Effects of Transfer- Pricing Regulations and Compliance on Tax Administration in Nigeria

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Abstract: This paper examines the effects of transfer- pricing regulation and compliance on tax administration in Nigeria. The paper uses a descriptive survey research design. Questionnaire was used as the research instrument for data collection. Analyses were made with ordered logit regression, Pearson product moment correlation, variance inflation factor (VIF) and white heteroskedasticity test. Ordered logit regression reveals that transfer- pricing regulation had a tendency to significantly influence tax administration with z-values of 2.8931 (p=0.00381) while transfer- pricing compliance had an insignificant effect of 0.016 with z-values of 0.1335 (p=0.89379) on tax administration in Nigeria at likelihood ratio test of Chi-square (2)= 25.7916 [0.0000]. This study implies that transfer-pricing and its compliance has the capacity to improve the effectiveness and efficiency of tax administration in Nigeria. Hence, we concluded that there is poor administration of transfer- pricing tax policy in Nigeria. It is, therefore, recommended that Federal Inland Revenue Service should put in place not only transfer- pricing laws but adequate machinery in terms of human and technological capital coupled with sensitization on the applicability of the existing transfer- pricing tax policy in Nigeria.

Keywords: Transfer- pricing; Regulation; Compliance; Tax Administration

JEL Codes: H26; H27; H20

1. Background

Soyode & Kajola (2006) defined tax as an obligatory exaction of money by a civic authority for public determinations and prosperity. Taxation is machinery as well as a process in which society, communities, and group of individuals contribute an agreed sum of money which is crucial to the resolution, development, and administration of the public. Lambo (2005) defined transfer tax as a tax on the passing of title property from one person to another. Transfer tax comes from transaction fee charged on the transfer of properties from one person to the other.

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Essentially, this type of tax is considered in the presence of legal registration of transfer, which could be in form of real estate, bond, ordinary share e.t.c. Notably, transfer tax in some respect needs notary confirmation, which might add up to the cost of transaction. As conceptualized in the United State of America, transfer tax is an estate tax and/or gift tax. This type of tax stems from the transfer of property due to death, but not tax placed on the property itself. Generally, taxpayer claims that transfer tax is an unconstitutional tax, since it's a direct tax that is not apportioned among the states in the proportion of the population distribution. In a broad sense, estate tax, gift tax, capital gains tax, sales tax on goods (not services), and certain use of taxes are all transfer taxes because they involve a tax on the transfer of title (Dubin, 2004).

Lambo & Obaji (2005) posited that expectation of taxpayers to enjoy social facilities such as educational system; health care system and transportation network are nothing to write home about, owing to the instability of the tax system. As reported by World Bank (2011), Nigeria ranked low in the rating of tax payment and compliance among all countries of the world. Specifically, it was reported that Nigerian ranked 109 out 183 countries of the world, and 27 of 46 Sub-Saharan African countries. Recently, Nigeria government has made some improvements on the tax system in respect to the tax compliance needs of the country by establishing Federal Board of Inland Revenue to function as the operational arm of the Federal Inland Revenue Services. The commission was responsible for effective tax administration, accounting, and reporting. In the same vein, government innovatively put up tax identification number programme in an attempt to occasion reliable tax base for tax administration in the country, as well as to link tax stakeholder together. Also, there is Joint Tax Board (JTB), amongst others, which are constituted to address problems of tax policies and its implementations; tax collection and compliance of taxpayers' compliance, given the fact that people are an integral part of the tax system.

Transfer tax has implication on the level of taxpayer's willingness, and as such, it influences tax revenue generation. Notably, it leads to government's inability to allocate national resource generated from taxation and other sources of revenue towards growth and development objectives. From observation, the level of taxpayer's unwillingness is higher in the informal sector due to limited government monitoring. Willingness to pay tax in developing countries is umpteen driven by the perception of how government engages resources raised from tax payment. The observation in developing countries is that revenue generation from taxation is relatively low, and this had limited the level of project development which could trickle down to an average person. OECD (2012) reveals that there is need for a new two-tiered approach to transfer pricing documentation based on the Master file and the Local file. The final draft is planned to be completed in June 2014 and likely to come up with a new chapter of transfer pricing guidelines which is to have a notable influence on documentation rule of transfer pricing of tax authorities.

