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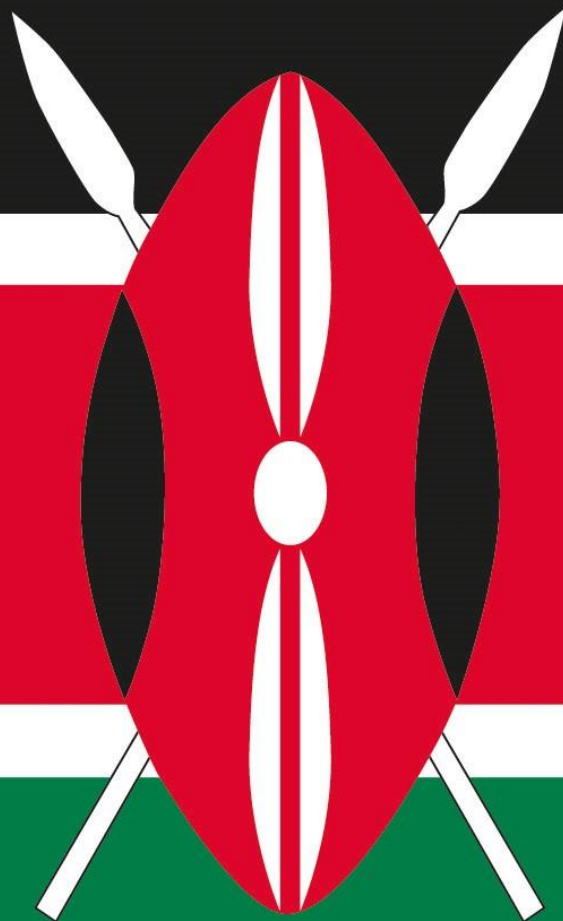
NEWSFLASH KENYA

TRANSFER PRICING

Issue:
January
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Latest news on law, tax and business in Kenya

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→ Background

In the past few years there has been increased attention on activities of multinational enterprises (MNEs) in Kenya and the East Africa region with a particular focus on pricing arrangements of transactions between related parties.

The Kenya Revenue Authority (KRA) has been aggressive in pursuing transfer pricing malpractices and has issued huge assessments against non-compliant taxpayers. Is your organization compliant?

→ Transfer Pricing Definition

Transfer pricing refers to the pricing of goods, services and intangibles (in the case of royalties) between related parties located in different countries.

Transactions between related parties are to be carried out at an “arm’s length” basis. Abuse of transfer pricing is illegal and occurs

when related entities manipulate the pricing of transactions between themselves resulting in transactions that are not carried out at arm’s length. Transfer pricing is an important area for revenue authorities as it is estimated that about 60 per cent of international trade happens within multinational entities.

→ Transfer Pricing in Kenya

In Kenya, Transfer Pricing rules became effective from 1st July 2006 and borrowed significantly from the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines.

Under Section 18(3) of the Income Tax Act (ITA), transactions between a resident entity and its related non-resident should be at arm’s length.

The Income Tax (Transfer Pricing) Rules, 2006 (the Rules) apply to:

- Transactions between associated enterprises within a multinational company, where one enterprise is located in, and is subject to tax in, Kenya, and the other is located outside Kenya; and
- Transactions between a permanent establishment and its head office or other related branches, in which case the permanent establishment shall be treated as a distinct and

separate enterprise from its head office and related branches.

The Rules form the basis for the determination of the arm’s length price in transactions between related parties. They entitle the Commissioner to adjust transaction prices where he is of the view that the related parties did not transact at arm’s length.

The following transactions are subject to the transfer pricing rules;

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

→ Documentation requirements

Rule 10 of the Rules provides that:

“Where a person avers the application of arm’s length pricing, such person shall –

1. develop an appropriate transfer pricing policy;
2. determine the arm’s length price as prescribed under the guidelines provided under these Rules; and
3. avail documentation to evidence their analysis upon request by the Commissioner. ”

A transfer pricing policy document will normally include the following information:

- the selection of the transfer pricing method and the reasons for the selection;
- the application of the Transfer pricing 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; and
- such other background information as may be necessary regarding the transaction.

→ 2019 Transfer Pricing updates

- On 5 December 2019, Kenya's National Assembly approved the bill for the ratification of the OECD-Council of Europe Convention on Mutual Administrative Assistance in Tax Matters as amended by the 2010 protocol.

The Convention, signed by Kenya on 2 February 2016, will enter into force for the country on the first day of the third month after the ratification instrument is deposited and will generally apply from 1 January of the year following its entry into force.

- On 26 November 2019, OECD announced that Kenya signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS).

According to its provisional list of reservations and notifications, Kenya intends to have the multilateral treaty cover 14 of its tax treaties. For the multilateral treaty to become effective for a particular treaty, both parties to a treaty must have included the treaty as a covered agreement, and both must have completed the required procedures for the ratification of the Multilateral Convention Treaty.

- The Convention is the first multilateral treaty of its kind, allowing jurisdictions to integrate

results from the OECD/G20 BEPS Project into their existing networks of bilateral tax treaties. The OECD/G20 BEPS Project delivers solutions for governments to close the gaps in existing international rules that allow corporate profits to “disappear” or be artificially shifted to low or no tax environments, where companies have little or no economic activity. The Convention became effective on 1 January 2019 and now applies to 114 tax treaties concluded among the 37 jurisdictions that have already deposited their instrument of acceptance, approval or ratification.

The Convention, negotiated by more than 100 countries and jurisdictions under a mandate from the G20 Finance Ministers and Central Bank Governors, is one of the most prominent results of the OECD/G20 BEPS project. It is the world’s leading instrument for updating bilateral tax treaties and reducing opportunities for tax avoidance by multinational enterprises. Measures included in the Convention address treaty abuse, strategies to avoid the creation of a “permanent establishment”, and hybrid mismatch arrangements. The Convention also enhances the dispute resolution mechanism, especially through the addition of an optional provision on mandatory binding arbitration, which has been taken up by 30 jurisdictions.

CONTACT FOR FURTHER INFORMATION



George Maina
Tax Consultant (Kenya)
Associate Partner
T +254 775 9740 50
george.maina@roedl.com

This is a general guideline tax and legal alert and should not be a substitute for proper advice. For queries and clarification, kindly get in touch with Rödl & Partner

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(opp. Westgate Mall)
Peponi Road, Nairobi
+254 (775) 974 050 | www.roedl.com/kenya

Responsible for the content:
George Maina
George.Maina@roedl.com

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