Transfer Pricing Country Summary
Kenya

May 2018

Legislation

Existence of Transfer Pricing Laws/Guidelines

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.

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.

Transfer Pricing Scrutiny

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 taxpayers 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.

Transfer Pricing Penalties

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.

Advance Pricing Agreement (APA)

There is presently no mechanism in the Act for an Advanced Pricing Agreement between the KRA and a Taxpayer.

Safe Harbor

In a bid to deter mass debt financing by non-resident intercompany transactions, the Kenyan thin capitalization rules are applied when the debt/equity ratio exceeds 3:1. Thin capitalization is calculated by taking into effect negative reserves; effective since 13 June 2008.

Documentation And Disclosure Requirements

Tax Return Disclosure

According to the Act, the Commissioner may by a notice in writing, require a person to furnish within thirty days a tax return for income, constituting any year of income. The tax return must contain a full and true statement of the income; deemed income; liable to tax and a documentation to substantiate the return as required; including a declaration signed by the person, or persons in whose name it is assessed. A form for the tax return is available online and it requires names of the foreign related party and disclosure of raw material used or transactions of trading stocks carried out.

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.

Record Keeping

Tax 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.

Language of Documentation

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.

Small and Medium Sized Enterprises (SMEs)

There is currently no special regime for Small and Medium sized enterprises in the Kenyan transfer pricing rules.

Deadline to Prepare Documentation

There is no statutory deadline for the preparation of documentation.

Deadline to Submit Documentation

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.

Statute Of Limitations

In Kenya, the statute of limitations for transfer pricing assessments is seven years after the relevant year of income; unless the Commissioner has reasonable cause to believe that fraud or gross or willful negligence has been committed in connection with, or in relation to tax for a year of income.

Transfer Pricing Methods

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

Comparables

Generally local comparables are preferred, however, often data from Kenya and the rest of Africa are not documented well enough. Therefore, since the onus is on the taxpayer to substantiate the arm's length nature of a transaction, most taxpayers in Kenya rely on European Databases such as 'Amadeus' in testing the arm's length nature of their transactions. The issues stemming from this use is that, the foreign databases may not reflect the actual market/ transactional circumstance and, or comparable to businesses in Kenya. This setback may complicate adjustments during benchmarking.