



FIRS Guidelines on Advance Pricing Agreements in Nigeria: Understanding the Procedures, Importance and Impacts of the Key Provisions.



Introduction

The FIRS Guidelines on Advance Pricing Agreements provide MNEs with a structured framework to reduce disputes and uncertainties in transfer pricing by establishing predetermined methodologies with tax authorities.

Transfer Pricing (TP) is often associated with contentious disputes. This is understandable, as tax audits frequently involve the uncertainty surrounding what constitutes a "fair price," especially in the absence of comparable transactions, issues of double taxation, and inconsistencies in applying the arm's length principle. To provide clarity and foster collaboration between Multinational Enterprises (MNEs) and tax authorities, the Federal Inland Revenue Service (FIRS) issued the Guidelines on Advance Pricing Agreements (the "Guidelines") on 27th November 2024.

Prior to these Guidelines, Advance Pricing Agreements (APAs) were only mentioned

in the Income Tax (Transfer Pricing) Regulations 2018 (the "2018 Regulation"), which left MNEs without clear guidance. According to the 2018 Regulation, a connected person could request to enter into an APA with the FIRS to establish criteria for evaluating compliance with the arm's length principle.

The Guidelines enhance the provisions of the 2018 Regulations by establishing a structured framework that allows taxpayers to negotiate pre-determined transfer pricing methodologies with the FIRS. These methodologies will govern proposed controlled transactions, helping MNEs and the FIRS to minimize uncertainties and build mutual trust.

What is an Advance Pricing Agreement (APA)?

An APA is an agreement between a taxpayer and tax authorities to set transfer pricing rules for controlled transactions in advance, ensuring compliance for up to three years.

APAs can be unilateral (one tax authority), bilateral (two countries), or multilateral (multiple countries). Bilateral and multilateral APAs help prevent double taxation.

An APA is an arrangement between a taxpayer(s) (MNEs, subsidiaries, and other connected persons) and a tax administration (FIRS and other international tax authorities) that determines in advance of controlled transactions, an appropriate set of criteria (e.g., transfer pricing methodology, comparable, and appropriate adjustments thereto, as well as critical assumptions as to future events) for the determination of the transfer price of those transactions that accords with the Arm's Length Principle over a fixed period based (not more than 3 years) on the fulfilment of certain terms and conditions.¹

An APA could be unilateral, bilateral, or multilateral:

- Unilateral APA:** A Unilateral APA is an arrangement between the tax authority and the taxpayer on the appropriate transfer pricing of the proposed controlled transaction. A unilateral APA does not include the participation of a tax treaty partner, and the terms of the agreement may not be accepted by the tax authority of a tax
- Bilateral APA:** A bilateral APA involves a taxpayer in Nigeria, its parent company, subsidiaries or connected persons resident in a foreign country, the FIRS, and the Competent Authority (CA) of that connected person. A bilateral APA, typically, is negotiated by the CAs of contracting parties under the Mutual Agreement Procedure (MAP) provisions of the relevant tax treaty.³
- Multilateral APA:** A multilateral APA involves a taxpayer in Nigeria, Connected persons resident in two or more foreign countries, the Revenue Service (i.e. the FIRS), and the CAs of countries of residence of those connected persons. The multilateral APA is typically concluded using the MAP provisions of the relevant tax treaties and negotiated by the CAs of the relevant jurisdictions.⁴

What is a Mutual Agreement Procedure (MAP)?

A MAP is an agreement between Nigeria and another country for the avoidance or elimination of double taxation for taxes on income and to prevent tax evasion and minimize avoidance.⁵ A

MAP is important to facilitate the resolution of tax disputes on double taxation and inconsistencies in the interpretation or application of a tax treaty.

How do APAs work?

The APA process has five stages, starting with a pre-filing consultation and ending with execution and monitoring. Each step ensures compliance with transfer pricing regulations.

The Guidelines provide five stages of the APA process.⁶ Therefore, every activity carried out to execute an APA must fall within these distinct stages:

- **Stage 1 (Pre-filing meeting)⁷:** This stage involves a mandatory preliminary consultation of the FIRS by the connected person before formally submitting an APA application. Discussions at this stage include issues surrounding the nature and scope of the proposed APA, the transfer pricing method(s) including the determination of the Arm's Length Principle, and the

identification of other collateral issues.

- **Stage 2 (Formal Application)⁸:** In consonance with the 2018 Regulations, which allow a connected person to apply to the FIRS for an APA, this is the stage where the taxpayer(s) submits a formal application to the FIRS within the timeframe agreed at the pre-filing meeting. The APA Application should include transactions, products, businesses, proposed TP Method (TPM) details, and other information and documentation as agreed in the pre-filing meeting.

To qualify, a taxpayer must be a Nigerian resident or have a taxable presence in Nigeria, with controlled transactions meeting a minimum threshold of \$10 million per year for single transactions or \$50 million for groups.

- **Stage 3 (Analysis and Evaluation)⁹:** Upon acceptance of the formal application, the FIRS will analyse and evaluate the data submitted. This may require the services of experts (e.g., auditors, legal advisors, etc., where necessary) and a mutual exchange of briefs between the CA of Nigeria and the CAs of the tax treaty partners.
- **Stage 4 (Negotiation and Agreement of the APA)¹⁰:** This stage involves examining the proposals and evaluating any available data regarding the APA. At this stage, the terms of the APA are drafted and negotiated between the FIRS, taxpayers, and other relevant treaty partners to finalize the terms and conditions of the APA upon confirmation.
- **Stage 5 (Drafting, Execution, and Monitoring)¹¹:** At this stage, the APA has been finalized. The FIRS then enters a multilateral or bilateral

agreement with the treaty partners and communicates the agreed terms to the taxpayer(s) in writing.

