Tax Newsflash

Transfer Pricing considerations for multinationals in Kenya

Vol. 1/2024

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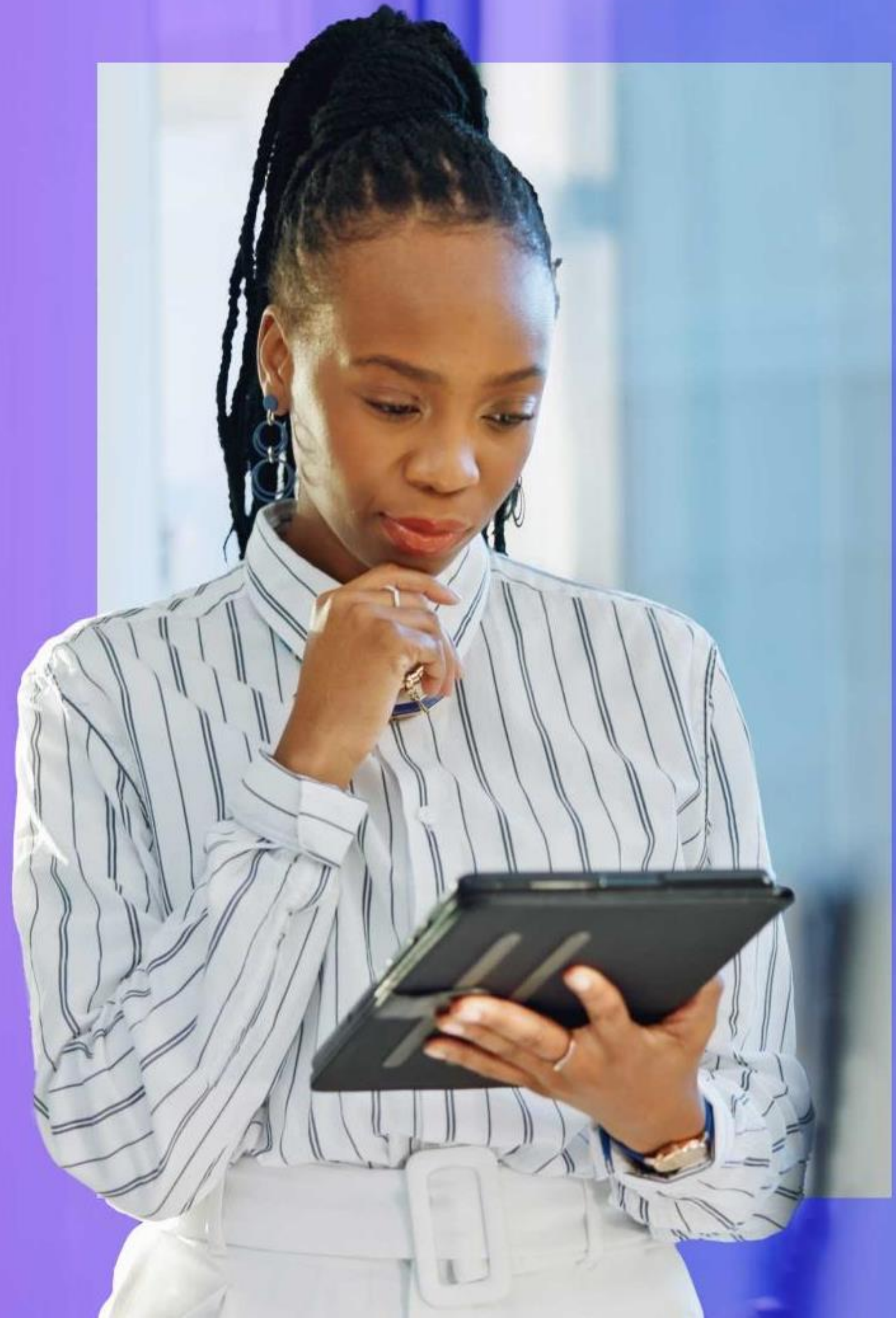
January 2024



Transfer Pricing considerations for Multinationals in Kenya

As the new year progresses, it is important for Multinational Enterprises (MNEs) to stay ahead of the intricacies of transfer pricing (TP) compliance and ensure that their TP practices align seamlessly with the evolving regulatory landscape. This is an opportune time for MNEs to look back and review their transfer pricing arrangements both from an operational effectiveness and compliance perspective.

