Self assessment

* Kenya operates a self-assessment regime. The duty of developing a transfer pricing policy solely lies on the taxpayer. Currently, there is no penalty for not maintaining a policy, however, failure to have a document in place sets the stage for scrutiny from the Commissioner of Domestic Taxes.
* A company that fails to maintain TP documentation would be in a disadvantaged position when defending its intercompany pricing with related parties.
* For this reason, it is highly advisable to have a TP policy should a KRA audit take place, then there is minimal risk of wrongful estimation of the value of intercompany transactions.

Transfer pricing rules

* Section 18(3) of the Income Tax Act CAP 470 provides that, 'Where a non-resident person carries on business with a related resident person or through its permanent establishment and the course of that business is so arranged such that it produces to the resident person or through its permanent establishment either no profits or less than the ordinary profits which might be expected to accrue from that business if there had been no such relationship, then the gains or profits of that resident person or through its permanent establishment from that business shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length'.
* In addition to the above, a multi-national enterprise (MNE) is required to comply with The Income Tax (Transfer Pricing) Rules, 2006 which offer guidelines on how to apply the arm’s length principle.
* The rules prescribe a general overview on the application of transfer pricing rules and Kenya heavily relies on the OECD guidelines which offer a more formulaic expression on implementation.
* The TP rules empower the Commissioner of Domestic Taxes (KRA) to request for TP documentation to any Multinational enterprise operating in Kenya on transactions where transfer pricing is applicable

Transfer pricing methods

* Paragraph 4 of the Transfer pricing regulations grants the taxpayer the liberty of choice of the method to apply in valuation of the arms- length price of intercompany transactions.
* The Income Tax Transfer Pricing Regulations 2006 recognizes five methods to apply in determination of the arm’s length price of transactions as outlined below:
  1. The comparable uncontrolled price (CUP) method
  2. The resale price method(RP)
  3. The Cost plus method
  4. The profit split method (PSM)
  5. The Transactional net margin
  6. 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 transactions, the arm’s length price cannot be determined using any of the methods contained in these guidelines.

Economic analysis and how to demonstrate an arm’s length result

* Economic analysis involves searching and selecting comparable transactions or companies considering the quality of data, assumptions and comparability factors and selection of the appropriate economic and statistical data related to a transaction.
* Paragraph 10(c) of the Income Tax Act (Transfer Pricing Regulations) states that 'where a person avers the application of arm’s length pricing, such person shall avail documentation to evidence their analysis upon request by the Commissioner'.
* The local TP guideline does not offer specific guidelines to be followed, however, from practice, the Authorities heavily rely on OECD guideline