



First transfer pricing judgment in Nigeria – *Prime Plastichem Nigeria Ltd v Federal Inland Revenue Service*

On 19 February 2020, the first judgment on transfer pricing in Nigeria was delivered by the Tax Appeal Tribunal (Tribunal) in the case of *Prime Plastichem Nigeria Ltd (Prime Plastichem) v Federal Inland Revenue Service (FIRS)*. The tax appeal was instituted by Prime Plastichem pursuant to Nigeria's Income Tax (Transfer Pricing) Regulations No 1, 2012 (TP Regulations). Prime Plastichem challenged the FIRS' imposition of additional income tax assessments on a transaction between Prime Plastichem and a related company. The additional assessments arose from the transfer pricing adjustments made by the FIRS. In these assessments, the FIRS applied a Profit Level Indicator (PLI), different from that applied by Prime Plastichem, as the appropriate method for the determination of the arm's length price applicable to the transaction in the relevant financial years. In its judgement, the Tribunal upheld the FIRS' assessment and dismissed the appeal of Prime Plastichem in its entirety.

Facts of the case

Following the commencement of the TP Regulations, Prime Plastichem, a private limited company engaged in the business of trading in imported plastics and petrochemicals, filed its TP Documentation for its 2013 and 2014 financial years (FYs) in respect of transactions with its related supplier, Vinmar Overseas Ltd (VOL). For its 2013 FY, Prime Plastichem adopted the Comparable Uncontrolled Price (CUP) TP method¹ in determining whether the pricing of its transactions with VOL meets the arm's length principle requirement prescribed by the TP Regulations. In 2014 FY, Prime Plastichem adopted the Transactional Net Margin (TNM) method² due to inability to find a comparable transaction.

The FIRS reviewed Prime Plastichem's TP Documentation and concluded that the company's comparable data for the 2013 FY did not meet the comparability requirements of the TP Regulations and the company had therefore wrongly applied the CUP method in determining its arm's

length pricing for the 2013 FY. In determining its arm's length pricing for the 2014 FY, the FIRS determined that although Prime Plastichem had correctly employed the TNM method, it had incorrectly used its Net Profit Margin instead of its Gross Profit Margin (GPM) as its PLI for the 2014 FY. The FIRS therefore made TP adjustments to the transactions in both FYs and raised an additional assessment of ₦1,738,481,875.33. Prime Plastichem objected to the additional assessment which the FIRS dismissed with its Notice of Refusal to Amend (NORA). Dissatisfied with the decision of the FIRS, Prime Plastichem filed an appeal at the Tribunal challenging the imposition of the additional assessments and demand notices issued by the FIRS.

The appeal

Prime Plastichem submitted five issues to the Tribunal for determination. It appealed to the Tribunal to determine whether the FIRS' actions in benchmarking its TP transaction with the TNM methods and using the GPM for the 2013 and 2014 FYs were valid and in accordance with the TP Regulations and the Organization for Economic and Development/United Nations Transfer Pricing Guidelines 2010 (OECD and UN Guidelines). It also sought the Tribunal's determination on whether the FIRS was correct in its imposition of penalty and interests and whether the Decision Review Panel (DRP) purportedly set up by the FIRS was in accordance with the TP Regulations.

Parties' submissions

Prime Plastichem submitted that it had duly filed its TP Documentation, which reflected the company's adoption of the CUP and TNM methods for its 2013 and 2014 FY TP assessments, respectively, with the FIRS and that the FIRS had responded by affirming the company's adoption of the CUP method as the appropriate transfer pricing methodology for the 2013

FY. The company therefore argued that its adoption of the CUP method was in accordance with the provisions of para 5(3) of the TP Regulations. The company also explained that it opted for the TNM method for its 2014 FY assessment due to a lack of comparative data upon which to base a CUP assessment (as VOL did not transact with third parties in Nigeria in that year). The company therefore argued that the FIRS' attempt to apply the TNM method to the company's 2013 FY was incorrect and not in accordance with the provisions of the TP Regulations.

Prime Platichem also argued that the FIRS' use of GPM as PLI was unsupported by the TP Regulations and the OECD and UN Guidelines. It further stated that the FIRS, in establishing the DRP, was legally obligated to inform the company about its establishment. It contended that it was deprived of its right to fair hearing as it was neither informed of the establishment of the DRP nor present when the dispute was being considered.

The FIRS submitted that Prime Platichem did not need to be notified of the establishment of the DRP and should have referred the dispute to the DRP in accordance with the provisions of the TP Regulations. The FIRS also submitted that Prime Platichem erred and went against the consistency principle of the OECD and UN Guidelines when it adopted two different methods – the CUP method and the TNM method in determining its arm's length pricing for the 2013 and 2014 FYs, respectively, as different methods should not be used to test the arm's length price of a transaction with the same functional analysis.

The agency explained that Prime Platichem's adoption of the CUP method was inappropriate as the company was not able to provide sufficient and reliable comparable data to justify its adoption of the CUP method for its 2013 FY. Further, the information provided by Prime Platichem in its TP Documentation was insufficient to demonstrate that the company's pricing of its controlled transactions were at arm's length. It therefore stood by its adoption of the TNM method and its assessments for both FYs as being grounded in the provisions of the TP Regulations and the OECD and UN Guidelines.

