance Pricing Agreement (APA) to **establish an appropriate set of criteria** for determining....*' A taxpayer may ask what an 'appropriate set of criteria' means or what amounts to 'an appropriate set of criteria'.

An appropriate set of criteria are the indices that come into play in determining whether a related party transaction would be at arm's length. They include but are not limited to:

- a) a functional analysis of the transaction including the functions performed, assets used and risks assumed (FAR),
- b) industry analysis including data on comparables; both internal and external,
- c) the proposed transfer pricing methodology and details of same, including justification / data that the proposed method would reflect arm's length prices,
- d) critical assumptions – these are the underlying conditions on which the APA would be entered into and founded upon, and;
- e) any other documentation which may support the taxpayer's request for an APA or specifically requested by the FIRS. Such may include but are not limited to the period of years in which the APA may be applicable, the organisational structure of the taxpayer and its related parties, the type of transaction to be submitted to APA amongst others.

Examples of these criteria are listed out in regulation 7 (2). They form the basis upon which negotiation is conducted during the APA process.

### **WHAT ARE 'CRITICAL ASSUMPTIONS'?**

Critical assumptions are the fundamental terms upon which both the taxpayer and the tax administration enter into an APA, breach or change of which entitles the innocent party to cancel or revoke the APA. They are the representations made by either party to the other, the belief on which they agree to enter into an APA. The assumptions would vary depending on the transaction and the appropriate set of criteria in question. The significance of the critical assumptions cannot be glossed over given the fact that either party can cancel or revoke an APA when there is a misrepresentation as to the

existence of a critical assumption or breach of one of the terms upon which an assumption is founded or a change in the structure of the controlled transaction or tax law. In this wise, regulation 7 (8) and (9) give both parties the right to cancel an APA in the case of a breach or change in any of the critical assumptions.

Regulation 7 (8) and (9) are akin to a material adverse clause<sup>18</sup> and because of their importance, critical assumptions should be properly drafted to guarantee the success of the APA. Regulation (8) and (9) provide as follows:

*(8) The Service may cancel an Advance Pricing Agreement by notice if –*

*(a) the connected taxable person has failed to materially comply with a fundamental term of the Advance Pricing Agreement;*

*(b) there has been a material breach of one or more of the critical assumptions underlying the Advance Pricing Agreement;*

*(c) there is a change in the tax law that is materially relevant to the Advance Pricing Agreement; or*

*(d) the Advance Pricing Agreement was entered into based on a misrepresentation, mistake or omission by the connected taxable person.*

*(9) A connected taxable person may cancel an Advance Pricing Agreement by a notice given to the Service where –*

*(a) there is a material change in the premise upon which the advance pricing request was made;*

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<sup>18</sup> A Material Adverse Change Clause (MAC) is a clause usually inserted in a contract with the effect that a party is relieved of his obligations under the contract upon the occurrence of an event which alters the conditions upon which the parties contracted.

*(b) the Advance Pricing Agreement is no longer relevant based on significant changes to the structure of the controlled transaction; or*

*(c) there is a change in tax law applicable in the jurisdiction of the controlled transaction that is materially relevant to the Advance Pricing Agreement.*

Both taxpayer and administrations are expected to abide by the terms of the contract and fulfil their obligations thereunder. In the event of a change in or a breach of the critical assumptions the innocent party should be promptly notified of such change or breach. Timely disclosure allows the innocent party to cancel the APA or helps both parties re-negotiate the APA based on the revised critical assumptions.

Although the Regulations do not expressly provide for revision of an APA, it is suggested that a material adverse change need not always result in the cancellation or revocation of an APA. Parties are advised to explore the option of revising an APA, if feasible, based on the revised critical assumption before opting for an outright cancellation or revocation. A guiding principle in revising an APA is that parties (the taxpayers and administrators) should ask themselves whether independent parties transacting at arm's length would be willing to renegotiate a contract where there is a change, of a similar nature, in the terms of a contract. If the answer is in the affirmative, then a revision should be explored. It is also suggested that the date of any revised APA should be the date in which the revised APA was executed.