The international tax and TP landscape globally and in Kenya has seen rapid changes. Multinational enterprises (MNEs) should be aware of these changes, especially in the context of recent regulatory developments and increased TP compliance requirements in Kenya.

In response to these and other significant changes, MNEs may wish to take action to address the following tax and transfer pricing developments:

1. Three-tiered approach to TP documentation
2. Year-end transfer pricing adjustments
3. Related party disclosures in the annual Income Tax Return (IT2C)
4. Tax amnesty
5. Branch profits tax
6. Draft Income Tax (Transfer Pricing) Rules, 2023
7. OECD Pillar One and Pillar Two developments
8. Finance Act 2023

1 Three-tiered approach to TP documentation

Effective 1 July 2022, Kenya introduced three-tiered annual transfer pricing reporting requirements for MNEs. This includes the Country-by-Country (CbC) report, master file, and local file.

MNEs are required to file an annual CbC report, which contains data on the MNE's global income allocation, taxes, and details of their economic activities in various jurisdictions. These measures aim to enhance transparency through comprehensive information exchange between revenue authorities.

The Income Tax Act (ITA) Cap. 470 of the Laws of Kenya (ITA) requires an ultimate parent entity or a constituent entity of a MNE with a gross consolidated turnover of at least **KES 95 billion** (including extraordinary or investment income), resident in Kenya, to file a CbC report with the Commissioner. This report should be filed within **twelve months** after the last day of the group's reporting financial year.

Additionally, a **CbC notification** must be filed by the constituent entity before the filing of a CbC report, no later than the last day of the group's reporting financial year.

Kenya is a party to the Convention on Mutual Administrative Assistance in Tax Matters (MAAC). Kenya deposited the instrument of ratification of the MAAC on 22 July 2020 which entered into force in Kenya on 1 November 2020. Further Kenya is a signatory to the Multilateral Competent Authority Agreement on the exchange of country-by-country reports (CbC MCAA) and has Activated exchange relationships for Country-by-Country reporting - OECD.

Where the UPE is not obligated to file a CbCR in its jurisdiction of tax residence, or in the absence of an activated exchange relationship, **local filing** of the CbCR by the constituent entity will be required.

Locally headquartered MNEs shall file a CbCR with the Commissioner not later than **twelve months** after the last day of the reporting financial year of the group;

MNEs should also review their compliance with the submission of the Master File, which contains standardised information relevant to the MNE group, and the Local File, which provides the relevant facts surrounding the controlled transactions.

An ultimate parent entity or a constituent entity of a multinational enterprise group is required to file the Master File and Local File to the Commissioner no later than six months after the last day of the reporting financial year of the MNE group.

CbC notification – due on the last day of the reporting financial year of the MNE group

Master File – due six months after the last day of the reporting financial year of the MNE group.

Local File – due six months after the last day of the reporting financial year of the MNE group.

CbC Report – due twelve months after the last day of the reporting financial year of the group;

2 Year-end adjustments

Year-end transfer pricing adjustments refer to changes made to the pricing of controlled transactions at the end of a financial year. They are used by MNEs to comply with their TP documentation and local TP regulations.

Despite their widespread use, these adjustments can present several operational and tax challenges. A year-end review enables companies to assess the ongoing relevance and effectiveness of their transfer pricing policies, identifying and mitigating potential risks associated with changing business and regulatory environments.

Increased compliance and transparency requirements, and the enhanced scrutiny of controlled transactions highlights the importance of strong operational transfer pricing (OTP) now more than ever. MNEs should consider OTP processes and solutions in order to streamline the implementation of transfer pricing policies, as well as integrate transfer pricing into the broader tax and finance processes.

Effective OTP makes the year-end close process more efficient and provides transparency to withstand scrutiny during a revenue authority audit.

It is also important to consider the impact of a year-end transfer pricing adjustment on customs compliance to help mitigate any customs risks.

3 Related party disclosures in the Income Tax Return (IT2C)

The Kenya Revenue Authority through a public notice on 5 June 2023, made changes to the Income Tax Corporation Tax (IT2C) return to include a form for declaration of related party transactions.