The following three research questions are formulated to guide the study:

i. To what extent can transfer- pricing regulation and compliance improve tax system in Nigeria?

ii. In what ways can Nigeria improve her tax system in order to increase the level of transfer- pricing regulation and compliance?

iii. To what extent does transfer- pricing regulation and compliance contribute to the tax administration in Nigeria?

This study will therefore consider the effect of transfer pricing regulation and compliance on tax administration in Nigeria.

2. Literature Review

2.1.1. Concept of Transfer- Pricing

Mckinley (2003) explained transfer price as the price charged between related parties in an intercompany transaction, such entities are not consolidated and their transactions are therefore not eliminated. A firm's transfer- pricing framework has notable effect on an average performance, especially when measured in terms of profit after tax, as pointed out by Garrison (2008), transfer price in the context of a firm is the price charged for transaction between divisions of an organization, either in terms of provision of goods or rendering of services. Transfer- pricing refers to the value at which one entity in a group of entities sells goods, services or intellectual property to another entity within the same entity. Needham (2013) observed that the tax reduction methods used by multinational companies have been well known for decades. These tax reduction methods include among other things, transfer- pricing and transaction completion in lower-tax countries.

Allain (2010) suggested that transfer- pricing adjustment between associated enterprises will trigger Value added tax effects. An increase or a decrease in the transfer price of a supply would obviously result in an additional consideration or a credit that should reflect the applied Value added tax consideration. Transfer- pricing fundamentally relates the objectives of the domestic tax authorities with that of the foreign tax authorities and taxpayers. It is an essential instrument used for ensuring integrated action in an organization as well as action differentiation in a bit to ensure performance evaluation.

2.1.2. Overview of Nigeria Tax System

Different tax policies, tax laws and administration framework characterized the Nigeria Tax System. These, coupled with policies and laws, are expected to work in agreement with one another in order to achieve the overall objectives for economic growth of the nation. However, with reference to the presidential committee set up on National tax policy in 2008, the overall focus and primary objectives of Nigeria tax system is to provide and contribute to the social and economic well- being of citizens, and this can be done either directly by improving existing and formulating new tax policies or indirectly by making optimum utilization of tax generated from revenue for the benefit and development of the citizens. To achieve these objectives through the generated revenue, the tax system was expected to minimize the economy distortion in Nigeria. Other expectations of the tax system of Nigeria in line with the presidential committee on National Tax Policy (2008) were as follows: to pursue equity distribution and fairness in the country; to provide economic growth and even development; to provide economic stabilization to the public; to correct market failure and other imperfections thereof; and to generate stable revenue and other resources required by government to accomplish public project and make beneficent investment for the public.

In an attempt to achieve maximum expectation, the system is assumed to be in compliance with the taxation principles, which are serving as a lubricant to the real effective tax system. Nigerian tax system has been surrounded by a multiplicity of tax collecting bodies at the three levels of government which are federal, state and local governments. The main problem associated with tax system in Nigeria is the little precision about the jurisdiction capabilities with a doubt on the country's observance of the fiscal federalism system of government (Ahunwan, 2009).

The following are some of the frequent resolutions proposed toward improving the tax system in the country; minimizing of tax evasion to the lowest level; uniform, fair and unbiased administration of related tax laws; promote voluntary compliance through effective tax system and; impacting public assurance in the truthfulness of tax system. Even at that, many Nigerians as corporate entities do not value and respect the tax system of the country due to government's failure to provide fundamental facilities as a result of ineffective tax system. In order to reinforce the country's tax system therefore, Federal Inland Revenue Service (FIRS), t must consider these strategic areas, namely; enforcement activities of tax laws and tax compliance; staff development and capacity-building; improved tax collection indicators and parameters andestablishing measures to limit bribery and corruption among tax officials.

