IMPACT OF TRANSFER PRICING REGULATIONS ON TAX PLANNING IN NIGERIA

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ABSTRACT

This paper draws motivation from the fact that despite the recent amendments relating to transfer pricing regulations in 2018 in Nigeria, the tax revenue losses as reported by the Tax Justice Network (2021) amounting to US$1.77 billion is quite alarming; thus, creating a curiosity and research gap, and therefore a calculated attempt to contribute to the growing numbers of empirical literature on the nexus between T.P regulations and tax planning. The study, in a bid to achieve this broad objective of the impact of T.P regulations on tax planning, relied upon the following specific objectives which are to: investigate if there is any significant difference between pre-regulation taxable income of multinationals and post-regulation taxable income multinationals; and examine if there is any significant difference between pre-regulation tax liability of multinationals and post-regulation tax liability of multinationals. The research design adopted by this study is the causal-comparative or ex-post facto research design. Paired sample t test was employed to analyse the secondary data of nine (9) MNCs which were chosen on the basis of convenient sampling, and results of the analyses show that there is no significant difference between pre- regulations taxable income and post-regulation taxable income, and there is no significant difference between pre- regulations tax liability and post-regulations tax liability. Recommendations from this research include Nigeria tax authorities should review their transfer pricing regulation, check for inefficiencies, and proffer effective solutions; transfer pricing regulations compliance agencies should be set up in order to ensure maximum compliance of MNCs. In conclusion, transfer pricing regulation in Nigeria does not have a significant impact on taxable income and tax liability reported by MNCs.

Keywords: Transfer pricing regulation, Tax planning, MNCs

JEL Classification: H25, E62

1.0 INTRODUCTION

Multinational corporations (MNCs) have over time promoted the issue of tax planning through their transfer pricing policy, thus making it a topical and protracted issue in international taxation. MNCs carry out their operations across different geographical boundaries and hence deal with different taxing jurisdictions. There are various ways used by companies especially those having subsidiaries or branches in other countries to reduce their tax liabilities. Such ways include transfer pricing, accelerated depreciation, offshoring profits, awarding stock options, thin capitalization, and royalty payments (Twesige & Gasheja, 2019). The different approaches to tax planning by MNCs can broadly be described as Base Erosion and Profit Shifting (BEPS).

Multinational corporations' transfer pricing is governed by a formal declaration of principles known as a transfer pricing policy. When goods and services are transferred from one individual, department, or group member to another, an organization's internal pricing policy known as "transfer price" is typically used. According to Ezejulue (2008), domestic transfer pricing between divisions, branches, or subsidiaries is used to monitor, assess, and encourage divisional managers toward the company's overall objectives. In the pursuit of the tax planning goals of a MNC, international transfer pricing policy will come into play. International transfer pricing refers to the prices at which a company undertakes cross-border transactions with related parties. These transactions can include tangible goods, intangible property, services, and financing transactions (Ezejulue, 2008).

In setting an international transfer price, a multinational corporation will concentrate on satisfying a single objective which is solely on the minimization of tax liability, hence maximizing profits. Therefore, the international transfer price is frequently not an arm's length transaction (only when it is used as a tax planning strategy) since MNCs utilize it as a strategy to divert profits away from their home nations and into tax havens. To do this, MNCs utilize transfer pricing tactics to move revenues from the location where they are generated to another region, typically the country where the parent business is headquartered, (Twesige & Gasheja, 2019).

The use of transfer pricing policy for tax avoidance purposes can be seen as one of the methods of tax planning. Tax planning is the identification and utilization of loopholes in relevant tax provisions to allow for the payment of the lowest tax possible. It involves conceiving of and implementing various strategies in order to minimise the amount of taxes paid for a given period.

Multinational corporations facilitate more than 60% of all worldwide trade and economic activity and 70% of these transactions are between linked parties (Ghana Revenue Authority, GRA 2013; Osei 2010). The majority of trade between developing nations and the rest of the world are carried out by multinational corporations and other businesses. As a result, there is a chance that manipulating transfer pricing will result in government revenue losses.

Through MNCs' use of transfer pricing, developing nations like Nigeria are losing billions of dollars in tax income. Observing the increase in revenue leakages through the manipulation of transfer prices by MNCs, Nigeria passed the Income Tax (Transfer Pricing) regulation into law in 2012. The regulation was amended in 2018. The transfer pricing regulations seek to ensure that Nigeria is able to tax-related economic activities carried out by taxable persons in Nigeria on an appropriate taxable basis and give the Nigerian tax authorities the means to combat tax planning or tax avoidance that may be caused by transfer pricing.

