

# Appendix D: Country Study Kenya

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## Abbreviations and acronyms

APAs	Advance Pricing Agreements
ATAF	Africa Tax Administrators' Forum
CIT	Corporate Income Tax
CUPs	Comparable Uncontrolled Prices
DR	Domestic Revenue
DTT	Double Taxation Treaty
EC	European Commission
GDP	Gross Domestic Product
IMF	International Monetary Fund
ITA	Income Tax Act
KRA	Kenya Revenue Authority
KRATI	Kenya Revenue Training Institute
LTO	Large Taxpayers Office
MDG	Millennium Development Goals
MNEs	Multinational Entity/ies
MoF	Ministry of Finance
ODA	Overseas Development Agency
OECD	Organisation for Economic Cooperation and Development
OECD TP Guidelines	OECD transfer pricing guidelines for multinational enterprises and tax administrations
SARS	South African Revenue Service
SARA	Semi Autonomous Revenue Agency
TP	Transfer Pricing
UNCITRAL	United Nations Commission on International Trade Law.
VAT	Value Added Tax
WIPO	World Intellectual Property Organisation.
WTO	World Trade Organisation

## 1. Introduction

The Kenya Revenue Authority (“KRA”) has been undertaking transfer pricing audits since 2003 and has had a mixed measure of success in policing transfer pricing practices since then. A number of key salient points have emerged in relation to the importance of transfer pricing in the Kenya economy, the legislative foundation of the transfer pricing regime and the capabilities of the KRA in effectively policing transfer pricing practices. We summarise some of the key issues below;

- The Kenyan economy is largely driven by the private sector with a significant presence of Multinational entities (“MNEs”) in most of the key economic sectors such as Agriculture, Manufacturing and Financial services. However, unlike other African countries, the mining industry is insignificant in Kenya;
- Taxation is the single largest source of government revenue with MNEs contribution to tax revenue and gross domestic product (“GDP”) in general considered significant;
- Although there is no conclusive evidence that MNEs in Kenya are engaged in abusive tax and transfer pricing practices, the inability of the tax authorities to effectively assess the often complex cross border transactions puts the authorities at the mercy of the MNEs and in a position where they may not be able to determine if the tax authority is receiving the right amount of tax from MNEs;
- Although, the Kenyan TP regime has undergone some positive reform in recent times, there is a general perception that legislative and judicial processes are deficient in some regards to curb TP malpractices, if any;
- The KRA’s push for taxpayers to submit TP documentation has increased the number of MNEs preparing TP documentation for their Kenyan activities. This has in turn caused the MNEs to pay more attention to the pricing of their Kenyan related party transactions. Although it is believed that this may have had a positive impact on tax revenues, there is no information available to substantiate this claim;
- Further, any gains from the introduction of the TP requirements and recognition of the Organisation for Economic Cooperation and Development (“OECD”) arm’s length principles will only be sustainable if the KRA is perceived by taxpayers as being sufficiently skilled to identify cases of malpractice;
- The lack of financial information on the performance and profitability of parts of the MNE group outside Kenya as well as the unavailability of local company comparables have been identified as hindrances to the ability of the KRA to effectively identify and address incidences of abusive transfer pricing;

-The lack of adequate capacity and technical expertise within the KRA is also viewed as the primary challenge in dealing with TP rules and enforcing the arm's length principle;

-Several initiatives which are considered to have the potential of improving KRA capacity include: structured training programmes, technical assistance through secondments, and external recruitments; undertaking risk based and specialised TP audits, improving the current legislative framework to eliminate opportunities for legal meandering, considering changes to the dispute resolution system, exploring the use of prescriptive rules and safe harbours, APAs and the use of penalties to encourage voluntary compliance with documentation requirements;

## 2. Current Situation

### 2.1. Economic Environment

In this section we provide a brief overview of the recent performance of the Kenyan economy and identify the key economic sectors. We also highlight the impact of the private sector on the economy as well as the possible influence of MNEs in this sector.

#### 2.1.1. Economic Outlook

Kenya's economy is market-based, with a few state-owned enterprises and a liberalised external trade system. The country is generally perceived as Eastern and Central Africa's hub for financial, communication and transportation services.