In Nigeria, some of the tax collectors are often pupations for corruption. To solve this problem, there is a need to establish computerized systems and boost tax authorities by rewarding honesty and transparency. Also, the public should be encouraged to report dishonest tax collectors to their supervisors or prosecuting attorney for punishment and prosecution while the higher management of tax assistance in the country would engage in constant reviews and performance appraisal of field staff/officers (Ahunwan, 2009). The country tax system is associated with some inherent problems such as inadequate accessible information to taxpayers; lack of tax revenue accountability on its expenditure; problems of multiple taxation at all levels of government, lack of transparency on taxation powers at all level of government encroachment; applying of aggressive and unconventional methods for tax collection; lack of trained manpower and insufficient funding, increased demand by the government to generate more revenue internally; inefficient funds collection and refund system; outdated tax laws and non-review of tax legislation to t represent the country's current tax realities; lack of unambiguous directional policy for tax matters and the absence of laid down practical guidelines for the process of the various tax authorities. These and some other problems are the most common issues which have not been sufficiently handled for many years in Nigeria's tax system. The major possible reason for this is substantial reliance on oil revenues and none- attention to tax-related sources of revenue. In recent times, the federal government is driving towards diversifying the economy to non-oil based economy due to global challenges in oil market by considering more non-oil tax revenue for building sustainable and stable sources of revenue to shoulder capital project.

2.1.2. Theoretical Consideration of Compliance

Tax is a crucial player in every society; the tax system is an opportunity for the government to collect additional revenue for funding developmental projects in the society. Taxation is one of the most relatively effective resource mobilizations means in a country towards the promotion of economic growth and development. Tax has been conceptualized as a compulsory level imposed by the government on an individual, an entity's income and/or property, in the quest to raise funds to finance the provision of security, infrastructural facilities that can ensure lasting conducive living condition for the citizenry **(**Appah & Oyandonghan, 2011). This compulsory levy is often imposed by the government for other reasons including regulation of the production supply and distribution of certain goods and/or services. According to Appah (2010), there are four key issues surrounding taxation, especially in understanding the role it plays in the growth and development process of an economy. Firstly, it's a mandatory citizenry contribution to the society. Secondly, it places uniforms obligation on payers, thirdly, benefits received is not equivalent to tax paid, and finally, tax imposition is not because the government has done anything substantial to the payers. Hence these observations reflect that maintaining good tax structure is sine-qua-non to maintaining sustainable economic growth and development.

According to Torgler (2011), the interest of researchers over the years towards the evaluation of the level of tax compliance as well as tax evasion has been on the increase both in developed and developing countries of the world. In addition to several aspects of tax that had been research overtime is the area moral fundamental of taxation in the country. This relates to the rationing of the reason why people pay tax, which also extends to the basic model of tax compliance choices. Many of these aspects can be discussed under the general rubric of behavioral economics, broadly described as a tool that uses methods and evidence from other social sciences to relay the basis behind the decision of an individual person or a group of persons.

In a multinational environment, the transfer- pricing policy contributes to a large variety of goals, including profit maximization, cash flow, sales and marketing optimization, taxes, and tariffs minimization and other socio-political objectives such as favourable financial relationship with the host country and currency stability. Quite a number of studies had been geared towards ascertaining the optimal transfer-pricing policies adopted among multinational firms. Most of these studies assumed that MNEs is to use one set of transfer- pricing books (Smith, 2002). They derive the optimal transfer price for each intra-firm dealings as well as tax compliances and performance goal evaluation. In contrast, a limited number of recent studies provided two models that distinct transfer price, one to serve as evaluation purposes and the other to serve tax purposes (Hyde & Choe, 2005).

