TRANSFER PRICING PRACTICES AND TAX REVENUE IN NIGERIA.

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Abstract

In this opinion paper, attempts were made to discuss the topic "transfer pricing practices and tax revenue in Nigeria." This paper introduced tax as the major source of revenue to the government as it recognizes that in fulfilling its social contract to the citizenry, government must generate enough tax revenue. Under review of related literature, the paper covers the arm's length principle (theory). The choice of the theory is premised on the ground that it provides the foundation upon which the concepts of the study were discussed. The concepts discussed in this paper include tax revenue, company income tax, petroleum profit tax, transfer pricing, methods of transfer pricing, the Nigerian transfer pricing laws and regulations. Several relevant and empirical literature were also reviewed under the heading "transfer Pricing and Tax Revenue Generation." Finally, the paper concluded that there is a negative relationship between transfer pricing practices and tax revenue generated by government. The paper, therefore, recommended that government should put in place adequate and appropriate transfer pricing laws and regulations to check transfer pricing abuses which will in turn impact positively on the tax revenue generated by government.

Keywords: Transfer pricing, multinational corporation, Tax revenue, company income tax, petroleum profit tax, social contract, arm's length principle.

Introduction

Governments around the world are into some sort of social contract with the citizenry and to fulfill the terms of this contract, every government and at different levels makes efforts to generate revenue. Among the major sources of revenue government pursue is tax revenue. The word 'tax' is derived from a Latin word 'Taxare'. When translated to English, means to estimate or value. In the words of Amaechina (1998) cited in Akinbobola (2021), tax is a levy which a government imposes on the income of the citizens or corporations in a state for which the government gives no direct benefit to the taxpayer. In other words, there is no *quid pro quo* (something for something) in tax payment. Tax therefore refers to a compulsory payment imposed by the government through its agents on the income of individuals and corporate entities as well as on goods and services for the purpose of raising funds to execute government programs and projects.

Tax is raised through the instrumentality of taxation. According to Adejuwon, (2008), taxation is a system of imposing compulsory levies by the government on the income of the individuals and companies either directly or indirectly for the purpose of generating revenue, redistributing such revenue generated from the surplus to deficit sector of the economy and providing social amenities for the benefit of the entire populace. It is pertinent to point out at this juncture that taxation is different from tax. While the latter pertains to the amount imposed, the former relates to the system of collecting the taxes.

A tax system refers to the interaction among the tax policies, tax administration and tax laws for the purpose of generating revenue for the government. It is these three pillars that constitute a country's tax system. The foundation of these three pillars is the tax policy. It is a general statement of intention that guides the thinking and actions of the various tax stakeholders towards the achievement of the tax objectives. Tax administration, refers to the relevant tax authorities charged with the responsibility of administering the tax law in a country. For instance, in Nigeria, the taxation of a corporation is exclusively administered by the Federal Board of Inland Revenue Service (FBIRS). The tax law by which every tax must be backed, represents the various legal instruments put in place to ensure the achievement of the tax policy. It also includes the principles, rules and regulations with which the government guide and check tax stakeholders' activities and practices including transfer pricing practices (TPP).

Transfer Pricing (TP) by all standards is a coherent business practice where inter-related companies transact under the arm's length principle (ALP). According to Cebreiro (2007), TP is a subject of international taxation, it specifically constitutes an aspect of the tax policy assessment framework across the national borders. Similarly, Oyedele (2013) assert that TP simply refers to how related (connected, associated, dependent, or controlled) parties price goods and services, assets, intellectual properties, loans, guarantee and other commercial transactions between them. Transfer pricing has become a topical issue of discourse among different stakeholders with varying views, for example, the taxman, because the price paid for goods or services delivered or received has a direct bearing on the profits of the seller and buyer and by extension on the tax itself. Where the transaction is carried out across the borders, the RTA is bothered more because any mispricing would effectively mean a shift of tax base from one jurisdiction to another or worse still, to a tax haven (Oyedele 2013).
To this extent, TP is suspicious. Through TP abuse, Multinational Companies (MNCs) move their profits offshore, leaving behind a dwindling tax base in their host countries by exploiting mismatch between tax jurisdictions (Vijayakumar, 2016). For example, selling goods or services to subsidiaries in low-tax areas at a reduced price resulted in low revenues for the high-tax area companies and high revenues and profits in the low tax jurisdiction. Wong et al. (2011) posit that the tax authority of the subsidiary will not complain about this abuse because of the tax revenue accruing to them whereas the parent company will consider it unacceptable.