The Tax Justice Network (2021), estimates that Nigeria loses US$1.77 billion in tax revenue annually due to profit shifting (BEPS) by large MNCs alone; hence highly significant. Consequently, there is a need to assess the effectiveness of the existing transfer pricing legislation on tax planning activities by MNCs, which is the subject of my research. However, this paper draws motivation from the fact that despite the recent amendments relating to transfer pricing regulations in 2018 in Nigeria, the tax revenue losses as reported by the Tax Justice Network (2021) are quite alarming, hence a calculated attempt to contribute to the growing numbers of the empirical literature on the nexus between T.P regulations and tax planning.

2.0 LITERATURE REVIEW

2.1 Conceptual Literature

Transfer pricing is the process of determining the cost of products and services that are exchanged between entities that are controlled (or connected) to a company. Transfer pricing is the term used to describe the price charged in international business dealings between related legal organizations (Ahmed, 2014).

The pricing of transactions between related companies or responsibility centers within an entity is known as transfer pricing. The transfer of tangible items, intangible assets like technology or brand names, services, or financing may all be a part of these transactions (Ahmed, 2014). The taxable profit of the entities involved is directly impacted by the different techniques

businesses employ to determine their transfer prices. In order to maximize the amount of tax income collected, the appropriate tax authorities are therefore interested in how corporations handle transfer pricing.

Many different authors have provided definitions of tax planning. Although the definitions vary from one another, they all have the same fundamental meaning. Tax planning entails making deliberate efforts to think about a taxpayer's potential future tax liability and how to minimize it. Tax planning refers to the development and application of various ways to reduce the amount paid for a specific period. It is budgeting for tax effectiveness. It is a tool at the disposal of the taxpayer to lessen the burden of tax paid or owed (Adetola & Oke, 2016).

According to Bariyima and Cletus (2014), tax planning includes not only tactics targeted at reducing tax liabilities but also takes into account the cash flow impact on the firm in terms of the best time for the business to settle tax liabilities without paying penalties. Tax planning needs a thorough understanding of tax law, how it applies to specific situations, and finding and utilizing loopholes. To make sure that taxpayers follow the law, it is important to take into account the appropriate tax legislation. The presupposition is that taxpayers leverage the relevant loopholes in tax systems to reduce their tax liability.

The topic of international tax planning is intricate and extensive. National and international businesses employ tax planning tactics to minimize their tax liabilities. The interplay between various countries' tax regimes is taken advantage of by multinational corporations. These corporations choose their capital structure in particular based on variations in worldwide taxation in order to reduce the overall tax burden of the company group. International tax planning emphasizes the reallocation of profits by multinational corporations to benefit from tax disparities across nations. Reducing the tax burden on multinational corporations is the main goal of international tax planning. Bariyima and Cletus (2014) opined that Multinational corporations can raise their after-tax incomes by lowering taxes. Multinational corporations may employ several strategies to accomplish this goal, and it is largely predicated on sound knowledge of various tax laws and tax treaties of the countries where the corporations are based. International transfer pricing is also a mechanism of BEPS which helps reduce tax burdens depending on the taxing jurisdiction of different clients.

2.2 Empirical Review

Ravi Taklalsingh (2019) carried out research on transfer pricing legislation's effect on multinational enterprises in the United States. Ex-post facto was used as the research design.

The Internal Revenue Service provided data on a sample of tax returns that represented 32 industry categories for each of the 14 years needed to answer the study objectives. The findings showed that the revised transfer pricing regulations had an impact on multinational corporations (MNCs), leading them to declare higher profits than they had previously.

Adeyeye *et al.* (2018) investigated the effectiveness of transfer pricing regulations of 2018 and tax compliance among Nigerian companies. The sample of the study was 151 staff of the Federal Inland Revenue Service in Lagos randomly selected from the population. A structured questionnaire was used in the study's survey research design to collect primary data. Descriptive and inferential statistical techniques were used to analyze the data. The analysis's findings suggest that transfer pricing laws are successful in reducing tax evasion committed using transfer pricing schemes.

Akinleye, Olaoye and Fajuyagbe (2018) examined the effects of transfer-pricing regulation and compliance on tax administration in Nigeria. The paper used a descriptive survey research design. Questionnaire was used as the research instrument for data collection. The study revealed that transfer-pricing regulation had a tendency to significantly influence tax administration.