The decision of the Tribunal

The Tribunal ruled in favour of the FIRS and decided that:

1. The FIRS' action in benchmarking Prime Platichem's TP transaction with the TNM method for both 2013 and 2014 FYs was valid and in line with the TP Regulations and the OECD Transfer Pricing Guidelines.
2. The FIRS satisfactorily proved that its use of GPM was in line with best practices and took account of the various factors enumerated by the OECD when selecting GPM as the most appropriate PLI in similar situations.
3. The FIRS is empowered by the TP Regulations to disregard the TP method adopted by the taxpayer and impose penalties enshrined in the relevant tax laws for failure to file their returns and pay the relevant taxes as and when due.
4. The contemplation of the TP Regulations is that the taxpayer may, within 30 days of the receipt of an adjusted assessment, refer the assessment to the DRP. The action to trigger filing of the appeal is the receipt of the adjusted assessment and not a formal notification from FIRS of the setting up of the DRP.

Analysis of the Tribunal's decision

Burden of proof

The Tribunal determined that Prime Platichem did not provide sufficient information to the FIRS to justify the company's adoption of the CUP method as the most appropriate method. The burden of proof of the arm's length nature of a controlled transaction is on the taxable person who will be deemed as having discharged the burden of proof if it provides documentation to support the consistency of the arm's length principle of the taxable profits derived from its comparable transactions.³

Use of different TP methods for different FYs

On the use of different TP methods by Prime Platichem, the Tribunal agreed with the position of the FIRS, that TP methods must be consistently applied from year to year where the facts are not materially different. The Tribunal, in agreeing with the FIRS however, relied on a non-existent paragraph of the OECD/UN Guidelines.⁴ The Tribunal supported its position with the provision of the United Nations Practical Manual on Transfer Pricing for Developing Countries 2013 (UN TP Manual) which provides that a method once chosen and applied, is expected to be applied in a consistent manner and any change in the TP method is typically required only if there are any changes in the facts of the transaction, functionalities of the parties to the transaction or availability of data.⁵ While Prime Platichem's claim for adopting different TP methods was due to the unavailability of data, the FIRS argued that the facts of the transaction and the functionalities of the parties to the transaction had not changed. The Tribunal, in adopting the argument of the FIRS as its position however, failed to consider the "non-availability of data" as a relevant factor to support Prime Platichem's need to change the TP method for its 2014 FY.

Applying GPM as a PLI under the TNM method

In applying the TNM method to its 2014 FY, Prime Platichem argued that the correct PLI was the Operating Profit Margin (OPM) while the FIRS argued that the GPM was the correct PLI. The Tribunal appears to have accepted the FIRS's position. Interestingly, the TP Regulations provide that the net profit margin relative to

an appropriate base, including costs, sales or assets, is to be used when applying the TNM method.⁶ If the TNM method was the right TP method to be applied as in the instant case, then the correct PLI to be applied would have been the OPM.⁷

Impact

It has been established by the TP Regulations and reinforced by the Tribunal's decision in the Prime Plastichem case that the burden of proof in a TP case is on the taxpayer. The decision also implies that a taxpayer, in making its assessment, must ensure that it consistently applies a TP method from year to year. A taxpayer appealing the decision of the FIRS on a TP assessment will need to provide sufficient information to justify any positions taken in its TP affairs. Finally, this decision may cause taxpayers, even when convinced that a different PLI is more appropriate, to default to using the GPM as a secondary check during preparation of its TP report.

Conclusion

The judgment in the Prime Plastichem case is the first judgement on TP in Nigeria and presents several lessons for multinational groups operating in Nigeria. It appears from the decision of the Tribunal that the Tribunal is not as sophisticated on TP matters. Taxpayers must therefore be prepared to argue and present their cases in a convincing manner in order to discharge the burden of proof to the satisfaction of the Tribunal as provided for by the TP Regulations. In addition, taxpayers need to ensure that TP specialists and other personnel within their organisation are involved in TP matters from the inception. This is to prevent

incorrect representations from being made to the tax authorities by persons who may not have knowledge in such matters.

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Endnotes

1. The Comparable Uncontrolled Price (CUP) method means a method in which the price charged for the property or services transferred in a controlled transaction is compared with the price charged for property or services transferred in a comparable uncontrolled transaction.
2. Transactional Net Margin (TNM) method means a method in which the net profit relative to the appropriate base, including costs, sales or assets that a person achieves in a controlled transaction, is compared with the net profit margin relative to the same basis achieved in a comparable uncontrolled transaction.
3. Paragraph 6(10) of the TP Regulations.
4. The Tribunal relied on para 29.4 of the OECD/UN Guidelines. This paragraph is non-existent.
5. Paragraph 6.1.3.3 of the United Nations Practical Manual on Transfer Pricing for Developing Countries 2013 (UN TP Manual).
6. Paragraph 19(aa) of the TP Regulations
7. Adu, S, "Insights: Lessons from Nigeria's First Tribunal Judgement on Transfer Pricing", Bloomberg Tax, <https://news.bloombergtax.com/daily-tax-report-international/insight-lessons-from-nigerias-first-tribunal-judgment-on-transfer-pricing>.
8. Brooks & Knights Legal Consultants (BKLC) is a law firm established in Lagos, Nigeria, which provides bespoke legal advisory and policy consulting services to individuals, corporates, government agencies and NGOs.

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