Instructively, before a taxpayer can be eligible to enter an APA, such taxpayer must satisfy the following requirements

1. The taxpayer must be a company resident in Nigeria or a non-resident company having a permanent establishment, significant economic presence, or any other taxable presence in Nigeria; and
2. The taxpayer must have a controlled transaction up to the equivalent of \$10 million for each covered controlled transaction (single transaction) for each year or the equivalent of \$ 50 million in the case of a group of controlled transactions for each year covered under the APA.

Why do Multinational Enterprises and tax authorities need APAs?

The APA process has five stages, starting with a pre-filing consultation and ending with execution and monitoring. Each step ensures compliance with transfer pricing regulations.

The Tax Appeal Tribunal's Ruling on the maiden transfer pricing case will give an insight into the role that APAs play in the TP landscape.

Prime Plastichem Nigeria Limited v. Federal Inland Revenue Service¹²

In this case, Prime Plastichem (the "Company") filed its Transfer Pricing (TP) Documentation for the 2013 and 2014 financial years, respectively. For the 2013 financial year, the Company applied the Comparable Uncontrolled Price Method (CUPM) in determining whether its purchase price meets the arm's length (ALP) requirements. However, in 2014, the Company applied the Transactional Net Margin Method (TNMM) to determine the ALP using the Operating Margin as the most appropriate Profit Level Indicator (PLI) for the transaction.

Upon review of the Company's TP Documentation, the FIRS was of the view that the Company had wrongly applied the

CUPM in determining the ALP in 2013 as the comparable data for the said year did not strongly meet the comparability requirements as provided by the 2012 Transfer Pricing Regulations. The FIRS further stated that although the Company had used the TNMM in the 2014 financial year, it had wrongly used its Operating Margin as its PLI.

According to the FIRS, the Company should have used its Gross Profit Margin (GPM) in determining its ALP in 2013 and 2014 as this was the most appropriate PLI for the assessment of the arm's length condition in both years. Thus, the FIRS made TP adjustments to the relevant transactions and raised an additional assessment of over N1.7 billion against the Company.

The Company argued that CUPM was the most appropriate method to use in 2013 and that the change from the use of CUPM to TNMM in 2014 was only a result of the lack of comparable data in 2014.

The Tax Appeal Tribunal ruled in favor of the FIRS, affirming TNMM as the appropriate method and allowing the FIRS to override a taxpayer's chosen TP method and impose penalties for non-compliance.

The Tax Appeal Tribunal (the "Tribunal") ruled in favour of the FIRS when it held that the TNMM was the appropriate benchmarking method for Transfer Pricing in this case as opposed to CUPM and that the application of the GPM was the appropriate PLI for the said transactions. The Tribunal further upheld the power of the FIRS to disregard the TP method adopted by a taxpayer under the TP regulations and to also impose penalties enshrined in the relevant tax laws on the Company for failure to file their returns and pay the relevant taxes when due.

The assessment dispute between Prime Plastichem and FIRS would have been averted if they had entered an APA, particularly in the wake of the Tribunal's decision that under the TP Regulations, the FIRS reserves the right to disregard the TP method adopted by a taxpayer.

Against this backdrop, MNEs and tax authorities need APAs for various reasons, including:

1. To prevent costly and time-consuming audits and litigations that may arise from such transfer pricing disputes.
2. To get reasonable certainty on the TP treatment for relevant transactions.
3. To remove the risk of double taxation.
4. To reduce the arbitrariness of tax compliance audits by tax authorities on the one side and prevent tax evasion on the other side.
5. To reduce compliance costs throughout the APA.

Conclusion

APAs play a crucial role in the TP landscape, and it is based on this understanding that the FIRS released the Guidelines to give effect to the 2018 Regulations. While the introduction of the Guidelines will reduce the number of assessment

actions filed against the FIRS and bring some level of certainty to contracting parties, the eligibility requirements may bar many MNEs and other connected persons from taking advantage of the Guidelines.

Endnote

1. Para. 2.1 of the Guidelines.
2. Para 3.1 of the Guidelines.
3. Para. 3.2 of the Guidelines.
4. Para. 3.3 of the Guidelines.
5. Para. 1.0 of the Guidelines on Mutual Agreement Procedure.
6. Para. 12.0 of the Guidelines.
7. Para 14.0 of the Guidelines.
8. Para 15.0 of the Guidelines.
9. Para 16.0 of the Guidelines.
10. Para. 17.0 of the Guidelines.
11. Para 18.0 of the Guidelines
12. TAT/LZ/CIT/015/2017.

About Stren & Blan Partners

Stren & Blan Partners is an innovative and dynamic Law Firm with a compelling blend of experienced lawyers and energetic talents. We are focused on providing solutions to our client's business problems and adding value to their businesses and commercial endeavours. This underpins our ethos as everything we do flows from these underlying principles.

Stren & Blan Partners is a full-service commercial Law Firm that provides legal services to diverse local and multinational corporations. We have developed a clear vision for anticipating our client's business needs and surpassing their expectations, and we do this with an uncompromising commitment to Client service and legal excellence

The Authors



Marvis Oduogu
Team Lead

MarvisOduogu
@strenandblan.com



Ifeanyi Ezechukwu
Senior Associate

IfeanyiEzechukwu
@strenandblan.com



Michael Afuye
Associate

MichaelAfuye
@strenandblan.com



Stren & Blan Partners

www.strenandblan.com
contact@strenandblan.com
@strenandblan

+234 (0)702 558 0053
3 Theophilus Orji Street, Off Fola Osibo
Road, Lekki Phase 1, Lagos, Nigeria