

Tax and Transfer Pricing Lessons From The South: What Businesses Must Keep In View

INTRODUCTION

In recent times, compliance with transfer pricing (TP) rules and the arm's length principle continues to take centre stage in the decision making of multinational entities (MNEs). In Africa, an increased emphasis on compliance with the arm's length principle is becoming increasingly important in light of the renewed enforcement posture of tax authorities and high penalty threshold established in various TP Regulations. In view of this, TP disputes continue to spring up across the continent. While many of these disputes are resolved at the audit stage, prior to litigation, some of these disputes are determined at the appellate levels in the relevant jurisdiction, presenting a learning opportunity for taxpayers and tax authorities.

Following the recent decision of the Supreme Court of Zambia in ***Zambia Revenue Authority v. Nestle Zambia Limited*** (the *Nestle Zambia case*), significant lessons worth noting arise for taxpayers with tax and transfer pricing compliance obligations. The case highlights essential aspects of transfer pricing especially with respect to the taxpayer's responsibility of proof when dissatisfied with the tax authority's independent assessments, and what may be considered an acceptable benchmark study, thereby providing important insights for Nigerian businesses and companies. In this article, we highlight some of the key lessons and takeaways from the case, applicable to Nigerian taxpayers.

Summary of the Nestle Zambia Case

As a background, following a consistent declaration of a loss position by Nestle Zambia Limited (NZL), from its incorporation in 2010 as a distributor for Nestlé products in Zambia, the Zambian Revenue Authority (ZRA) initiated a transfer pricing audit on NZL. As part of the audit process, the ZRA requested documentation from NZL, including the Master File and Local File. However, NZL submitted only its Master File. The audit subsequently revealed that NZL was financed by its shareholders primarily through debt rather than equity and engaged in significant transactions with related entities, including those involving general administrative and support services, licensing and distribution agreements, and the supply of Nestlé products. ZRA subsequently issued an assessment, adjusting NZL's income and subjecting the Company to tax amounting to approximately USD 583,386.13.

Being dissatisfied with the ZRA's position, NZL filed an appeal at the Zambian Tax Appeal Tribunal, which determined, amongst others, that the assessment arising from the audit was invalid due to the ZRA apply inappropriate transfer pricing methods and using comparables from unsuitable jurisdictions. In its decision, the Tribunal also categorised NZL as a low-risk distributor and directed ZRA to reassess.

Dissatisfied with the decision of the Tribunal, both parties appealed to the Supreme Court. At the Supreme Court, the ZRA argued that the Tribunal had misinterpreted the law, overlooking NZL's obligation to demonstrate that its transactions were conducted at arm's length. It emphasized that the taxpayer has an obligation to disprove an assessment and maintain sufficient documentation. On its part, NZL submitted that it was a fully – fledged distributor and that the comparables selected were unsuitable.

Allowing the appeal in favour of ZRA, the Supreme Court reiterated that the onus is on the taxpayer to provide evidence once an assessment has been made. The Court also noted, amongst others, that as a result of the fact that the greater risks and strategic functions rests with other related parties, NZL's classification by the ZRA as a low-risk distributor was supported by evidence. It also held that using comparables from other jurisdictions does not automatically invalidates a benchmarking study. However, it may be justified where reliable local data was unavailable.

Lessons for the Nigerian Businesses and MNEs operating in Nigeria

As Nigerian jurisprudence on transfer pricing continues to improve, decisions from other jurisdictions within Africa provides viable lessons for Nigerian businesses. Some of these lessons include:

» Accuracy in Tax Returns Filing

As a first point, MNEs carrying on business in Nigeria must ensure accuracy when conducting their tax returns filing. Notably, pursuant to the provisions of **Section 55, Companies Income Tax Act 2004 and Section 11, Nigeria Tax Administration Act 2025**, companies registered in Nigeria are required to submit a self-assessment return in the prescribed format on an annual basis to the Tax Authority along with the Audited financial statements and proof of tax payment. As seen in the instant case where the NZL's tax position was reassessed as a result of inaccurate filings, there is a need to ensure that filings submitted to the tax authorities are based on an accurate representation of the realities of the business, the true nature of the business and financial position of the business.

In practice, where inaccurate information or documentation are provided to the tax authorities, business stand at the risk of being subjected to back taxes which could compound with additional interest and penalties. Accordingly, businesses and MNEs operating in Nigeria must maintain transparency and consistency in their annual self-assessment filings to avoid attracting scrutiny or being perceived by the tax authorities as engaging in tax evasion.