2.1.4. Empirical Evidence

Dyreng (2008) carried out research on firms' ability to avoid taxes over a long period of time using a dataset of 2077 U.S. firms from 1995 to 2004. The researcher revealed a significant fraction of firms that could avoid corporate taxes for the 10-year period. This explained a long-term tax avoidance which might be triggered by management actions. Firms may be involved in tax planning for a long period but may be limited if the motivation for such activities is based on tax law ambiguities.

Sikka (2010) affirmed that engaging transfer- pricing towards reducing tax avoidance and evasion is open to regulatory authorities more than the public because detecting tax avoidance and evasion using other means is more difficult and less economical for regulatory authorities to detect and this makes it a complex game that involves numerous bodies – corporations, accountants, lawyers, consultants, governments, tax authorities, multinational agencies, NGOs and others engaged in establishing and revising the rules of the game with regard to which method(s) of calculating prices is acceptable.

International Monetary Fund (IMF) states that multi-global trade has created problems for national tax authorities from the potential use and abuse of transfer-pricing by multinational organizations. According to Tanzi (2000), there is a belief that some enterprises are in the practice of manipulating prices in the bit to retract profits from areas of high tax to areas of low rates. Trans- pricing rules and the arm's length model were first introduced in Russia in 1999. Some of the issues have been given visibility by the trade in oil and gas as major contributors to the Russian economy. In early 2004, a World Bank report stated that the country's oil and gas exports accounted for 25% of the country's Gross Domestic Product (GDP) rather than 9% reported in the official data. According to Ahrend (2004) reasons for discrepancy in transfer- pricing include among other things the fact that corporations objectively harness the loopholes in the tax system.

Mutua (2012) examined transfer- pricing management strategies by MNEs and concluded that there is an increased level of tax compliance enforcement, where Nigeria would be forced to conduct TP audits and assessments on MNEs that fail to comply with the rules. He observed that Nigeria has not imposed penalties to companies without TP policies and recommended that there is a need for MNE to understand what TP means and that enlightenment should be carried out on the effects of the levels of inter-company transactions with related companies. He also recommended that there is a need to establish how performance management is measured in MNEs, whether it depends on the levels of sales or otherwise. From PWC (2013) report, it was indicated that Nigeria is currently requesting transfer-pricing documentation from all taxpayers with cross-border-related- party transactions with the intention of risk profiling them for the purpose of conducting transfer- pricing audits. They recommended that multinationals should take transfer-pricing seriously, develop and properly maintain properly documented and defensible transfer- pricing policies. Nigeria Government may be losing billions of shillings through well-connected dodgy tax deals involving multinational corporations. Through transfer- pricing, the foreign firms avoid taxes, denying the country the much-needed revenues for development. Therefore, it is very paramount to investigate the effect of transfer- pricing regulation and compliance on the tax Administration in Nigeria.

3. Methodology

3.1. Research Design and Data Source

The research design adopted in the study is descriptive survey, while questionnaire was subjected to content validity, test and test-retest reliability test was administered to a total of one hundred and twenty (120) staffers of Federal Inland Revenue Service in South-West, Nigeria.

3.2. Model Specification

The model stated below was based on the functional relationship between transfer-pricing regulation, compliance and tax administration.

$TAXAD = \beta + a_1\, TPR + a_2\, TPC + \mu$

Where:

TAXAD= Tax Administration, TPR= Transfer Pricing Regulation, TPC=Transfer Pricing Compliance

3.3. Estimating Technique

Specifically, data collected from the research instrument was analyzed using ordered logit regression and correlation analysis followed by post-estimation test such as Variance inflation factor (VIF) and White Heteroskedasticity test.