Nigeria, a host to some of the MNCs in the world, has continued to experience a significant loss in revenue through transfer pricing techniques. For instance, MTN in 2013 set aside N11.398 billion and paid to MTN Dubai. Similarly, MTN confirmed it made unauthorized payments of N37.6 billion to MTN Dubai between 2010 and 2013 (Maya, 2015). These transfers out of Nigeria through a sophisticated tax planning strategy impacted on tax revenue generated by Nigeria in the aforesaid fiscal periods.
Worried by this development, the Nigerian government in line with the Organisation for Economic Co-operation and Development (OECD) TP Guidelines, and the United Nations TP Manual, rolled out several laws and regulations to check the abuses of TP. Among which are the Income Tax (Transfer Pricing). Regulations 2012, which was replaced by the Income Tax (Transfer Pricing) Regulations 2018. The aim among other is to increase the revenue base of the government by blocking loopholes and bringing more taxpayers into the tax net (Income Tax (Transfer Pricing) Regulations, 2018).

This paper introduced tax as the major source of revenue to the government as it recognizes that in fulfilling its social contract to the citizenry, government must generate enough tax revenue. Under review of related literature, the paper covers the arm's length principle (theory). The choice of the theory is premised on the ground that it provides the foundation upon which the concepts of the study were discussed. The concepts discussed in this paper include tax revenue, company income tax, petroleum profit tax, transfer pricing, methods of transfer pricing, the Nigerian transfer pricing laws and regulations. Several relevant and empirical literature were also reviewed under the heading “transfer Pricing and Tax Revenue Generation.” Finally, the paper concluded that there is a negative relationship between transfer pricing practices and tax revenue generated by government. The paper, therefore, recommended that government should put in place adequate and appropriate transfer pricing laws and regulations to check transfer pricing abuses which will in turn impact positively on the tax revenue generated by government.

REVIEW OF RELATED LITERATURE

THEORETICAL FRAMEWORK

Theoretical framework is relevant to a study because it provides the foundation upon which the study is carried out. It helps define and explain the relevant concepts to the study. Therefore, the relevant theory to the study is the arm’s length principle (theory).

The Arm’s Length Principle (Theory)

Transfer pricing is governed by section 482 of the Internal Revenue Code. Section 482 highlights the “Arm’s Length” principle as follows: In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm’s length with an uncontrolled taxpayer. A controlled transaction meets the arm’s length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm’s length result).

Conceptual Review

Tax Revenue

Revenue represents any kind of income to an entity. In the case of government, revenue constitutes all kind of funds generated by government to prosecute its projects and programs. The various sources of revenue to the government include loans, penalties, fines, donations, fees, royalties, proceeds from sales government properties and taxes. Tax is a levy which a government imposes on the income of the citizens or corporations in a state for which the government gives no direct benefit to the taxpayer (Amaechina, 1998 cited in Akinbobola, 2021). Tax revenue therefore is the total amount of revenue generated from the tax imposed. It is a product of two tax components. That is, tax base and tax rate. It is derived thus: tax revenue = tax base * tax rate. Tax base is the object on which tax is charged or imposed (e.g, the income of the taxpayer) while the tax rate is the proportion of the tax base that is payable as tax to the government. It is expressed as a percentage of the tax base and fixed by the tax law backing the tax (e.g, currently, the rate of VAT is 7.5%).The amount of tax revenue generated can be affected by the rate of tax compliance which in turn can be influenced by TP. Tax revenue is raised from different types of taxes. They include petroleum profit tax, capital gain tax, personal income tax and company income tax.

