



**Grant Thornton**

**TAX ALERT:**

**THE INCOME TAX  
(TRANSFER PRICING)  
RULES 2023**

**Background**

**In compliance with the Statutory Instruments Act, 2013 the Commissioner General, Kenya Revenue Authority and on behalf of the Cabinet Secretary, National Treasury and Economic Planning, has proposed a revision of the current Transfer Pricing Rules, 2006 that were issued under legal notice 67/2006( TP Rules, 2023).**

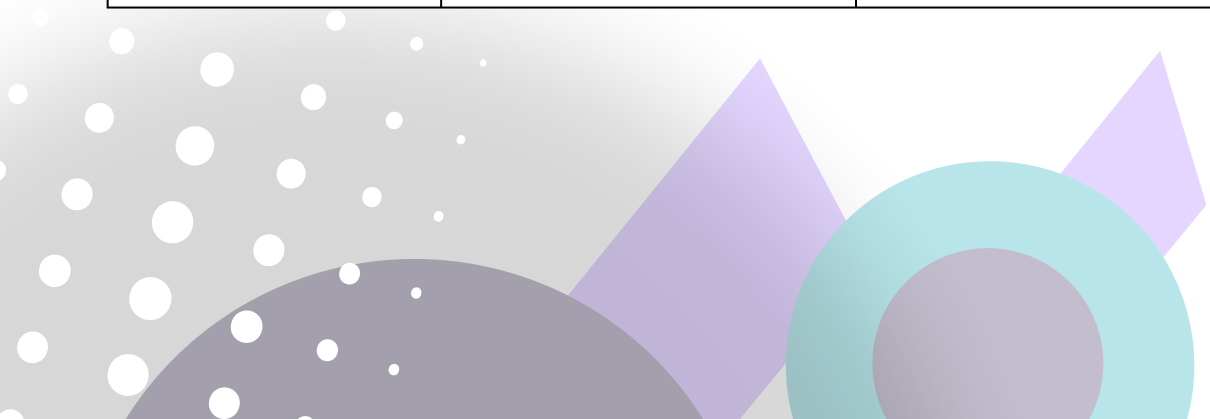
**This alert summarizes the proposed rules as follows;**

## Summary

Rule(s)	Current rules	Proposed rules	Our Comment
Rule 1; Citation	The rules are termed as Income Tax (Transfer Pricing rules) 2006 and came into effect on 1st July 2006	These rules shall be termed as Income Tax (Transfer Pricing rules) 2023 (Rules) and shall come in to force upon gazettment.	The revised rules are intended to align transfer pricing rules to numerous changes that have occurred in the ITA and ease application/interpretation as discussed in below sections.
Rule 2; Interpretation	This section provides definitions on; a) arm's length price, b) comparable transactions, c) controlled transaction, and d) related enterprises.	<p>Notable proposals are as follows; A controlled transaction shall no longer be limited to 'goods or services' but shall be 'any transaction between related enterprises'</p> <p>Controlled transactions shall include commodities with publicly quoted prices such as agricultural produce, fisheries products, solid or liquid or gas minerals, hydrocarbons and derivatives thereof, other products or natural minerals or mineraloids obtained from the land or waters.</p> <p>Related enterprises shall include transactions with entities within preferential regimes, as defined by ITA.</p>	Rule 2 proposes to broaden the scope and enhance clarity regarding intercompany transactions. The intent is to eliminate any ambiguity surrounding transaction that are not currently defined in the TP rules.
Rule 4: Person to choose method;	The section provides for the taxpayer to choose the most appropriate transfer pricing Method in determining arm's length price.	The section is proposed to remain the same.	The taxpayer will choose an appropriate method for their transactions from methods listed under Rule 7 of this alert.