Table 1. Measurement of Variables and Expected Associations with Tax Administration

Variables	Symbols	Unitof Measurement	Expected Signs (Apriori Expectation)
Dependent Variable			
Tax Administration	TAXAD	(1-5Likert Scale) Ordinal	
Independent Variables			
Transfer Pricing Regulation	TPR	(1-5Likert Scale) Ordinal	+ (high transfer pricing regulation, high tax administration)
Transfer Pricing Compliance	TPC	(1-5Likert Scale) Ordinal	+ (high transfer pricing compliance, high tax administration)

Source: Authors' Design, 2017

4. Model Estimation and Interpretation of Findings

This section shows the correlation of the characteristics of the variables ranging from Pearson correlation matrix, orderd logit regression, variance inflation factor (VIF) and White Heteroskedasticity test.

Table 2. Pearson Correlation Matrix

Correlations				
		Tax Administration	Transfer Pricing Regulation	Transfer Pricing Compliance
Tax Administration	Pearson Correlation	1	.273**	.075
	Sig. (2-tailed)		.003	.432
	N	113	113	113
TransferPricing Regulation	Pearson Correlation	.273**	1	.272**
	Sig. (2-tailed)	.003		.004
	N	113	113	113
Transfer Pricing Compliance	Pearson Correlation	.075	.272**	1
	Sig. (2-tailed)	.432	.004	
	N	113	113	113
**. Correlation is significant at the 0.01 level (2-tailed).				

The results as presented in table 2 revealed that there exists a positive significant correlation between tax administration and transfer- pricing regulation, with a correlation coefficient of 0*.273(p=0.003),* which implies that the strength of the relationship between the duo is about 27.3% even though the relationship is weak. Also, there exists insignificant relationship of 7.5% *(p=0.432)* between tax administration and transfer- pricing compliance in the country, this weak relationship can be accounted for as a result of poor implementation of transfer- pricing related laws in the Nigeria tax system, even though as accounted by Ovunda (2015), the Federal Inland Revenue Service (FIRS) had attempted to combat perceived income shifting by foreign taxpayers out of Nigeria, with the publication of new transfer- pricing rules as far back as September 21, 2012 and series of back- up in the anti-avoidance provisions embedded in various tax laws particularly in Section 22 of the Companies Income Tax Act (CITA) Cap C21, LFN 2004, as amended by the CIT (Amendment) Act of 2007, section 15 of Petroleum Profit Tax Act and section 17 of Personal Income Tax Act (PITA). The relationship between the performance of tax administration, transfer- pricing regulation and compliance is still poor based on the correlation result. The results indicated a tandem with the a priori expectation that transfer- pricing regulation and its compliance have a positive correlation with tax administration in Nigeria.

Table 3. Ordered Logit Regression Analysis

Ordered Logit, using observations 1-113
Dependent variable: TAXAD
Standard errors based on Hessian

	Coefficient	*Std. Error*	*Z*	*p-value*	
TPR	0.323182	0.111708	2.8931	0.00381	***
TPC	0.0160475	0.120201	0.1335	0.89379	
cut1	6.52616	3.4329	1.9011	0.05729	*
cut2	9.3394	3.49424	2.6728	0.00752	***

Mean dependent var	4.300885		S.D. dependent var	0.639265
Log-likelihood	-101.3292		Akaike criterion	210.6584
Schwarz criterion	221.5680		Hannan-Quinn	215.0854

Number of cases "correctly predicted" = 58 (51.3%)

Likelihood ratio test: Chi-square(2) = 25.7916 [0.0000]

Based on table II above, below is the ordered logit regression equation

^TAXAD = + 0.323*TPR + 0.0160*TPC + 6.53*cut1 + 9.34*cut2

(0.112) (0.120) (3.43) (3.49)

T = 113, loglikelihood = -101

(Standard errors in parentheses)