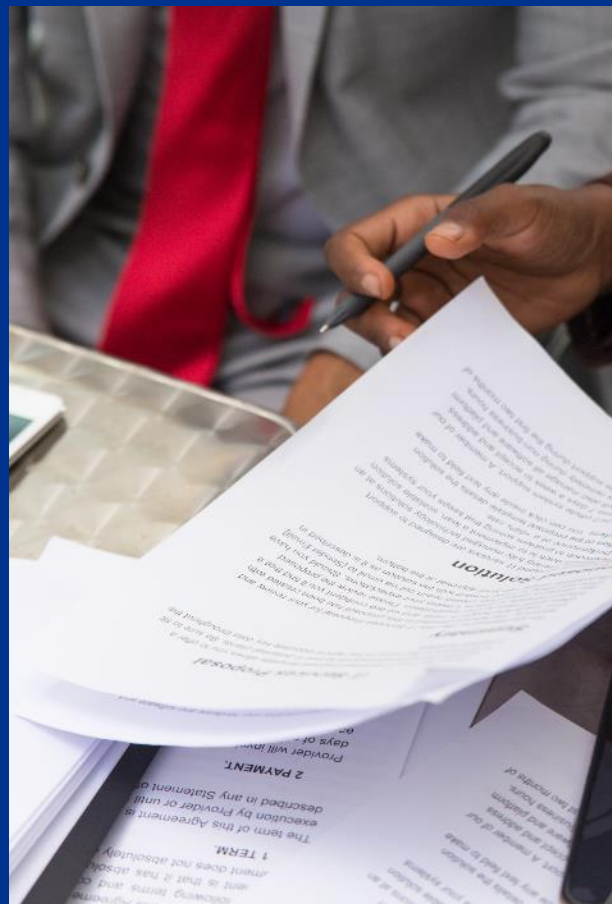
Taxpayers with related parties outside Kenya and/or any controlled transactions are required to disclose their transactions annually in the IT2C return.

Taxpayers are required to submit details of the related party transactions, financial performance of the local entity compared to the consolidated performance of the parent company, controlled transactions giving rise to taxable income as well as details of amounts due to or due from related parties. Further there is a requirement to disclose the transfer pricing method applied for the controlled transactions.

Read more

Income Tax Return - Declaration of Related Party or Controlled Transactions in the Income Tax Company Return.pdf (kpmg.com)

4 Tax amnesty



The Finance Act, 2023 (the Act) introduced a tax amnesty on interest and penalties on tax debt for periods up to 31 December 2022.

The tax amnesty will run from **01 September 2023** to **30 June 2024.**

This amendment aims to eliminate the power of both the Commissioner and the Cabinet Secretary to waive penalties and interest accruing after 1 January 2023. As a result, any outstanding penalties and interest after this date will be fully payable without the option for a waiver.

Given the potential complexities and risks associated with transfer pricing, companies are encouraged to conduct a review of their transfer pricing policies and documentation with a bid to assess their transfer pricing compliance status and take advantage of the amnesty on any arising penalties and interest.

Read more

Take advant age of the Tax Amnesty (kpmg.com)

5 Branch Profits Tax

Effective 1 January 2024, the Finance Act, 2023 introduced a provision to tax the after-tax profits on profits deemed to be repatriated by a permanent establishment at 15%.

The Act introduces a formula to determine the repatriated income as follows;

R= A1 + (P - T) – A2

R - the repatriated profit;

A1 - net assets at the beginning of the year;

P - net profit for the year of income calculated in accordance with generally accepted accounting principles;

T -the tax payable on the chargeable income; and

A2 - the net assets at the end of the year.

The net assets has been defined as the total book value of assets less total liabilities for the year of income and shall not include revaluation of assets.

In light of the above, branches should assess the impact of the new regulation on operations, ensure accurate financial documentation, and stay informed on compliance deadlines.

6 OECD Pillar One and Pillar Two

In October 2021 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (Inclusive Framework) agreed a two-pillar solution to reform the international tax framework in response to the challenges of digitalisation of the economy. As part of the October Statement, Inclusive Framework members agreed to a co-ordinated system of Global anti-Base Erosion (GloBE) rules that are designed to ensure large multinational enterprises pay a minimum level of tax on the income arising in each jurisdiction where they operate.

The OECD has released Model Rules on Pillar one and Pillar Two as approved by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS).

Pillar One, applicable to large multinational corporations, will reallocate certain amounts of taxable income to market jurisdictions. This will lead to changes in the effective tax rate and cash tax obligations and will also affect current transfer pricing arrangements. It is crucial for MNEs to evaluate the long-term effects of these changes, as the OECD plans to expand the number of entities subject to Pillar One over time.