» **Accuracy in Entity Categorization/Characterization**

In the instant case, NZL's categorization by the ZRA formed the crux of the Supreme Court's position. Hence, MNEs operating in Nigeria must accurately categorize their roles within the relevant related party transaction. Accuracy in entity characterization ensures that MNEs accurately ascribe the relevant functions, assets, and risks to the relevant parties. An accurate delineation of the role of each entity ensures a meaningful and realistic comparison of the price or level of income of the entity in a controlled transaction against the price or level of return from a similar independent transaction. Notably, entity characterization is not just a formality, it drives the selection of the transfer pricing method, the identification of comparable companies and the results of the benchmarking analysis. Significantly, an incorrect assertion on entity characterization could result in significant implications during a TP audit as seen in the instant case.

» **Proper Documentation and Furnishing of all information Required by the Tax Authority.**

Further to the above, MNEs operating in Nigeria must be mindful of the importance of maintaining accurate and proper records of all transactions with associated and related parties, particularly for TP purposes, and to demonstrate compliance with the arm's length principle. The need for this can be seen in the effect of NZL's failure to maintain and provide all information requested by the tax authority. To adhere to this principle, businesses must ensure that the terms governing controlled transactions are comparable to those that would apply in a typical transaction with an unrelated uncontrolled entity, in line with ***Regulation 4 of the Income Tax (Transfer Pricing) Regulations 2018***.

It is important to note that in Nigeria the tax authority is empowered to request for additional information for an accurate TP audit and thus, provision of all information and documentation as demanded by the tax authority will help to manage exposures. By law and in practice, the lack of internal documentation to substantiate related party transactions traditionally implies that costs incurred for such related party transactions would be added back and taxed accordingly.

Onus of proof

It is a well-established principle of tax that a taxpayer who is dissatisfied with an assessment has the obligation to demonstrate that the assessment is inaccurate or excessive. This principle is applicable to both tax and transfer pricing audits and has been reaffirmed in the case of ***Mobil Oil (Nig) Ltd v Federal Board of Inland Revenue (FBIR) (1977) LPELR-1884(SC)***. This is because the company possesses intimate knowledge of its own transactions and is therefore in the best position to provide the correct information to support its claim. Hence, businesses operating in Nigeria must therefore ensure that sufficient documentation and information exist and maintained to ensure substantiate their position, failing which the tax authority's position would stand.

Choice of Transfer Pricing Method and Benchmark Study

Regulation 5 of the Income Tax (Transfer Pricing) Regulations, 2018 outlines five approved transfer pricing methods, namely: the Comparable Uncontrolled Price (CUP) Method, the Resale Price Method, the Cost-Plus Method, the Transactional Net Margin Method (TNMM), and the Transactional Profit Split Method. The Regulations, however, also empower the taxpayer to apply any other method it considers appropriate, as may be prescribed from time to time.

Nigerian businesses should note that the choice of an appropriate transfer pricing method or benchmarking approach for determining the arm's length price depends on the specific circumstances of each transaction. In other words, the selected method or benchmark must be tailored to reflect the unique characteristics of the company's dealings. This position is echoed in the case of **Netherlands v Holdings B.V. (21/01534)** where the Supreme Court emphasized the importance of selecting the most appropriate transfer pricing method based on the specific facts and circumstance of each case.

CONCLUSION

The case of ZRA v NZL highlights the importance of maintaining transparency and accuracy in company tax filings and documentation to avoid any perception or allegation of tax evasion by the authorities. Beyond compliance, transparent reporting reflects sound corporate governance and enhances investor confidence. Furthermore, when a TP audit is conducted, companies must ensure that complete and reliable documentation is maintained and that all information requested by the tax authority is promptly and accurately provided. Proper documentation not only facilitates a fair review but also prevents the tax authority from resorting to indirect or less favourable methods of assessment.

This decision therefore serves as a reminder to Nigerian businesses of the increasing sophistication of tax authorities across Africa and the growing emphasis on TP compliance in line with international standards. Ultimately, it highlights the evolving expectations of tax transparency and the need for Nigerian taxpayers to foster a cooperative relationship with the Nigerian Revenue Service in the years ahead especially with a new regime set to kick in soon.

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