

GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

Kenya

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TAX



Kenya



KPMG observation

Although the introduction of transfer pricing rules in Kenya is fairly recent, the Kenya Revenue Authority (KRA) has since started to conduct transfer pricing audits. The KRA currently chairs the Africa Tax Administrators Forum Transfer Pricing roundtable and assists other African tax authorities in performing transfer pricing audits. The KRA has so far issued assessments (deficiency notices) of up to 50 million United States dollars (USD) to taxpayers and it is expected that this focus will continue because all on-going tax audits must incorporate a report of findings on taxpayer transfer pricing activities.

We note that there is increased cooperation with other competent authorities around the world for both information sharing and settling transfer pricing disputes through mutual agreement procedures (MAPs).

Basic information

Tax authority name

Kenya Revenue Authority (KRA).

Citation for transfer pricing rules

Legal Notice no. 67 of 2006 and Section 18 (3) of the Income Tax Act (ITA).

Effective date of transfer pricing rules

1 July 2006.

What is the relationship threshold for transfer pricing rules to apply between parties?

An enterprise will be deemed to be related to another:

- if one of the enterprises participates directly or indirectly in the management, control or capital of the other enterprise or a third person participates directly or indirectly in the management, control or capital of both enterprises
- where an individual who participates in the management, control or capital of the business of one, is associated by marriage, consanguinity or affinity to an individual who participates in the management, control or capital of the other.

The transfer pricing rules apply to cross-border transactions and to transactions undertaken between a permanent establishment and its head office or other related branches.

What is the statute of limitations on assessment of transfer pricing adjustments?

Seven years from the year to which the income relates.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Although the ITA does not require taxpayers to include copies of transfer pricing documentation when submitting the annual tax return, the KRA has, in the past, released a form (as an appendix to the tax return) where taxpayers should disclose details of related party transactions. Given the significance of transfer pricing as a source of tax revenues, this form is likely to be introduced as a formal requirement when filing tax returns.

Transfer pricing documentation should be reviewed annually to ensure that it remains relevant in view of changes in the business environment. According to the transfer pricing rules (paragraph 10), the Commissioner can request documentation at any time – thus documentation must be readily available.

What types of transfer pricing information must be disclosed?

The following information must be disclosed:

- the selection of the transfer pricing method and the reasons for the selection
- the application of the 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
- other background information on the transaction may be necessary.

What are the consequences of failure to prepare or submit disclosures?

The consequences of not preparing or submitting transfer pricing documentation that contains related party disclosures includes the potential shifting the burden of proof to the taxpayer, penalties, interest on additional taxes, higher audit risk and the possibility of double taxation.

Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

Yes. There is a statutory requirement to prepare a transfer pricing policy study for the following transactions:

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

Failure to document a transfer pricing policy may result in price adjustments and subsequent tax on the adjusted transaction price.

Compliance penalties apply when a taxpayer fails to file the required returns in a timely manner. The penalty is an additional tax of five percent of the normal tax or 10,000 Kenyan shillings (KES), whichever is higher.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

The benefits are as follows:

- shifting burden of proof
- penalty protection
- reduced tax exposures

- assisting in aligning cost bases for tangible products for indirect taxes such as excise and customs duty
- helping the company in the realignment of its activities, risks and assets
- reducing the risk of tax audits and adjustments
- the ability to meet the expectation that the taxpayer will have documentation prepared for submission if the KRA requests it.

Where the Commissioner has made a transfer pricing adjustment that results in the collection of any tax due and not paid, such tax shall be deemed to be additional tax which, under the ITA will attract penalties (20 percent of the unpaid tax) and interest for the period of time the tax has been understated (two percent per month or part thereof shall be charged on the amount of tax remaining unpaid for more than one month after the due date until payment).

Any taxpayer who, in relation to any year of income, knowingly omits any amount from their income tax return is liable to additional tax equal to double the difference between the tax chargeable according to the submitted return and the normal tax properly chargeable in respect of the total income assessable. If the taxpayer acted with negligence, a penalty equal to one half of such additional tax is payable.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

Where a person claims to apply arm's length pricing on transactions with related non-resident entities such person is required to develop and document an appropriate transfer pricing policy.

Such documentation should be provided to the Commissioner on request. However, with most African tax authorities now requiring contemporaneous documentation, it is likely that contemporaneous documentation requirements will be in place in the near future.

When a transfer pricing study is prepared, should its content follow Chapter V of the OECD Guidelines?

Yes.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No. However, effective 1 July 2014, all tax advisors must be licensed by the Commissioner to practice in Kenya.

Transfer pricing methods

Are transfer pricing methods outlined in Chapter II of the Organisation for Economic Co-operation and Development (OECD) Guidelines acceptable?

Yes. However, the Commissioner may prescribe other methods where in his opinion, the Chapter II methods (which are similar to those in the transfer pricing rules) do not yield an arm's length price.

Is there a priority among the acceptable methods?

Paragraph four of the transfer pricing rules states that the taxpayer may choose the most appropriate method to employ in determining the arm's length price from among the methods set out in paragraph seven (these include the methods noted previously). However, the Commissioner may from time-to-time prescribe other methods where in view of the nature of transactions, the arm's length price cannot be determined using any of the previously mentioned methods.

If there is no priority of methods, is there a "best method" rule?