The implementation timeline for Pillar One is uncertain and hinges on its approval by a significant number of jurisdictions. Under the agreement, digital services taxes and other similar measures are set to be abolished, but the specifics and timeline are yet to be determined. The range of businesses covered has significantly deviated from the initial focus on highly digitalized business models. While extractive and regulated financial services are exempt, most other industries are generally included.

Pillar Two on the other hand includes the global minimum tax and the Subject to Tax Rule (STTR). The STTR is a treaty-based rule that allows source jurisdictions to reclaim taxes when certain categories of cross-border intra-group covered income are subject to nominal corporate income tax rates below 9%. The global minimum tax is based on the Global Anti-Base Erosion (GloBE) Model Rules. These rules allow a jurisdiction to impose a top-up tax on the low-taxed income of in-scope taxpayers up to 15%.

The GloBE rules, when introduced in domestic law, work in conjunction with those of other jurisdictions to create a coordinated system of minimum taxation. This ensures that large multinational enterprise groups (MNE Groups) pay a minimum level of tax on their income in every jurisdiction where they operate.

On 30 September 2023, the African Tax Administration Forum (ATAF) released its revised Suggested Approaches to Drafting Domestic Minimum Top-up Tax (DMTT) Legislation. The DMTT is part of the GloBE rules, which aim to ensure that large multinational enterprises' global profits are taxed at a minimum Corporate Income Tax rate of 15%. It is anticipated that Kenya will draft legislation on Pillar Two in line with the suggested approach by OECD and ATAF.

Read more

BEPS 2.0: Pillar One and Pillar Two - KPMG Global

7 Draft Income Tax (Transfer Pricing) Rules, 2023

On 4 September 2023, the Commissioner published the Draft Income Tax (Transfer Pricing) Rules, 2023 (The Draft Rules). Upon gazettement, The Draft Rules will revoke the existing Income Tax (Transfer Pricing) Rules 2006, which are currently in force.

Some key provisions of the Draft TP Rules include:

a) Application of transfer pricing regulations to transactions between resident and both resident and non-resident parties located in **preferential tax regimes**, whether related or unrelated;

b) Wider scope of transactions subject to Transfer Pricing Rules; The Draft Rules have expanded the scope of transactions subject to TP rules to include insurance and re-insurance transactions, cost contribution arrangements (CCA's), transactions involving derivatives and transactions of business restructuring.

c) Wider scope of the information requested by the Commissioner; The Draft Rules has broadened the extent of information that the Commissioner may request. This includes but not limited to segmented financials, tested party financials even when the entity is outside the country, allocation schedules, APA arrangements.

d) Arm's length price in relation to importation and exportation of commodities

Going forward, businesses should conduct a thorough review of their existing transfer pricing policies and documentation to ensure they are aligned to the new rules, should these be gazetted into law.

Read more

[Tax Alert on Draft Transfer Pricing Rules 2023.pdf (kpmg.com)]

8 Finance Act, 2023

The President signed into law the Finance Act, 2023 (Act) on 26 June 2023. The Act was subsequently gazetted on 27 June 2023. While most of the changes took effect from 1 July 2023 and 1 September 2023, a few others took effect on 1 January 2024.

Some key changes impacting international tax and transfer pricing include;

- Reduction of the corporate tax rate applicable to branches from 37.5% to 30% and further introduced a provision to tax the after-tax profits on profits deemed to be repatriated by a permanent establishment at 15%.
- Introduction of Digital Assets Tax (DAT) of 3% to be paid on income derived from the transfer of digital assets including cryptocurrencies, NFTs and similar digital assets. The owners of the platform are to deduct and remit the DAT to the KRA within 5 working days after making the deduction. Non-resident owners of the platforms through which digital assets are exchanged or transferred are required to register under the simplified tax regime, similar to the existing regime under Digital Services Tax.
- Introduction of mutual administrative assistance in tax matters. The provision provides for administrative co-operation between Kenya and other states in the assessment and collection of taxes. This co-operation ranges from exchange of information, (spontaneous, on request or automatic), tax examinations abroad, simultaneous tax examinations and assistance in collection of taxes.
- Introduction of the restriction on the deduction of WHT paid against income adjusted by an audit. The Act restricts taxpayers from getting a deduction for WHT paid on payments to non-resident persons where an audit adjustment has been made in respect to such payments.

Read more on Finance Act 2023 changes

KPMG Finance Act 2023 Analysis

KPMG is happy to assist on any issues arising from this alert. You can contact our tax and regulatory team on taxandregulatory@kpmg.co.ke

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