Kenya's economy posted a real GDP growth of 2.6 % in 2009 compared to 1.6 % in 2008. The growth was mainly supported by a resurgence of activity in the tourism sector and resilience in the building and construction industry.<sup>1</sup>

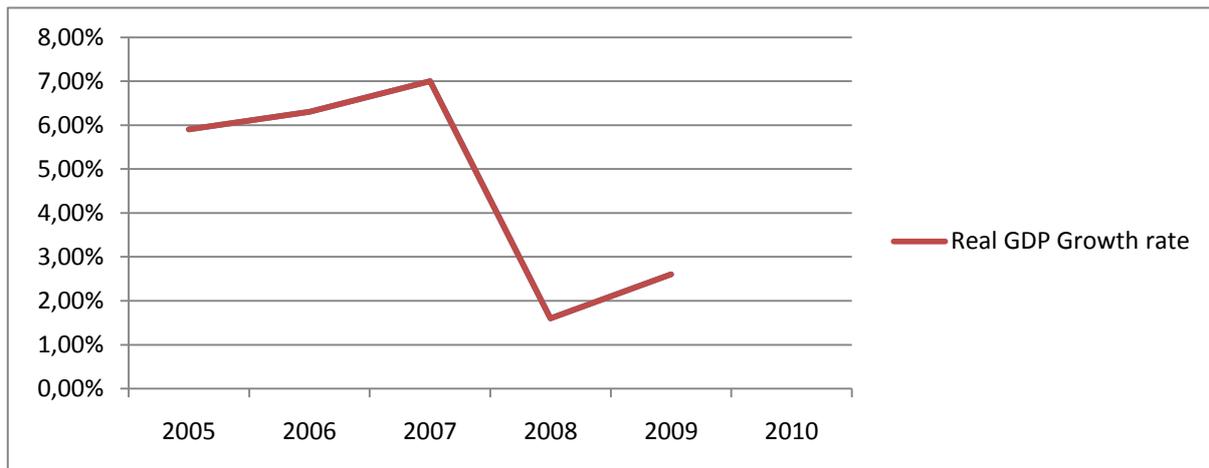
The International Monetary Funds ("IMF") believes the economy is likely to expand by 5.7 % in 2011 from an estimated 5 % growth in 2010 due to public spending on infrastructure and private sector growth.<sup>2</sup>

The chart below traces the prevailing GDP growth pattern between 2005 and 2009.

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<sup>1</sup> Kenyan National Bureau of Statistics, Economic Survey 2010.

<sup>2</sup> Ragnar Gudmundson (IMF Kenya representative) press interview of 2 Feb 2011.



**Figure 1**

### 2.1.2. Key Industry Sectors

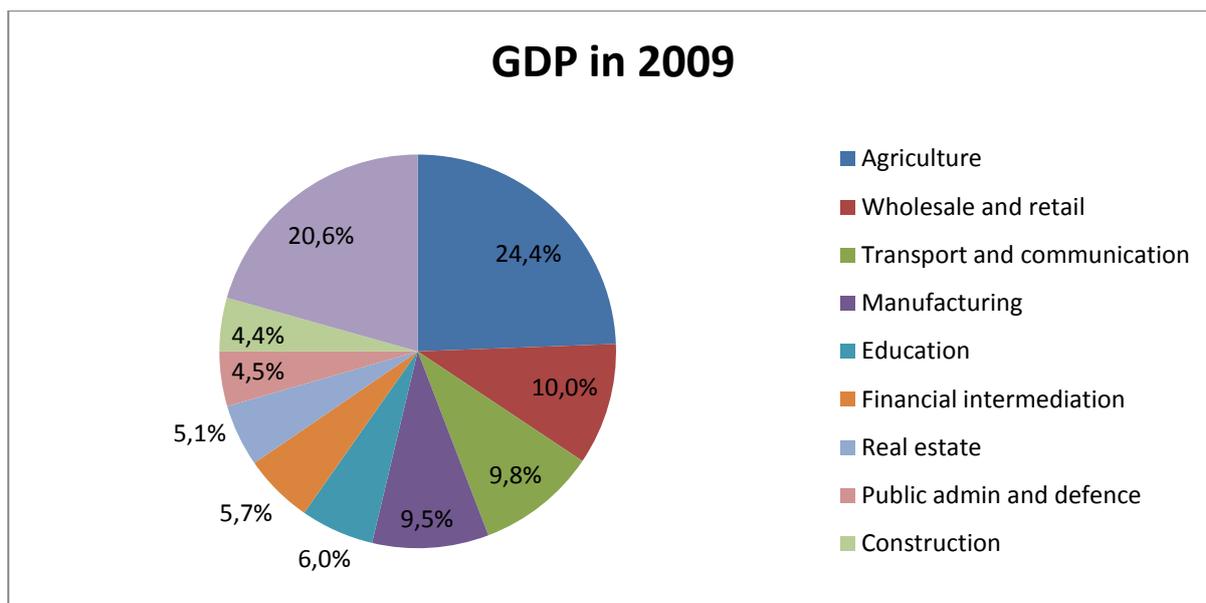
The five biggest contributors to the Kenyan economy in recent times have been the agriculture, wholesale and trade, transport and communication, manufacturing and education industries. In 2009, these industries collectively contributed about 59.9 % of the country's GDP.<sup>3</sup>

