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Transfer Pricing in Kenya:
Is your organization compliant?

Preamble

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Preamble

By George Maina Rödl & Partner Kenya

Recently, there has been increased attention on activities of multinational enterprises (MNEs) in Kenya and the East Africa region with a particular focus on pricing arrangements of transactions between related parties.

The Kenya Revenue Authority (KRA) has been aggressive in pursuing transfer pricing malpractices and has issued huge assessments against non-compliant taxpayers. Is your organization compliant?

> What is Transfer Pricing?

Transfer pricing refers to the pricing of goods, services and intangibles (in the case of royalties) between related parties located in different countries. Transactions between related parties are to be carried out at an "arm's length" basis. Abuse of transfer pricing is illegal and occurs when related entities manipulate the pricing of transactions between themselves resulting in transactions that are not carried out at arm's length. Transfer pricing is an important area for revenue authorities as it is estimated that about 60% of international trade happens within multinational entities.

> Transfer Pricing in Kenya

In Kenya, Transfer Pricing rules became effective from 1st July 2006 and borrowed significantly from the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines. Under Section 18(3) of the Income Tax Act (ITA), transactions between a resident entity and it related non-resident should be at arm's length.
The Income Tax (Transfer Pricing) Rules, 2006 (the Rules) apply to:

- transactions between associated enterprises within a multinational company, where one enterprise is located in, and is subject to tax in, Kenya, and the other is located outside Kenya; and

- transactions between a permanent establishment and its head office or other related branches, in which case the permanent establishment shall be treated as a distinct and separate enterprise from its head office and related branches.

The Rules form the basis for the determination of the arm's length price in transactions between related parties. They entitle the Commissioner to adjust transaction prices where he is of the view that the related parties did not transact at arm's length.

The following transactions are subject to the transfer pricing rules;

- the purchase or sale of goods and services;
- the sale, purchase or lease of tangible assets;
- the transfer, sale, purchase or use of intangible assets;
- the provision of services;
- the lending or borrowing of money; and
- any other transactions which may affect the profit or loss of the enterprise involved.

> Documentation requirements in Kenya

Rule 10 of the Rules provides that:

'Where a person avers the application of arm's length pricing, such person shall –

i. develop an appropriate transfer pricing policy;
ii. determine the arm's length price as prescribed under the guidelines provided under these Rules; and
iii. avail documentation to evidence their analysis upon request by the Commissioner.'

A transfer pricing policy document will normally include the following information:

- the selection of the transfer pricing method and the reasons for the selection;
- The application of the Transfer pricing method, including the calculations made and price adjustment factors considered
- The global organization structure of the enterprise
- The details of the transaction under consideration.
- The assumptions, strategies and policies applied in selecting the method; and
- Such other background information as may be necessary regarding the transaction.

> Transfer Pricing Global Developments

On 23rd May 2016, the OECD Council approved the amendments to the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration ("Transfer Pricing Guidelines").

These changes focused on activating the 2015 OECD Base Erosion and Profit Shifting (BEPS) Report as well as implementing recommendations on Transfer Pricing Documentation and Country-by-Country Reporting. These two developments are discussed briefly below:

BEPS Report

Governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdictions and that the tax base reported by MNEs in their respective countries reflect the economic activity undertaken therein.

For taxpayers, it is essential to limit the risks of economic double taxation that may result from a dispute between two countries on the determination of an arm's length remuneration for their cross-border transactions with associated enterprises.

Country-by-Country documentation

The revised standards for transfer pricing documentation involve incorporating a master file, local file, and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity. Country-by-country reports will be disseminated through an automatic government-to-government exchange mechanism.

> Our Transfer Pricing Services

At Rödl & Partner, we have an experienced transfer pricing team with the skills, experience and tools to assist companies to both develop TP documentation and localize global TP documentation to bring them into line with local legislation.

We also assist MNEs in updating and implementing their existing global TP policies to mirror local legislation. Additionally, we guide and assist organisations undergoing change to identify and maximize profit opportunities in the value chain.

This is a general guideline tax alert and should not be a substitute for proper tax advice. For queries and clarification, kindly get in touch with Rödl & Partner.

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"With its growth potential, Africa is becoming an increasingly attractive investment destination. Many African countries enjoy political and economic stability and offer excellent opportunities for a business venture. The enormous range of opportunities poses, however, new challenges to companies venturing into Africa to do business there. Whether you are planning to start business in the renewable energies or the tourism sector, or want to launch an infrastructure project, you can always rely on our experienced Africa experts! They work to develop for you tailor-made solutions to help you break into new markets with a structured strategy and implement your business project in the African market."

Rödl & Partner

"Each element of our human towers supports another. This works only if we put to that more than just the physical abilities of all of us. It is the solidarity that gives us strength, structure, stability and – last but not least – the courage we need to develop great things."

Castellers de Barcelona

Each and every person counts" – to the Castellers and to us.

Human towers symbolise in a unique way the Rödl & Partner corporate culture. They personify our philosophy of solidarity, balance, courage and team spirit. They stand for the growth that is based on own resources, the growth which has made Rödl & Partner the company we are today.

„Força, Equilibri, Valor i Seny" (strength, equilibrium, valour and common sense) is the Catalan motto of all Castellers, describing their fundamental values very accurately. It is to our liking and also reflects our mentality. Therefore Rödl & Partner embarked on a collaborative journey with the representatives of this long-standing tradition of human towers – Castellers de Barcelona – in May 2011. The association from Barcelona stands, among many other things, for this intangible cultural heritage.

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