Yes. The taxpayer should apply the most appropriate method with due regard to the nature of the transaction, or class of transaction, or class of related persons or function performed by such persons in relation to the transaction.

The best method is seen as the method that:

- best approximates the arm's length result
- uses the most reliable data
- has the fewest adjustments to the data.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, how long does the taxpayer have to submit its documentation?

The KRA may require a taxpayer to furnish documentation within a specified time, usually no less than 30 days.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

An aggrieved taxpayer has recourse through an appeal procedure system established under the ITA. The order of appeal for an adjustment proposed by the tax authorities is as follows:

- first level: Local Committee
- second level: High Court of Kenya
- third level: Court of Appeal
- fourth level: Supreme Court of Kenya.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

A sustained adjustment results in unpaid corporation tax. Any assessment raised is arrived at based on the impact of the existing transfer pricing policy on taxable profits and consequently on corporation tax. Therefore, in arriving at the tax payable on the revised taxable profit, the KRA applies the corporation tax rates of 30 percent on residents and 37.5 percent on non-residents.

Under the ITA, penalties accrue on unpaid taxes at the rate of 20 percent. Additionally, the principal tax outstanding attracts interest at two percent per month over the period it remains unpaid. However, because of the *in duplum* rule, the interest is capped to a maximum of the principal tax assessed on adjustment.

To what extent are transfer pricing penalties enforced?

Transfer pricing penalties are enforceable to the full extent of the Income Tax Act. The Commissioner may recover the taxes due from the person assessed e.g. through attaching bank balances and registering liens over fixed assets.

What defences are available with respect to penalties?

Documentation forms the basis for penalty protection. A taxpayer is expected to capture all justification in the transfer pricing documentation for demonstrating the arm's length nature of prices charged on intra-group transactions.

What trends are being observed currently?

The tax authority is vigilant on training its staff on transfer pricing to ensure enforcement of the transfer pricing rules. For example, transfer pricing audit teams are specializing based on the different aspects of a documentation report. Thus the KRA audit team will have an expert on functional analysis, asset analysis, risk analysis, economic analysis etc.

Additionally, the tax authority has subscribed to Orbis as a benchmarking tool. This tool has over 65 million companies in its database and is more advanced than the benchmarking tools currently in use by most tax advisors.

The KRA is conducting more audits on multinational corporations and levying tax penalties on transfer pricing adjustments on sale of goods and services, financial transactions, shared services, etc.

Special considerations

Are secret comparables used by tax authorities?

No secret comparables are used by the revenue authorities.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes. KRA has expressed a preference for local comparables, especially where comparable uncontrolled prices are readily available and have intimated the possibility of making country risk adjustments where comparables from different geographical locations such as Europe are used.

Do tax authorities have requirements or preferences regarding databases for comparables?

No. The KRA does not have requirements or preferences regarding databases to be used for comparables. However the larger the database to be used, the more optimal the transfer pricing benchmarking results. As stated earlier, KRA is at an advantage as it uses a more comprehensive database (Orbis). This may result in differing benchmarking results as compared to other databases, consequently resulting in tax exposures to the particular companies involved.

What level of interaction do tax authorities have with customs authorities?

In Kenya, all domestic taxes are administered under the Commissioner of Domestic Taxes of the KRA, even though Customs is headed by a Commissioner. These domestic taxes include: customs and excise duties, VAT and corporation tax among others. As such, the level of interaction among these tax administration departments is relatively high.

Are management fees deductible?

Yes, except if the management fees are paid by a branch to its non-resident head office.

Are management fees subject to withholding?

Management fees are subject to withholding tax at a rate of 20 percent if paid to a non-resident person. However, this rate may vary depending on whether Kenya has a Double Tax Agreement (DTA) with the country which the management fees are being paid to.

On the other hand, withholding tax is not applicable on management fees paid by a branch to its non-resident head office.

Are year-end transfer pricing adjustments permitted?

Yes, but it should be carefully executed. It has to be pre-agreed and clearly show a change of transfer prices (not transfer of profit).

Other unique attributes?

Before the issuance of the specific transfer pricing legislation, the KRA had engaged a Kenyan multinational in the High Court with regard to transfer pricing issues. The KRA has also proposed to amend the annual tax return to include a section on transfer pricing disclosures.

Other recent developments

From a country perspective, the government has embarked on the enhancement of the capacity of the KRA in terms of staff skills in the area of transfer pricing, not only for the purposes of keeping abreast of emerging tax planning trends, but also to ensure that adequate measures are put in place to address tax avoidance whenever it arises.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Minimal.

If extensive, is the competent authority effective in obtaining double tax relief?

Sometimes.

When may a taxpayer submit an adjustment to competent authority?

In the event that the tax adjustment will affect both countries and may involve transfer of profits and therefore impact on tax paid with respect to the respective years.

May a taxpayer go to competent authority before paying tax?

Yes, we have previous experience with competent authority in UK (HMRC).

Advance pricing agreements

What Advance Pricing Agreement (APA) options are available, if any?

No APAs or advance rulings of any kind are unavailable. However, a taxpayer may seek a non-binding opinion from the KRA on the interpretation or administration of the tax provisions.

Is there a filing fee for APAs?

Not applicable.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

Not applicable.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

Not applicable.

Language

In which language or languages can documentation be filed?

English.

KPMG in Kenya

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