



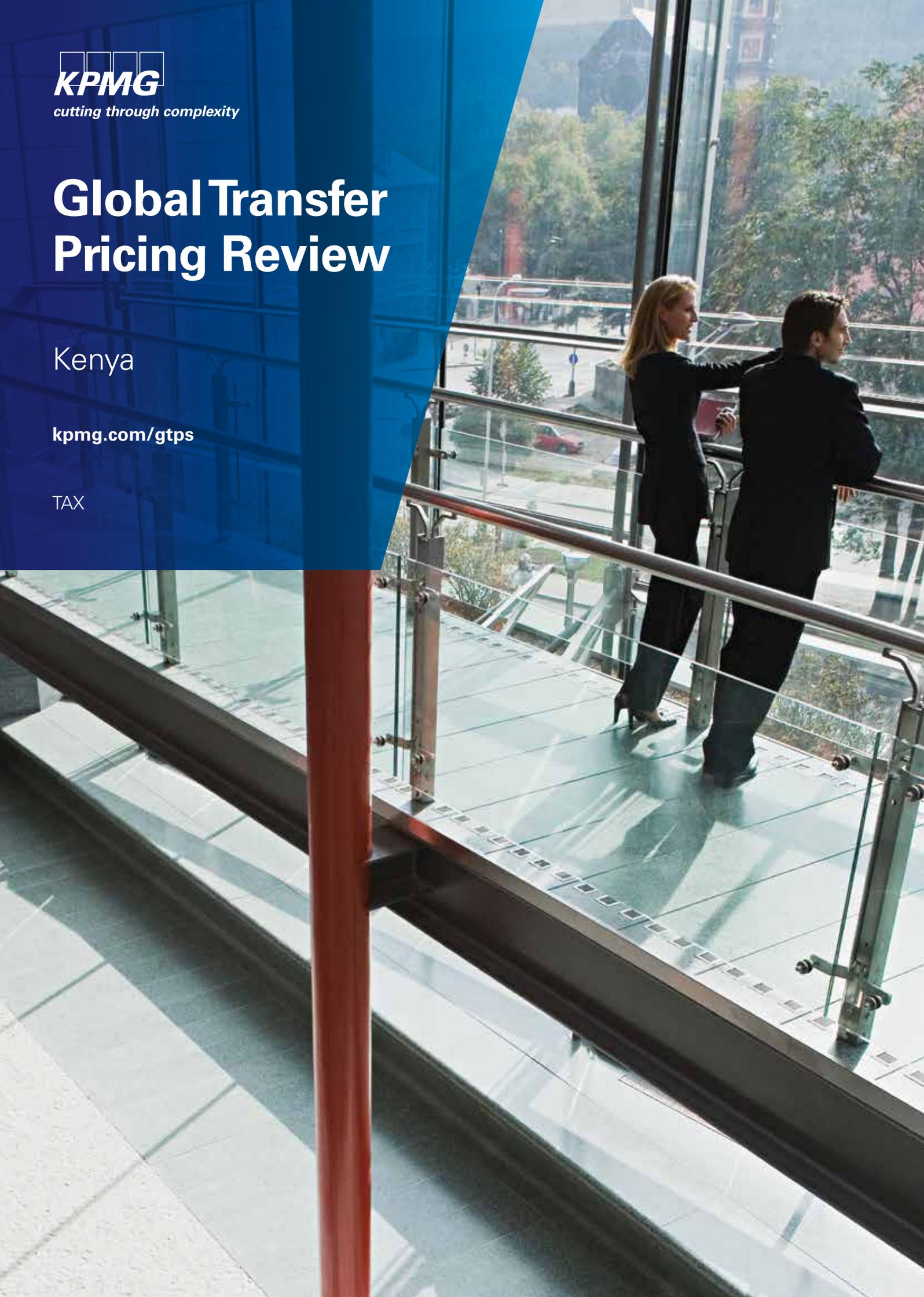
cutting through complexity

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 USD50 million to taxpayers and it is expected that this focus on transfer pricing will continue since all ongoing tax audits must incorporate a report of findings on taxpayer transfer pricing activities.

As a recent trend, KPMG in Kenya notes that there has been increased cooperation between Kenya and other competent authorities around the world for both information sharing and settling transfer pricing disputes through mutual agreement procedures (MAPs).

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Applicable
Legal requirements	●
Protection from penalties	●
Reduce risk of adjustment	●
Shifts burden of proof	●

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; or

- 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 submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. Although the ITA does not require taxpayers to include copies of transfer pricing documentation when submitting the annual tax return, the KRA has introduced an online tax return platform where taxpayers should disclose details of the related party transactions.

What types of transfer pricing information must be disclosed?

The disclosure required while filing the tax return is the related party, the transaction value and description of the transaction.

What are the consequences of failure to submit disclosures?

The consequences of not providing the related party disclosures details entails filing an erroneous return and it is a trigger for an audit.

Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

It should be in English.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, for all transactions. 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, and thus documentation must be readily available.

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

No.

Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

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.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 30 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

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, what dispute resolution options are available?

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; and
- 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 defenses 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.

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes, sometimes.

Does the tax authority have other preferences in benchmarking? If so, please describe.

Preference is given to the CUP method if it is available.

The KRA advocates for the use of the median and are not comfortable with accepting that the arm's length price lies within the interquartile range.

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 there limitations on deductibility of management fees beyond the arm's length principle?

Yes, some. Management's fees paid by a branch to the head office are not deductible expenses in arriving at the taxable profits. They are also not subject to withholding tax. Management fees beyond the arm's length price, will not be allowable deductions when arriving at the taxable income for corporation tax.

Are management fees subject to withholding?

Yes.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

Yes. Where the royalty payments exceed the arm's length price, the excess royalty payments will not be allowable deductions when arriving at the taxable income for corporation tax.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

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.

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, it may involve transfer of profits and therefore impact on the 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 APA options are available, if any?

None.

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.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

Not applicable.

KPMG in Kenya

Peter Kinuthia

Tel: +254 20 2806 000

Email: pkinuthia@kpmg.co.ke

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