Of these, the agriculture sector is the biggest and its contribution to GDP averaged about 23 % between 2006 and 2009. The sector contributes more than 60 % of export earnings and directly influences overall economic performance through its contribution to GDP. Periods of high economic growth rates have been synonymous with increased agricultural growth.

Other industries with a significant contribution to GDP include financial services, real estate and construction, public finance and defence etc.

The pie chart below shows the share contribution of these sectors to GDP in 2009.

<sup>3</sup> Kenyan National Bureau of Statistics, Economic Survey 2010.



**Figure 2**

Source: Kenya National Bureau of Statistics – Economic Survey, 2010.

### 2.1.3. Private Sector Contribution to GDP

The private sector<sup>4</sup> plays a significant role in the Kenyan economy.

Kenya National Bureau of Statistics figures show that about 87 % of GDP contribution in 2009 came from this sector.<sup>5</sup> From a private sector perspective, the five biggest contributors are the agriculture, wholesale and retail trade, manufacturing, transport and communication, and financial services industries with their collective contribution accounting for about 59.6 % of GDP<sup>6</sup> in 2009.

### 2.1.4. MNEs' Contribution to GDP

MNEs began operations in the early 1990s. However, major entrances were witnessed following Kenya attaining independence in 1963. Most MNEs are incorporated as wholly owned subsidiaries of foreign companies.

However, some MNEs are listed on the Nairobi Stock Exchange with the minority shares held by the Kenyan public.

Although there are no available statistics on the specific contribution of MNEs to GDP, their presence is highly visible in most of the economic sectors which are dominated by private enterprises.

<sup>4</sup> Private sector in this context refers to any economic activity generated by non-government sources.

<sup>5</sup> Valued at 2001 prices.

<sup>6</sup> Derived from 2010 Economic Survey.

Some of the economic sectors with a significant MNE presence include agriculture (horticulture, tea, coffee etc.), manufacturing (food and all other manufacturing), transport and communication (mobile communication, internet etc.), financial services etc. Unlike in other African countries, the mining industry is insignificant in Kenya.

## 2.2. Tax structure and the role of taxation in Kenya

This section provides the key features of the Kenyan tax system, the significance of tax revenue to total government revenue and the possible impact of MNEs on tax revenue.

### 2.2.1. Key Taxes

The main types of taxes legislated in Kenya are shown in the table below.

Type of tax	Description	Rate
<b>Direct taxes</b>	Individual Income Tax	Graduated scale ranging from 10% – 30%
	Corporate tax	0%*, 20%*, 25%*, 30%, 37.5%
<b>Indirect taxes</b>	Value Added Tax (“VAT”)	General rate 16%
	Excise duty	Levied selectively on particular goods and services
	Customs duty	Generally charged on the cost, insurance and freight (“CIF”) value of the imported goods

\*Depending on certain conditions but the nominal rate is 30 % for incorporated entities and 37.5 % for branches of foreign companies.

The income tax rate of 30 % is the same as for most countries within the East African region. It is also the average nominal rate for most developed countries.

Value added tax (“VAT”) generally applies at the rate of 16 % whereas customs and excise duties vary depending on the nature of the transaction.

