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Tax Alert Kenya

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Transfer Pricing in Kenya: Is your organization compliant?

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Preamble

By George Maina Rödl & Partner Kenya

In the past few years 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 per cent 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.

> Kenya: 2018 Transfer Pricing updates

In 2018 there have been several proposed changes to the current Transfer Pricing legislation in Kenya. Some of the proposals are discussed briefly below:

Income Tax Bill, 2018

The draft Income Tax Bill published in May 2018 contains several proposed changes to the current Transfer Pricing legislation. Some of the proposals include:

- Transactions between two related entities where one party is located in a "beneficial" or "preferential" tax regimes will be subject to transfer pricing. This may affect entities located in a Special Economic Zone (SEZ) or Export Processing Zone (EPZ);
- Expand transactions subject to transfer pricing to include insurance and re-insurance transactions; transaction of business restructuring or reorganization entered into by a person with an associated person and cost contribution arrangements; and
- Country-by-country reports to be filed with the KRA within twelve months after the last day of the reporting financial year of the multinational enterprise group.

Finance Bill, 2018

Following the reading of the National Budget for the 2018/19 financial year, the Finance Bill was published which had the following proposed change:

- The definition of "dividends" has been extended to include benefits arising out of related-party transactions such as discharge of intercompany debts (loan forgiveness) and external debts of a related party (loan novation). This will in effect introduce transfer pricing adjustment mechanisms to transactions between related resident entities.

> Transfer Pricing - Africa Developments

The African Tax Administration Forum (ATAF), an international organisation with full legal standing established under the Vienna Convention, published a Transfer Pricing Framework and accompanying Regulations as well as Explanatory notes.

This Framework is intended to be utilized as a suggested approach to Transfer Pricing legislation for different countries in Africa who are members of the ATAF.

The KRA is an active member of the ATAF and there is a possibility that Kenya's future Transfer Pricing Regulations or changes in legislation may be based off ATAF's Framework. From a Kenyan perspective, below are a couple of notable provisions suggested in ATAF's Framework:

- Controlled transactions that are economically closely linked to one another may be combined with one Transfer Pricing method applied; and
- Controlled transactions may be disregarded for tax purposes in cases where arrangements between related parties would differ from independent persons behaving in a commercially rational manner in comparable circumstances.

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> 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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