Sebastian *et al.* (2022) analyzed how the introduction of standard regulations has helped in limiting tax planning through profit-shifting activities. The research was done in Chile on multinationals using firm difference-in-differences specification and tax data between 2007 and 2015. A total of 20 in-depth interviews with Chilean transfer pricing experts were conducted to supplement the quantitative data. The investigation came to the conclusion that the change had no major impact on tax payments, any of these routes, or Chilean firms' ability to move profits elsewhere.

Lohse and Riedel (2013) added to this literature by analyzing a paper titled Do transfer pricing laws limit international income shifting? Evidence from European multinationals. The authors gathered information on the breadth and development of transfer pricing legislation in 26 European countries between 1999 and 2009, as well as evidence of profit-shifting practices in those nations, and combined it with data on MNCs and corporate tax policies in Europe. According to the study's conclusion, the implementation of transfer pricing documentation is found to minimize profit-shifting behavior by around 50% on average and transfer pricing fines are likely to have a restricting effect on shifting behavior, to name a few significant points.

Muleri and Muriithi (2018) carried out a study on the effects of transfer pricing on tax liability for multinational enterprises in Kenya’s cement industry. The study used a 10-year longitudinal research methodology to evaluate correlations between the independent and dependent variables starting in 2005. Both descriptive and inferential analyses were performed on the quantitative data acquired for the study. It was determined that business models that were in place addressing thin capitalization procedures, the use of tax havens, and intra-company payments had no impact on the tax paid over the course of ten years.

Another interesting observation is the emergence of Sari and Rahayu (2020) article on transfer pricing practices and specific anti-avoidance rules in Asian developing countries. The research employed panel data from a sample of 200 subsidiaries in 10 countries over a period of 5 years from 2010-2014. The finding revealed that specific anti-avoidance rules reduce the use of transfer pricing in minimizing tax liabilities.

Beebeejaun (2018) contributed to the existing literatures on transfer pricing through his study on "The Fight against International Transfer Pricing Abuses: A Recommendation for Mauritius". The research's methodology includes a critical examination and comparative legal assessment of the pertinent statutes, precedents, and literature. According to the study's findings, firms can evade taxes because there are no specific formal laws governing transfer pricing.

Bakke, Hopland and Møen (2019) carried out a study on profit shifting and the effect of more strict transfer pricing regulation on tax revenue. The study employed extensive firm and group level data from Norway collected over a 20-year period using a population-wide panel. The data for the years 1993 to 2012 were analyzed using the ordinary least squares model. According to the report, Norway loses around 6% of its annual business tax revenue. It was determined that the use of transfer pricing for tax planning by multinational corporations has decreased as a result of the introduction of more stringent transfer pricing regulations and an increase in transfer pricing audits.

Schindler, Dirk and Guttorm (2013) carried out a study on transfer pricing and debt shifting in multinationals in Norway. The study examined how debt-shifting and profit-shifting activities are affected by government regulations using differentiation and Cramer's rule. The finding revealed that government regulation intended to protect the national tax base may have unintended effects and stricter regulation on transfer pricing can potentially increase the use of transfer pricing.

Madawa and Frank (2022) carried out an empirical analysis on the adoption and execution challenges of transfer pricing regulations in Nigeria. A descriptive survey technique was adopted. Structured questionnaires were administered to 114 respondents comprising accountants, auditors, lawyers and tax practitioners spread across accounting firms in South-South Nigeria. The result of the analysis carried out revealed that transfer pricing regulations help curb transfer pricing activities of multinationals.

2.3. Theoretical Review

This study reviewed strategic management and economic theory.

Strategic Management Theory

MNCs are made up of branches, subsidiaries, and affiliates that are based in various nations and have specialized skills and activities. These related parties conduct business with one another at transfer prices that are geared toward the MNC's strategic tax management. Organizational characteristics such as resource allocation, performance evaluation, business strategy, and tax management are present in transfer pricing (Plesner & Rohde, 2014). Also, they added that one of the findings in the literature revealed a relationship between transfer pricing and business strategy with strategic decisions driven by tax management.

According to strategic management theory, management strategy matters in deciding the overall profit of the multinational corporation as they pursue strategies for lowering their worldwide tax obligations. Profit reporting supports strategic tax management because the principle of strategic management suggests that management employ techniques to lower their global tax liabilities. This theory has a direct bearing on this study based on the fact that the T.P decision of MNCs is taken at the strategic level of an MNCs, thus deciding whether to use it as a mechanism of BEPS or otherwise and whether it is intended for reduction of tax liability of the MNCs, hence this study is anchored on this theory.