### 2.2.2. Tax Administration and Structure

#### 2.2.2.1. *The Kenyan Revenue Authority*<sup>7</sup>

Kenya adopted the Semi-Autonomous Revenue Agency (“SARA”) tax administrator model with the formation of the KRA in 1995. Prior to this, tax matters had been handled under different departments in the Ministry of

<sup>7</sup> Revenue Administration Reforms in Kenya: Experience and Lessons.

Finance. The formation of the KRA stemmed from a realisation of the need to enhance domestic revenue mobilisation capacity.

2.2.2.2. *Functional Organisation*<sup>8</sup>

Since its inception, the KRA has gradually transformed from a largely tax-type based institution (see chart below) to an organisation organised along functional lines. This is the result of a series of reforms geared at adapting to present environmental realities and international best practices.

The KRA is headed up by a Commissioner General, who reports to a Board of Directors. The Board of Directors are signatories to a performance contract with the Ministry of Finance. Four Commissioners who report to the Commissioner General are responsible for providing various services to taxpayers including customs, domestic tax, motor vehicle registration, and investigations and enforcement. There are also Senior Deputy Commissioners in charge of KRA's regional offices. There is also a Commissioner in charge of support services, who also reports to the Commissioner General.

KRA – functional organisation<sup>9</sup>

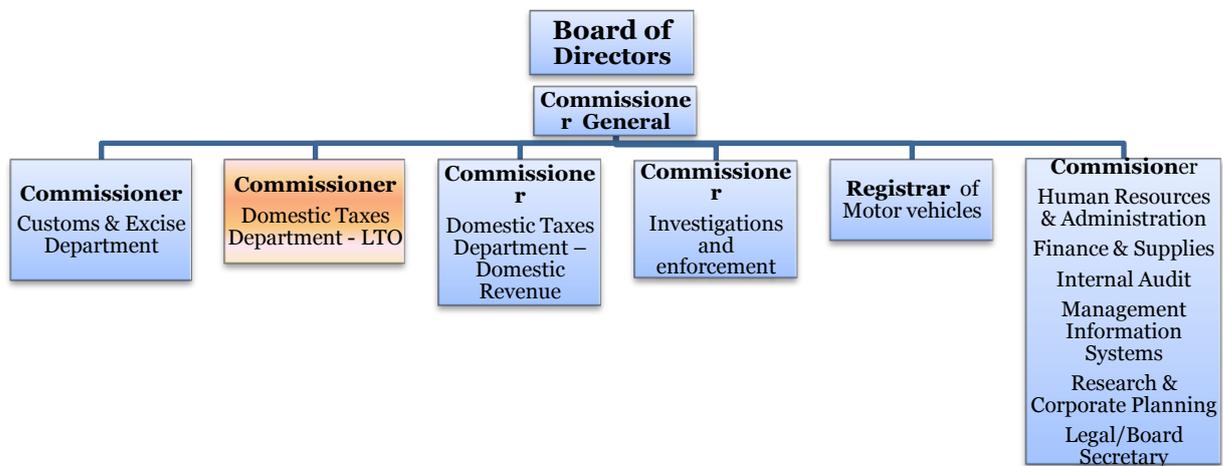


Figure 3

Tax collection responsibilities are divided between the following departments:

- Domestic taxes department consisting of Large Taxpayers Office (the “LTO”) and Domestic Revenue (“DR”); and
- Customs and Excise.

<sup>8</sup> Revenue Administration Reforms in Kenya: Experience and Lessons.

<sup>9</sup> KRA.

### 2.2.2.3. *Staff profile and independence*

The total number of staff members at the KRA is currently estimated at 4,700 (including support staff).

The KRA has a robust graduate recruitment programme and offers competitive salaries, based on staff performance. KRA officials are well educated and older officials with less training are increasingly becoming a minority.

One of the internal control mechanisms adopted by the KRA to ensure the independence of its staff is the rotation of officers within the various departments of the authority. There is also a hierarchy of officials relating to the approval of assessments and the vacation of such assessments or any other settlement. The KRA also has an internal audit division and a hotline.