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Rule 5; Scope of guidelines	The section limits the scope of the guidelines to transactions between associated cross border entities and a transaction between a permanent establishment and its head office.	The proposed section shall expand the scope of the guidelines to include other areas that touch on transfer pricing. These are ascertainment of gains and profits in preferential tax regimes, filing of Country by Country report, master file and local file, penalties and offenses relating to filing, and definition of CBCR related terms.	The proposed rules shall align scope of guidelines to changes that have been introduced by Finance acts 2021, 2022 and 2023. The rules on CBCR were introduced by Finance Act 2021 to enable KRA have visibility of financial and related information in relation to transfer pricing risks. Regulation surrounding Preferential Tax Regimes was introduced by Finance Act 2022 to widen the scope of transactions falling within the ambit of transfer pricing by including non-resident persons operating within the preferential tax regime
Rule 6; Transactions subject to rules.	This section limits transactions subject to TP rules to; (a)The sale or purchase of goods; (b)The sale, purchase or lease of tangible assets; (c)The transfer, purchase or use of intangible assets; (d)The provision of services; (e)The lending or borrowing of money; and Any other transactions which may affect the profit or loss of the enterprise involved.	The proposal seeks to replace the current Rule by including the following: (a)Financing transactions, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business; (b)Insurance and re-insurance transactions; (c)A transaction of business restructuring or re-organization entered into by a person with an associated person, irrespective of the fact that it has bearing on the profit, income, losses or assets of such persons at the time of the transaction or at any future date (d)Cost contribution arrangements Transactions involving derivatives.	From the proposed guidelines, we observe key pivotal inclusions aligned with guidelines from International quasi legislative bodies such as the OECD notably encompassing Chapter financial transactions as per chapter X of the OECD, business restructurings as per chapter IX, Cost Contribution arrangements as per chapter VIII and other areas covered by the OECD.



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Rule 7; Methods	<p>This section provides for use of the below;</p> <ul style="list-style-type: none"> <li>(a) Comparable Uncontrolled Price Method;</li> <li>(b) Resale Price Method;</li> <li>(c) Cost Plus Method</li> <li>(d) Profit Split Method</li> <li>(e) Transactional Net Margin Method</li> </ul> <p>Such other method as may be prescribed by the commissioner.</p>	<p>Over and above the current recognized methods by the ITA, there is a proposal to expand this section to clarify, for the purpose of current methods, Comparable Uncontrolled Price Method and other methods as may be prescribed by the commissioner, that;</p> <ul style="list-style-type: none"> <li>· In relation to the publicly quoted price, (as defined by the rules), that the quoted price shall be the sales price used for purposes of computing the taxable income.</li> </ul> <p>In other cases, the quoted price shall be determined by taking an average of the prices 5 days before and after the shipping date as evidenced by relevant shipping documents.</p>	<p>The commodities market such as oil, gas and metals are subject to volatile prices that can result in losses and write-downs. This would translate to reduced tax take for the government, during a time when tax authorities are under pressure to raise extra revenue.</p> <p>In our view, this coupled by the nature of the different commodities industry(s) is why the commissioner proposes to issue guidelines on the applicability of CUP when dealing in commodities. The OECD considers the CUP method suitable for establishing arm's length price for the transfer of commodities between associated enterprises.</p>
Rule 8; Application of the methods	<p>This part limits the application of the rules to section 18(3) of the ITA.</p>	<p>This section proposes to expand the application of the rules to other sections 18, 18A, 18B, 18C, 18D, 18E &amp; 18F of the act. These sections generally relate to ascertainment of gains and profits in preferential tax regimes, notification, filing, definition of CBCR, master file, local file and related terms and offences and penalties</p> <p>It further proposes that the commissioner may issue guidelines specifying conditions and procedures to guide the application of recognized methods.</p>	<p>This is a clean up to include new provisions introduced by various finance Acts 2021, 2022 and 2023 as the previous rules were outdated.</p>