Economic theory

Hirshleifer's (1956) economic theory focused on the issue of interdivisional pricing of goods and services to maximize the overall profit of the entire firm. Hirshleifer indicated that the market price might be the right transfer price and that this pricing would have an impact on the entire company, including how management is evaluated for performance and how international taxes are handled. According to this hypothesis, interdivisional pricing matters for calculating the firm's overall profit.

3.0 METHODOLOGY

This study adopts the causal comparative (or ex-post facto) design in order to determine whether there are significant differences between the pre-regulation taxable income and tax liability of MNCs and post-regulation taxable income and tax liability of MNCs. Secondary data were used. The paired sample t test was employed (at 0.05 level of significance) for the comparative analysis of taxable income and tax liabilities extracted from the financial information of nine (9) multinational companies for a period between 2007 and 2016. The choice of nine (9) MNCs was premised on a convenient sampling technique based on the availability of data.

4.0 RESULTS AND DISCUSSION

4.1 Analysis of Hypothesis One

Ho: There is no significant difference between the pre-regulation taxable income of MNCs and the post-regulation taxable income of MNCs.

Table 4.1: Paired Samples Test on the Relationship between Income Tax (Transfer Pricing) regulations on taxable income of MNCs.

Paired Samples Test									
		Paired Differences					T	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	TAXINC 1 - TAXINC 2	-42209754.63	150227511.76	22394595.23	-87343095.70	2923586.43	-1.885	44	.066

Source: SPSS Ouput (2022)

The p-value of .066 is greater than the 5% significance level thus it can be concluded that there is no significant difference between pre-regulations taxable income and post-regulations taxable income. Thus, income tax (transfer pricing) regulation has not impacted significantly on the taxable income of MNCs.

4.2 Analysis of Hypothesis Two

Ho: There is no significant difference in pre-regulation tax liability of MNCs and post-regulation tax liability of MNCs.

Table 4.2: Paired Samples Test on the Relationship between Income Tax (Transfer Pricing) Regulations on Tax Liability of MNCs.

Paired Samples Test									
		Paired Differences					T	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	TAXLIA1 - TAXLIA2	-3694919.25	29375207.43	4378997.38	-12520208.58	5130370.07	-.844	44	.403

Source: SPSS Ouput (2022)

The p.value of .403 is greater than the 5% significance level thus it can be concluded that there is no significant difference between pre-regulations tax liability and post-regulations tax liability. Thus, income tax (transfer pricing) regulation has not impacted significantly on the tax liability of MNCs.

4.3 Discussion of Findings

The paired sample test revealed that there was no significant difference between pre-regulations taxable income and post-regulations taxable income. Thus, income tax (transfer pricing) regulation has not impacted significantly on the taxable income of MNCs. This is in line with the conclusion reached by Schindler, Dirk and Guttorm (2013) that more strict regulation on transfer pricing can potentially increase the use of transfer pricing. Contrarily, Ravi Taklalsingh (2019) indicated that transfer pricing regulations influenced MNCs income significantly than before.

The test revealed that there was no significant difference between pre-regulation tax liability and post-regulation tax liability. Thus, income tax (transfer pricing) regulation has not impacted significantly on the tax liability of MNCs. Similarly, Muleri and Muriithi (2018) concluded that tax paid over the 10-year period had not been affected by business models in existence regarding thin capitalization practices, tax haven utilization, and intra-company payments. Sebastian, Dina, Juan and Jose (2022) indicated that transfer pricing regulation has not significantly limited the profit-shifting opportunities of multinationals and consequently increased tax payments.

5.0 CONCLUSIONS AND RECOMMENDATIONS

This study was motivated by the need to unearth how effective transfer pricing regulation has been in curbing MNCs' tax planning activities. The hypotheses of the study were tested using the paired samples test and thus revealed that income tax (transfer pricing) regulation has not impacted significantly on the taxable income and tax liability of MNCs. As a result of the study findings, it can be concluded that the transfer pricing regulations in Nigeria has thus far been ineffective in achieving what it was set out to achieve.

From the research analysis and conclusions above, the following recommendations were made: The Nigeria tax authorities should review their transfer pricing regulations, check for inefficiencies and proffer effective solutions to such inefficiencies in order for the transfer pricing regulations to become effective in reducing MNCs transfer pricing. Also, transfer pricing regulations compliance enforcement agencies should be set up in order to ensure maximum compliance of MNCs to the regulations of which failure to comply will attract huge fines.

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