Company Income Tax

This is the tax on the income/profit of companies that operate in the country except those in upstream sector of petroleum operation. This tax is also backed and regulated by the Company Income Tax Act C21 LFN 2004 as amended. Before this present Act (CITA 2004), there were several other Acts that regulated the assessment and collection procedure of company income tax including the Company

Income Tax Act (CITA) 1961 which applies in relation to all companies in Nigeria as from 1st April, 1961. This was repealed and replaced by Company Income Tax Act 1977. This was also repealed and replaced by Company Income Tax Act 1990. Other acts that also affect the administration of the company income tax are the Finance Acts. The latest being the Finance Act of 2021 that was recently passed into law.

Company income tax is applied at the rate of 30% on the chargeable profit of companies other than those in crude oil or gas production.

It is relatively easy to collect as a result of government persistence on the submission of tax certificates in respect of any official responsibility from administration by corporations. This tends to promote obedience. However, the administration of companies' income tax in Nigeria does not measure up to appropriate standards. This has given rise to several abuses. If good old tests of equity, certainty, convenience and administrative efficiency are applied, Nigeria will score low considering the following points: due to poor monitoring, people in the self-employed and unquoted private companies group evade tax (Osho, Efuntade & Jemiseeye, 2020). It is one of the major sources of tax revenue to the government. It is administered by the Federal government through its revenue agency, FIRS.

Petroleum Profit Tax

This is tax on the income/profit of companies engaged in crude oil or gas production. This tax is backed and regulated by the Petroleum Profit Tax Act Cap P13 LFN 2004 as amended. Petroleum profit tax is charge at the rate of 85% on the chargeable profit of companies into crude oil or gas operations. It is one of the major sources of tax revenue to the government. It is administered by the Federal government through FIRS.

Transfer Pricing (TP)

Transfer pricing (TP) in the general sense is the process of establishing the in-house prices (so-called transfer prices), where goods, services, money and other assets are transferred from one business unit to another, as well as the following calculation of the financial result of each business unit inconsideration of these transfer prices. Sometimes these operations are not carried out directly between units, but via special intermediary units (transfer centres) (Fields & Mais, 2004) Because of divergent proliferation of national rules, controversies concerning transfer pricing between fiscal authorities of different countries shall enhance, leading to the unwanted situation of double taxation of multinational companies, which may concern huge amounts of money. Through transfer pricing – used and invoiced prices between the companies within the same multinational company – the multinationals actually determine where they generate value and what the proper amount of taxes is for each of the involved countries. So, fiscal authorities undertake periodical checking to make sure these internal agreements regarding prices are adequate (Kim & Lu, 2011).

Methods of Transfer Pricing

Transfer pricing can be carried out through several methods. According to Okoye (2011), transfer pricing methods can be grouped into three categories: cost-based, market-based and negotiated. While maintaining a different view, Choi and Mueller (1992) identified four categories: comparable uncontrolled, resale, costplus and other pricing methods. Meanwhile, Ezejelue (2008) classified two broad groups: traditional transaction methods and profit methods. These methods aim to maximize the profit and optimize the performance of MNC members or transaction enterprises.

The Nigerian Transfer Pricing Laws and Regulations

The key principle of transfer pricing is based on the arm's length rule which means that pricing term between related firms or companies in the exchange of goods and services should realize the same results as if they were unrelated. Furthermore, related companies must act as if they were unrelated. The purpose of this requirement is to ensure that profit which should be liable to domestic tax does not become a gain to another country to which profit is shifted. Tax on transaction between related companies is provided in Nigerian tax laws elucidated in section 13 (2) (d) Companies Income Tax Act (CITA) laws of the federation 2004. Similarly, section 11 (2) (d) of the Nigerian Tax Law of 1990 cited in (Onyeukwu, 2007) in a nutshell explains that:

(i) The profits of a foreign company in Nigeria from any trade or business are deemed to be gotten from Nigeria.

(ii) Where transactions between the companies are deemed fictitious, the profit can be adjusted by the tax board to reflect arm's length transaction. Section 18 of the Nigerian Tax Law of 1990 clarifies on the meaning of artificial transaction as follows:

Where the tax authority is of opinion that a transaction is fictitious or would reduce tax payable by a company, it is required that such disposition should be adjusted and liable to tax as considers appropriate without ostracizing companies involved in the fictitious transaction. This suggests that the tax authority is conferred with the onus of making adjustments where the internal pricing system of the related parties do not reflect the open market prices.