# Summary

Rule(s)	Current rules	Proposed rules	Our Comment
<p>Rule 9; Power of commissioner to request for information</p>	<p>This Rule as currently drafted provides for powers of commissioner to request for information with limited specificity of the documents the commissioner can request for</p>	<p>The proposal empowers the Commissioner to request for additional information including;</p> <ul style="list-style-type: none"> <li>(a)Copies of contracts or agreements relating to the controlled transactions;</li> <li>(b)Key factors affecting the pricing of controlled transactions;</li> <li>(c)If applicable, an explanation of the reasons for performing a multi-year analysis;</li> <li>(d)Details of any Advance Pricing arrangements;</li> <li>(e)Any other documentation or information necessary for taxpayer’s compliance.</li> </ul> <p>In relation to financial information, this has been updated to include;</p> <ul style="list-style-type: none"> <li>(a)Audited Financial Statements for both parties to the transaction including where the selected tested party is outside Kenya;</li> <li>(b)Segment reports showing turnover, costs and expenses including details of selection of the appropriate allocation keys and the rationale of selecting those allocation keys;</li> </ul> <p>Such other background information as may be necessary regarding the transaction</p>	<p>The proposed Transfer Pricing (TP) Regulations 2023 propose to introduce a commendable level of specificity in the request made by the tax authority. In our view, this specificity would address the long outstanding need for clarity in TP documentation request. It is worth emphasizing that the requirement for taxpayers to provide information related to a tested party in a foreign Jurisdiction is a key inclusion. In our view, this expansion has been introduced to address challenges faced by the tax authorities where taxpayers decline to share financial statements related to foreign related parties.</p> <p>We note that, should the Regulations be enacted, these clarity will not only enhance transparency but also align Kenya’s TP Regulations more closely with international standards and best practice which in our view, will promote fair and consistent application of TP Rules.</p>
<p>Rule 10; Application of arm’s length pricing</p>	<p>This Rule provides that where arm’s length price is implied by a person, then a transfer pricing policy coupled with a determination of arm’s length price and relevant analysis documentation should be made available by the person.</p>	<p>The proposed section shall not make any amendments to the current Rule.</p>	<p>Tax payers shall maintain proper documentation to support the transfer prices adopted in their transactions.</p>

## Summary

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Rule 11; Certain Provisions of Tax Procedures Act, 2015 (TPA) to apply		The provisions of the Tax Procedures Act (TPA) 2015 relating to fraud, failure to furnish returns and underpayment of tax shall apply with respect to transfer pricing.	The TPA provides a framework for the collection, assessment and enforcement of taxes. The Regulations propose to align transfer pricing non-compliance with the TPA.
Rule 12; Unpaid tax to be deemed additional tax		Any tax due and unpaid in a transfer pricing arrangement shall be deemed to be additional tax for purposes of section 38 of the Tax Procedures Act, 2015.	

## Key take-away

The proposed transfer pricing rules will align the current Income Tax (Transfer Pricing) Rules published in 2006, to Kenya's principal tax laws such as the ITA and TPA, which have undergone numerous piecemeal changes from 2006 to date.

The changes span from handling of tax offences to inclusion of legislation on universally accepted best practices such as those adopted under the OECD/G20 BEPS project such as Country-by-Country Reporting, Transfer Pricing and Limitation on Interest Deduction.

Whereas the proposed Rules align to the ITA, more regulation is needed, especially that which encourages proactive dispute resolution. Such regulation would include introduction of safe harbor rules with a materiality threshold for low value adding services, therefore excluding them from rigorous transfer pricing documentation. The other would be introduction of advance pricing arrangements (APA) where a department within KRA is set up and entrusted with the responsibility of satisfying transactions as arm's length. Documenting of such transactions would then be excluded from transfer pricing policy and noted as APA transactions. This would create certainty when embarking on large-scale international transactions that have transfer pricing implications.

We encourage multinational entities whose transactions are envisioned as per the proposed rules to maintain sufficient transfer pricing documentation and supporting documents.

For further discussion on this alert or any other tax concern, please contact any of the team members below.



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