# Transfer Pricing Country Summary

## Kenya

June 2022

# 1. Introduction

Kenya introduced Transfer pricing rules in 2006 to supplement the provisions of section 18 (3) of the Income Tax Act (ITA) 2006, Cap 470, as amended by the Income Tax rule, 2012 and Income Tax rule, 2014. Section 18(3) of the Income Tax Act empowers the Commissioner of Domestic taxes to adjust the profits accruing to a resident corporate person from intercompany transactions with non-resident persons to reflect such profits that would have accrued, if the transaction was conducted at arm's length by independent parties. The Minister is also empowered to issue guidelines for the determination of the Arm's Length value of a transaction, and to specify further requirements to foster the TP provisions, especially the documentation requirements.

# 2. Laws & Regulations

## a) References to OECD/EU/Local Rules

- Section 18 (3) of the Income Tax Act (ITA) 2006,
- Cap 470, as amended by the Income Tax rule, 2012 and Income Tax rule, 2014.
- Section 18(3) of the Income Tax Act.

## b) Definition of Related Party

Entities are regarded as related if each participates in the capital, control and management of the business of both, be it within or out of the Kenyan borders, or if a third person has direct or indirect participation in the management, control or capital of both of the business of the other. Also, any individual who is associated by marriage, is a blood relative or has an affinity to an individual involved in the management, control or capital of the business of the other is considered to be a related party. The minimum threshold for control is 25% of the shareholding or voting power in the entity, unless the type of corporation implies other specifications.

## c) Nature of Transfer Pricing Documentation

- Kenya aims to enforce new TP rules, in accordance with BEPS Action 13 to enhance transparency in TP documentation. Currently, Kenya has a TP documentation model that comprises of a local and a Master file. Schedule 8 pr. 11 that CbCR documentation shall be enacted for MNE entities. The KRA (Indian Tax Authority) may request certain additional documents as part of the TP audit.
- Books of the MNE as well and accounts.
- The selection of the transfer pricing method
- The application of the method, and justification on the arm's length principle
- The global organization structure of the enterprise;
- The details of transactions under consideration
- The strategies, and policies applied in selecting the method
- Background information as may be necessary regarding the transaction.

## d) Tax Havens & Blacklists

Kenya does not have a blacklist of countries that are considered tax havens.

## e) Advance Pricing Agreement (APA)

There is not a mechanism for APAs in place currently in Kenya.

### f) Audit Practice

Kenya is one of the African countries with a high risk, and requires maximum TP scrutiny. The Kenya Revenue Authority (KRA) has established a Transfer Pricing unit with a team of about 15 officers. The TP Unit is charged with TP audits as demonstrated by its aggressive request for taxpayers to furnish documentation. Generally, selection for audit is based on risk profiles, with considerations including but not limited to the following factors:

- Consistency in tax remittances gauged through trend analysis;
- Benchmarking against sector or industry statistics;
- Intelligence gathering including information supplied through the KRA's Information Reward Scheme; Industry/ sector peculiarities - such as prevalence of cash transactions, offshore activities;
- Special considerations - such as large investment deductions or transfer pricing for multinationals;
- Compliance record determined through results of past audits, nil and non-filer returns;
- Record of persistent losses and general random selection.

Audits are generally carried out within the taxpayer's premises, could comprehensive or single-issue audits. The Kenya Revenue Authority conducts periodic refresher courses for its officials on a wide range of issues. It also operates a 'Kenyan Revenue Training Institute (KRATI)' in Mombasa, which, in partnership with other foreign institutions delivers specialist training and capacity building to its staff. It is therefore no doubt that scrutiny on TP matters by the KRA is extremely high.

## 3. Transfer Pricing Documentation

### a) Level of Documentation

With the strict transfer pricing documentation requirement, MNE' must document their intercompany transactions. The time taken to respond to the KRA requests (about 3 months) may give reason why voluntary compliance is relatively low. However, the KRA requires a detailed documentation from the taxpayer, which includes:

- The method used in determining the transfer price and the reasons for its selection;
- The application of the method including the calculations made and price adjustment factors considered;
- The global organizational structure of the enterprise;
- Details of the transactions under consideration;
- The assumptions, strategies and policies applied in selecting the method and such other background information as may be necessary regarding the transaction.