In a nutshell, the implication of the aforementioned sections of the Nigeria laws is that the issue of determining transfer pricing with regards to Nigeria is a subjective judgment by the tax authority and makes adjustment to capture the arm's length treatment of intercompany transactions if it will instigate threats to taxation. In Nigeria, some factors which can trigger recognition of transactions between companies as being at variance with arm's length principle and may in turn forces tax authority to subjective judgments.

Other regulations by the government in line with the Organisation for Economic Co-operation and Development (OECD) TP Guidelines, and the United Nations TP Manual, intended to check the abuse of TP include the Income Tax (Transfer Pricing). Regulations 2012, which was replaced by the Income Tax (Transfer Pricing) Regulations 2018. The aim among other is to increase the revenue base of the government by blocking loopholes and bringing more taxpayers into the tax net.

Empirical Review

Several empirical studies have been carried out on transfer pricing and tax revenue.

Transfer Pricing and Tax Revenue Generation

Ovie, Eniola and Lateef (2022) investigated the impact of transfer pricing on revenue generation and debt profile in Nigeria. The study aimed at examining the impact of transfer pricing on revenue generation and debt profile in Nigeria. Other objectives of this paper are to review the adequacy of the transfer pricing regulations regarding revenue generation, as well as the debt profile. It uses a qualitative research methodology relying on document review for analysis and interpretation to give more insight into transfer pricing regulation in Nigeria. Findings showed that the revised transfer pricing regulations pose some challenges that should be looked at, and also that debt servicing has denied Nigeria infrastructural development. The study recommended that the Federal Inland Revenue Service should issue a statement for clarity of purpose to avoid conflict that may arise from implementing transfer pricing regulations 2018, and also, for debt/revenue ratio to be analyse before loans are taken.

Osho, Efuntade and Jemiseye (2020) carried out an investigation on the impact of taxation on transfer pricing in Nigeria economy. This study aimed to examine the impact of taxation on transfer pricing in Nigeria economy. To achieve this objective, the study used Augmented Dickey Fuller (ADF) Unit root test and Johansen co integration econometric tools to determine the order integration and the long run relationship among the variables. This time period was considered long enough to establish a causality relationship between the study variables, whereas, the availability of data relevant for the study was also a justification for determining this time period. The data were sourced from the of Central Bank of Nigeria (CBN), Statistical Bulletin Office of the Federal Inland Revenue Services (FIRS), Federal Inland Revenue Service (FIRS), World Bank Statistical Bulletin and Annual Abstract of Statistics from the National Bureau of Statistics (NBS). Findings revealed that company income tax and personal income tax have negative impact on transfer pricing in Nigeria. In addition to this, the result provides attention (warning) for the government to be more careful in every tax policy that affects the tax expense of companies in Nigeria. It was recommended that, the tangible benefits should be greater than the risk received given that any slight increase/decrease in tax expense could have a considerable effect on the decline/increase in transfer pricing rates in Nigeria.

Yusuf, Mustapha, Babangida, Yusuf and Baba (2020) conducted an investigation into regulating transfer pricing mechanism for improved tax collection in Nigeria: a synoptic exposure. This study examines and syntheses the regulation of Transfer Pricing (TP) for improved tax collection as well as its implication on taxpayers. The methodology adopted was a content analysis drawn from the literature and relevant regulations on the subject matter. The study concludes that the recent regulations released by the FIRS would impact positively on part of the government by creating more revenue as it blocks leakages. More interestingly, it would help in improving tax collection as a result of the stiff penalty imposed on defaulters, which may equally encourage prompts returns and increased government revenue. As a follow-up, the paper recommends that companies should establish a TP policy and align it with the regulations to make it effective. In addition, on the part of the government, the study recommends a strong institution, that is, by strengthening the FIRS with a sound vision and institutional mechanism to implement and impose the relevant provisions as deemed appropriate, devoid of corruption and window dressing

Conclusion

This paper concluded that government should continue to add more impetus in the path it is towing by putting in place and implementing adequate and appropriate tax laws and regulations in line with the OECD Guidelines and the UN Manual to tackle transfer pricing abuses by Multinationals. This will bring in more taxpayers known as connected persons into the tax net and by extension expand the tax base and tax revenue generation in the future.

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