Examples of critical assumptions would include assumptions as to:

- (a) the functions performed, assets used and risks assumed (exchange rate, market, reputational risks) by the parties to be bound by the APA,
- (b) exchange rates, interest rates, capital structure and credit ratings,

- (c) market conditions, price and volume of trade,
- (d) the state of domestic law including tax laws and other legislation that may have a bearing on the controlled transaction,
- (e) foreign tax laws and the laws of other States that may have a bearing on the controlled transaction,
- (f) other governmental regulation, import and export duties, tariffs; and
- (g) any other fact or condition; economic or otherwise of the taxpayer, administration or any third party that may substantially affect an APA if there was a change in such fact or condition.

Since they form the basis on which parties agree to enter in the APA, critical assumptions should be explicitly stated in advance and included in the terms of the APA so that parties are at ad idem at the time of contracting.

From the standpoint of the fact that an APA is a contract, an innocent party may have a cause of action in the High Courts for its breach.

### **WHO IS ELIGIBLE FOR AN APA?**

Under the Regulations<sup>19</sup>, a connected taxable person<sup>20</sup> is eligible to request for an APA provided 'the cumulative amount resulting from the transaction in every year of assessment (sic) not less than N250,000,000 (Two Hundred and Fifty Million Naira) of a connected taxable person's total deductible costs or total taxable revenues'.

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<sup>19</sup> Regulation 7 (2) (d)

<sup>20</sup> See n. 7

## **WHAT IS THE SCOPE AND TIMEFRAME OF AN APA?**

It is presumed that any type of related party transactions, whether cross border or within the Nigeria,<sup>21</sup> falls within the scope of an APA. Regulation 3 provides that the scope of an APA includes sale and purchase of goods and services, transfer, sale and licensing of intangibles, financial services and all transactions which affect the profit and loss of the taxpayer in question. In other jurisdictions, an APA would be most suited for complex controlled transactions with high transfer pricing risk<sup>22</sup>.

The Regulations are silent as to the period of time it would take to conclude an APA from the time a formal request is received. The likely reason for this may be because of the diverse issues that may arise in an APA with the result that it may be difficult to project a timeframe. It is however advised that a period be fixed and allowances be made for extension of time to conclude an APA. Costs may be imposed where a taxpayer is not diligent in pursuing the APA. This suggestion is made against the backdrop that the FIRS does not impose any fee for requesting an APA. A period of 12 – 18 months would be ideal with the possibility of extensions in the event it involves the competent authorities of other States.

The life span of an APA is, however, stipulated to be three years.<sup>23</sup> There are no provisions for renewals of an APA, nonetheless, it is suggested that where an APA is successfully executed, it may be renewed by consent of all contracting parties.

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<sup>21</sup> Nigeria is made up of 36 States including a Federal Capital Territory.

<sup>22</sup> Some jurisdictions categorize transactions in accordance with their level of complexity and apply the relevant APA to resolve issues raised thereunder in simple, standard or complex APAs.

<sup>23</sup> Regulation 7 (7)

## **PREPARATION FOR AN APA – WHAT THE TAXPAYER SHOULD DO**

In making a formal application for an APA, the taxpayer must make sure that its *house is in order*, otherwise the FIRS may, as empowered by regulation 7 (3), reject the request. The taxpayer is expected to have competent transfer pricing personnel who would be responsible for the following:

- (a) maintaining documentation: this cannot be over emphasized because the documents presented to the FIRS constitute the case of the taxpayer justifying the reasons why the FIRS should enter into an APA with it and upon terms favourable to it,
- (b) ensuring that documentation is robust: it is not enough to maintain documents; documents must be robust. All intercompany agreements, data on comparables and necessary adjustments and any document that supports the taxpayer's position must be in place,
- (c) deciding what documents should be shared with the FIRS,
- (d) making sure that the documentation and transfer pricing policy are in consonance with economic / commercial reality,
- (e) in the case of bilateral or multilateral APAs, ensure that the taxpayer and its related party present a consistent case to the relevant competent authorities,
- (f) in the event documentation is maintained in a foreign language and or in a foreign jurisdiction, translation should be carried out,<sup>24</sup>

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<sup>24</sup> Regulation 17 provides that official language for maintaining documents is English

(g) ensure that the taxpayer adheres to its own commitments under the mutual expectations,<sup>25</sup>

(h) have a contingent plan in the event APA is not successful. This includes anticipated litigation.

These are the basics. This list is by no means inexhaustible. The above are only meant to act as a guide to the taxpayer as the strategy to be adopted are dependent on the facts and circumstances of each case.

The documents to be submitted are also dependent on the type of transaction and in some cases, the type of APA.

### **PREPARATION FOR AN APA – WHAT THE FIRS SHOULD DO**

The FIRS is also saddled with certain responsibilities in attaining the success of an APA, chief of which is introducing APA Guidelines. Although the Nigerian Regulations provide the framework of an APA, they are silent on the practice directives, to wit,

(a) how to lodge a request and whom to address it to,

(b) the time frame within which to conclude an APA,

(c) the team of professionals who would enter into negotiations with the taxpayer,

(d) the APA case plan and the scheduling,

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<sup>25</sup> Mutual expectations are the duties the taxpayer and tax administration owe to one another during the APA. They are a characteristic of the cooperative nature of the APA. The primary duty of the taxpayer is to disclose all relevant documentation and or information to the FIRS.

- (e) the types of APA – whether different *modus operandi* would apply to different situations depending on the complexity of the APA,<sup>26</sup>
- (f) making sure there are provisions for renewal of an APA,
- (g) looking at the possibility of entering bilateral / multilateral APAs with competent authorities who are yet to enter DTT with Nigeria,
- (h) expanding its treaty network, that is, entering into DTT with more countries,
- (i) establishing the different stages of the APA process,<sup>27</sup>
- (j) making provisions for appeals at every stage of the APA process or at the end of an APA,
- (k) providing a framework for dealing with collateral issues<sup>28</sup>
- (l) endeavours to fulfil its own commitments under the mutual expectations<sup>29</sup>

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<sup>26</sup> In Australia, APAs are split into 3 categories, to wit simple, standard and complex APAs depending on the complexity of the transaction.

<sup>27</sup> Most jurisdictions have stages ranging from pre-filing/pre-lodging to conclusion of the APA. This helps to sift eligible from illegible APAs.

<sup>28</sup> A Collateral Issue is an issue which is separate from a controlled transaction but equally important as it may have a bearing on the transaction and APA. It could be a treaty, tax or regulatory or administrative issue.

<sup>29</sup> The FIRS' commitments include providing guidance on APA process, having an APA case plan, ensuring discussions with competent authority of contracting States, providing an appeal process, maintaining open dialogue, keeping sensitive information confidential, provide framework for dealing with collateral issues etc.

## **WHAT A CONCLUDED APA SHOULD CONTAIN**

Although there are no general rules, a concluded APA should contain the following information:

- (a) the identities and place of business of the taxpayer and the related parties,
- (b) the transfer pricing methodology to be adopted,
- (c) the profit level indicator,
- (d) the number of years that the APA would be applicable for,
- (e) the critical assumptions, mutual expectations and any collateral issues
- (f) an arm's length range; if applicable,
- (g) a definition of the terms to be adopted in the APA, and
- (h) the process of dealing with compensating adjustments.<sup>30</sup>

It should be noted that this list is not exhaustive as the contents of a concluded APA would depend on the facts and circumstances of each case. For example for transactions involving intangibles or financial instruments different items would be included in the APA.