Form the results in table 3, the Likelihood ratio test: Chi-square(2)= 25.7916 [0.0000] indicate that the overall model is significant at 5% level, which implies that the variables (transfer Pricing Regulation-TPR and Transfer Pricing Compliance-TPC) identified are significant in explaining the variation in Tax Administration-TAXAD in Nigeria. It is evident in cut1 and cut2 which are both significant. The result revealed based on the z-values that transfer- pricing regulations have a tendency to significantly influence tax administration in Nigeria, since their calculated z-values of 2.8931 *(p=0.00381)* is greater than the critical z-value of at 5% level of significance, which implies that an increase in the scope of transfer-pricing regulation will result to 32.31%. This is in tandem with the conclusion of Ahmed (2014) that the enactment of Income Tax (Transfer Pricing) Regulations 2014 will help avoid mispricing and potential loss of tax revenue which occasioned transfer- pricing practices in multinational companies. Transfer- pricing compliance showed an insignificant effect of 0.016 on tax administration in the country with z-values of 0.1335 *(p=0.89379)*, this poor effect can be accounted for as a result of lack of administrative infrastructure and structure, corruption in the tax system, lack of training for FIRS staffers', friction between the FIRS and the Multinational Companies (MNCs). Ovunda (2015) and Ahmed (2014) indicated that the poor compliance nature of multinational companies to transfer- pricing regulation are as a result of lack of knowledge on its laws by MNCs and requisite skill on transfer-pricing, customs-related challenges such as customs valuation, managing indirect charges in a transfer- pricing environment, transfer- pricing and tax residency risks, the application of transfer- pricing in a joint venture environment, poor database and difficulty in identifying transactions that are subject to the arm's length rule and its application. The above result is also in tandem with the a priori expectation that transfer- pricing regulation and its compliance positively impact tax administration in Nigeria.

Diagnostics Tests

The following diagnostic test; variance inflation factor (VIF) and White Heteroskedasticity test were conducted in other to ensure reliability and validity of the above results. The results of the diagnostic test were thus presented below:

Table 4. Variance Inflation Factor Test

Coefficients			
Model		Collinearity Statistics	
		Tolerance	VIF
1	TPR	.926	1.080
	OTRE	.926	1.080

Based on the results in table 4, all the variables (Transfer Pricing Regulation-TPR and Transfer Pricing Compliance-TPC) are relevant to the explanation of tax administration with respect to transfer- pricing, since the VIF factors are all below the benchmark of 10, this is in accordance with the earlier result in table 3 which is the Likelihood ratio test: Chi-square(2)= 25.7916 [0.0000] indicating that the overall model is significant at 5% level. With this assertion, it is confirmed that there is absence of multicollinearity in the model.

Table 5. Heteroskedasticity Test

Heteroskedasticity Test: White	
F-statistic	1.738276
Unadjusted R-squared	0.015383
P(Chi-square(5) >1.738276)	0.884043

Table 5 shows that the F-statistic and Unadjusted R-squared values of 1.738276 and 0.015383 with p-value of 0.884043 respectively indicate the presence of no heteroskedasticity in the model since the F-statistic and Unadjusted R-squared have a p-value greater than the critical values at 5% level of significance. Thus, it is concluded that there is no heteroskedasticity in the model

5. Conclusion and Recommendations

Based on the findings of the study, it is concluded that there is poor administration of transfer- pricing tax policy in Nigeria, and in addition, transfer- pricing and its compliance has the capacity to improve the effectiveness and efficiency of tax administration in Nigeria. It is therefore, recommended that FIRS should put in place not only transfer- pricing laws but adequate machinery in terms of human and technological capital coupled with sensitization on the applicability of the existing transfer- pricing tax policy in Nigeria.

6. Limitations of the Study and Further Areas of Research

This study is limited by the inability to directly quantify transfer- pricing in an attempt to track its influence of tax administration in Nigeria. Moreso, the study could not cover a wide range of audience for the qualitative response measures adopted in the study, though these limitations does not by any means erode the authenticity of discoveries made in the study. This study however suggest that further investigation on transfer- pricing should cover a wider scope, employing quantitative measures that can better represent the subject matter in the discourse of tax administration in Nigeria.

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