Nigeria's Tax Appeal Tribunal (TAT) Issues First Transfer Pricing (TP) Judgment

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Background

Prime Plastichem Nigeria Ltd (PPNL) trades in imported plastics and petrochemicals. In 2013, PPNL applied the Comparable Uncontrolled Price (CUP) method in evaluating the arm's length nature of its purchase of petrochemical products from its offshore related party, Vinmar Overseas Limited (VOL). However, in 2014, it applied the Transactional Net Margin Method (TNMM) for the same purpose.

In 2016, the FIRS reviewed the company's TP affairs and issued an assessment of **₦1.74 billion (circa USD5.7m)** including penalty and interest. The FIRS disregarded the CUP analysis applied in 2013 and applied the TNMM for both 2013 and 2014. The FIRS and the company disagreed on the right profit level indicator (PLI) to be adopted in applying the TNMM and the comparables selected in the TNMM analysis. The parties also disagreed on the applicability of penalties and interest and whether the Decision Review Panel (DRP) which took the final decision on the FIRS' position had been properly constituted.

PPNL's argument

PPNL argued that the FIRS was wrong to dismiss its use of the CUP method in 2013 (as well as the benchmarking analysis performed under the TNMM in 2014) without providing a justification for doing so. The company also put forward the position that the right PLI to be used in applying the TNMM was the Operating profit margin. The company challenged the role of the DRP and argued that it was not properly constituted and the effect was that the company was denied a fair hearing.

FIRS' argument

The FIRS argued that PPNL did not provide sufficient and reliable information to allow it accept the CUP analysis performed for 2013. It argued that in the circumstances the TNMM with the Gross Profit Margin (GPM) as PLI was the most appropriate method to be applied for both the 2013 and 2014 financial years. The FIRS insisted that interest and penalties had been properly assessed since PPNL had failed to pay the correct amount of taxes at the time of filing its income tax returns. The FIRS posited that the DRP had been properly set up and PPNL had been duly invited. The FIRS also asserted that PPNL provided inconsistent information on different occasions during the proceedings.

TAT's decision

The TAT accepted the FIRS' arguments and ruled that:

1. PPNL had not satisfied the required burden of proof to allow the TAT rule in its favour.

2. The TNMM was the right method as PPNL did not provide reliable information to allow the FIRS evaluate the appropriateness of the CUP method for 2013. Further, the taxpayer had been inconsistent in applying the TP methods and had also stated that the CUP was applied in error in 2013.

3. The GPM was the right PLI to be applied in the circumstances since it was the profit indicator that was directly impacted by the intercompany transaction. It agreed with the FIRS' assertion that this was in line with global best practice.

4. FIRS can impose the penalties enshrined in the law for failure to pay the relevant taxes as and when due.

5. The DRP had been properly constituted by the FIRS.

Analysis and takeaway

On the rejection of CUP method, the lesson is that taxpayers must provide sufficient information to support any positions taken on TP matters. The TAT's decision suggests that the burden of proof is on the taxpayer to demonstrate that their position is correct and not for the FIRS to disprove it.

On the other hand the TAT seems to have accepted many of FIRS' assertions regarding the provisions of the OECD and UN TP guidelines without a robust independent analysis to identify where such assertions were clearly incorrect. For example it is not correct that the GPM is a recognised PLI for the application of the TNMM. It is also not correct that the FIRS' application of the TNMM is in line with global best practice.

The decision on penalties and interest contradicts a previous decision by the TAT which was to the effect that penalties and interest would only apply to undisputed tax assessments. These conflicting decisions create further uncertainty for taxpayers who must now wait for the decision of a superior court on the matter.

Also, it appears that the TAT's decision was influenced by inconsistencies in the submissions made by the taxpayer at different times. The implication of this is that taxpayers must take all interactions with the FIRS seriously and ensure that the correct information is provided at all times by people with the right level of knowledge and information on TP policies.

Conclusion

TP issues are now top priority for the FIRS. It is expected that more disputes will arise, some of which will go all the way to the courts. This decision shows that the TAT will struggle to appreciate some of the TP concepts that many sophisticated taxpayers take for granted. Taxpayers who must go to the TAT should ensure that their arguments are not only technically sound but also persuasive and easy for the TAT to understand.

For a deeper discussion, please contact any member of our **Tax Dispute Resolution team** below or your usual contact within PwC Nigeria:

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