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<sup>30</sup> Compensating adjustments are discussed under the sub-head 'POST APA – WHAT NEXT?' below.

## **POST APA – WHAT NEXT?**

Once an APA has been concluded, it becomes necessary for the FIRS to ensure that the taxpayer has honoured its obligations under the APA. How is this achieved? Along with filing its annual returns, a taxpayer must file an Annual Compliance Report (ACR) for each year of the APA containing sufficient information showing the actual results of the APA and demonstrating compliance with the APA. By so doing, the FIRS is assured of the compliance of the taxpayer to the APA. It is expected that the ACR would be accompanied by supporting documents which include the audited financial statements of the taxpayer and all other documents which would demonstrate compliance with the APA. The ACR aids the FIRS in carrying out audits in respect of the years in which the APA was applicable.

Another aspect of post APA which has been mentioned earlier is renewals of an APA. The FIRS should provide the opportunity for renewal of an APA once it has been successfully concluded and run its course. The cost for such renewals is presumed to be minimal considering the fact that most of the criteria, critical assumptions, mutual expectations and collateral issues have already been negotiated. Renewals also provide the opportunity of perfecting the previous APA in the event there were minor irregularities. It is to be noted that the consent of all parties must be sought and obtained before an APA is renewed; any such renewal must be done timeously so that it can take effect upon the expiration of the earlier one.

A question which is bound to arise at the post APA stage is, '[W]hat happens where the actual results of a controlled transaction differ from the expected projections under the APA?' For this purpose, an APA contemplates the use of compensating adjustments. A compensating adjustment is defined by the OECD Transfer Pricing Guidelines as:

*An adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer's opinion, an arm's length price for a*

*controlled transaction, even though this price differs from the amount actually charged between the associated enterprises...*<sup>31</sup>

Transfer pricing is not an exact science therefore actual results may differ from the expected results and when this occurs, compensating adjustments are made to harmonise the actual results with the APA.

A compensating adjustment is made to bring the actual results of a controlled transaction within the range of the APA. An APA prescribes the range, point or result to which a compensating adjustment should be made in so far as the difference in the actual and expected results is within the critical assumptions.

It is to be noted that the Nigerian Regulations do not make provisions for the compensating adjustments, nonetheless, recourse should be made to the OECD Transfer Pricing Guidelines as contemplated in regulation 11 (b). How can this be adopted within the Nigerian context?

Under an APA, the transfer pricing methodology is agreed upon between the taxpayer and the tax administration as well as the expected returns to be made by the taxpayer under the controlled transaction [(the expected returns is usually within a range i.e. between X% (the higher boundary) and XX% (the lower boundary)]. The profit level indicator is also agreed upon (for example earnings before interest and taxes – the EBIT margin). Now, in the event the actual EBIT falls below the lower range (X%), it means that the taxpayer has earned less than contemplated under the APA (a shortfall). Therefore, tax imposed on the taxpayer should be revised to reflect the reduced earnings.

The revised tax to be imposed acknowledges the shortfall as equal to the difference between the actual EBIT margin and X% (the lower boundary) in that year of the APA. The same also applies to a situation where the actual EBIT is in excess of the upper range (XX%), the taxpayer has earned more than anticipated under the APA. The tax has to be revised upwards in order to

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<sup>31</sup> Ibid n. 10

reflect the conditions imposed in the APA. In this case the excess is equal to the difference between the taxpayer's actual EBIT margin and XX% (the upper boundary) in that year.

## **CONCLUSION**

It is to be noted that because the Regulations are barely 9 months old there is yet to be any reported concluded APA between a taxpayer and the FIRS. It is for this reason that the FIRS is expected to promote APAs by enlightening taxpayers on the benefits of entering into an APA. Entering into APAs ensures that taxes are remitted promptly, reduces tedious audit exercises and prevents the adversarial nature of litigation or audit process. It is therefore hoped that the use of APAs is encouraged amongst all stakeholders.