### b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

### c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

### d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

### e) Choice of Transfer Pricing Method

In principle and practice, in the absence of the arm's length price in intercompany transactions, the Income Tax Act provides for a substitution of the price by the actual market price. In so doing the Kenyan High court acknowledged the 'OECD Transfer Pricing Guidelines' represents the international accepted standard and principles used in applying transfer pricing rules. The OECD guideline is thus applicable in the absence of a specific guidance in the Kenyan TP rule. The Transfer Pricing methods that pertain in Kenya as per the Income Tax Act (ITA) are:

· The Comparable Uncontrolled Price Method (CUP);

· Resale Price Method (RPM);

· Cost Plus Method (C+);

· Transactional Net Margin Method (TNMM)

and the · Transactional Profit Split Methods (PSM)

· And such other method as may be prescribed by the commissioner from time to time, where in his opinion and in view of the nature of the transaction, the arm's length price cannot be determined using any of the methods contained in the guidelines

### f) Economic Analysis – Benchmark Study

A benchmark study is required in Kenya so as to determine the arm's length principle of the transactions. Accordingly, local comparables are preffered as well and comparables from other countries in Africa. International comparables may be accepted depending on the TP method used as well and the circumstances of the case.

### g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the ''conduct of parties'' the prevailing concept.

### h) Financial Statements

Taxpayers need to disclose their financial statements when filling their TP documentation.

### i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. This information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

| | Prepare or File? | Format | Deadline | Notification Deadline* | Threshold* (Yes/No) | Local Language (Yes/No)*(If "No", it can be filed in English) |
|---|---|---|---|---|---|---|
| **Corporate Income Tax** | File | Special form | The return is due within six months following the company's financial year-end. | n/a | n/a | n/a |
| **Master File** | n/a | n/a | n/a | n/a | n/a | n/a |
| **Local File** | n/a | n/a | n/a | n/a | n/a | n/a |
| **CbCR** | File (not called CbCR) | Special form | 31/12/2022 (no later than 12 months after the reporting period) | n/a | n/a | No |
| * Country has signed the MCAA agreement for the filing of CBCR. | | | | | | |
| * Country does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises. | | | | | | |

## j) Mandatory Language

Tax returns, records or other documentation must be prepared and submitted in the English or Swahili language; at the time the transfer price is arrived at.

## k) Notification Requirement

The KRA requires Transfer pricing documentation be furnished within 30 days upon request by the commissioner. Tax return deadlines are due on the last day of the sixth months following the end of the business accounting period/date.

## l) Record Keeping

ax records, all receipts and expenses, of goods purchased and sold and accounts, books, deeds, contracts and vouchers, which in the opinion of the Commissioner are adequate for the purpose of computing tax, must be kept for a period of at least 10 years. The Commissioner may equally order the preservation of such tax documentation; contravention of which may expose the taxpayer to penalties not exceeding twenty thousand shillings as the Commissioner deems fit.

## m) Penalties and Interest Charges

The KRA relies on tax revenue to fuel the country's economic growth. Thus, contravention of any Tax Law is highly penalized. The provisions of the Income Tax Act relating to fraud, failure to furnish returns and underpayment of tax also applies to transfer pricing, thus:

- Failure to furnish a tax return or give notice to the commissioner as required is penalized by an additional tax equal to 5% of the normal tax;
- Failure to file a provisional return as requested by the commissioner exposes the taxpayer to an additional tax of 3% of the normal tax;
- An omission to include taxable income, or claims of undue tax reliefs, incorrect tax statements, fraud, or gross negligence is penalized with a tax not exceeding two times the normal amount chargeable; or a fine not less than 1000KS and or more than 50,000KS with respect to each return; and,
- If any amount of tax remains unpaid after the due date, a penalty of 20% of the amount immediately becomes due, except where tax installment penalties are applicable.