### 2.2.2.4. *The Large Taxpayers Office<sup>10</sup>*

The LTO was established as a fully-fledged department<sup>11</sup> of the KRA in 2006 to provide one-stop-shop services in respect of all tax matters affecting large taxpayers and to specifically monitor and provide services to taxpayers that contribute the bulk of revenues. The primary eligibility criterion for treatment as a large taxpayer subject to LTO control is annual turnover of KShs 750 million (USD 9 million) and above. Most MNEs are therefore within the LTO. Currently, the LTO administers about 800 large taxpayers. The operations of the LTO are centralised in Nairobi while the DR has a total of 18 stations and three satellite stations spread across the country.

Transfer Pricing issues are generally handled under this unit.

## 2.2.1. **Tax Revenue**

### 2.2.1.1. *Tax and Government Revenue*

In Kenya, taxation remains the single largest source of government budgetary resources. Between 1995 and 2005, tax revenue made up 80 % of total government revenue (including grants).<sup>12</sup> In the last five years, the contribution of tax to total government recurrent revenue (excluding grants) has averaged 93 %.

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<sup>10</sup> Revenue Administration Reforms in Kenya: Experience and Lessons.

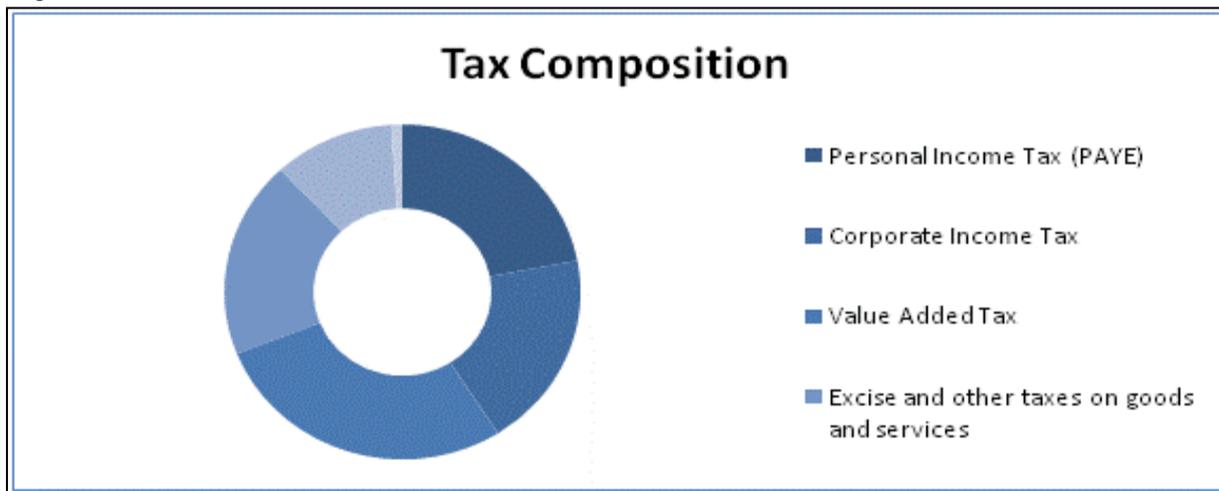
<sup>11</sup> It was previously a division under the Domestic Taxes department.

<sup>12</sup> Institute of Economic Affairs – Taxation and Tax Modernisation in Kenya.

### 2.2.1.2. *Composition of Tax Revenue*

Compared to direct taxes, indirect taxes contribute a greater share of overall tax revenues. In the 2009/10 tax year, the highest tax contribution came from VAT followed by Personal Income Tax and then Corporate Income Tax. The diagram below shows the %age contribution of the different tax types to total tax revenue during this period.

**Figure 4**



We attach as appendix 2a the composition of Government's Gross Receipts Account, 2005–2010.<sup>13</sup> The percentage contribution of each tax type for the period 2005–2010 is included appendix 2b.

### 2.2.1.3. *Tax and GDP*

Since the formation of the KRA, the ratio of tax revenue to GDP has gradually climbed from 14 % in 1995/96 to 22 % in 2009/10.<sup>14</sup> This current ratio of 22 % is relatively high compared to most of the other countries in the region. Between 1994 and 2003, Uganda reported an average tax to GDP ratio of 11.1 % and in Rwanda it was 9.2 %.<sup>15</sup> Tax to GDP and corporate income tax ("CIT") to GDP ratios for the period 2005 to 2009 (for Kenya) are presented in appendix 2b.

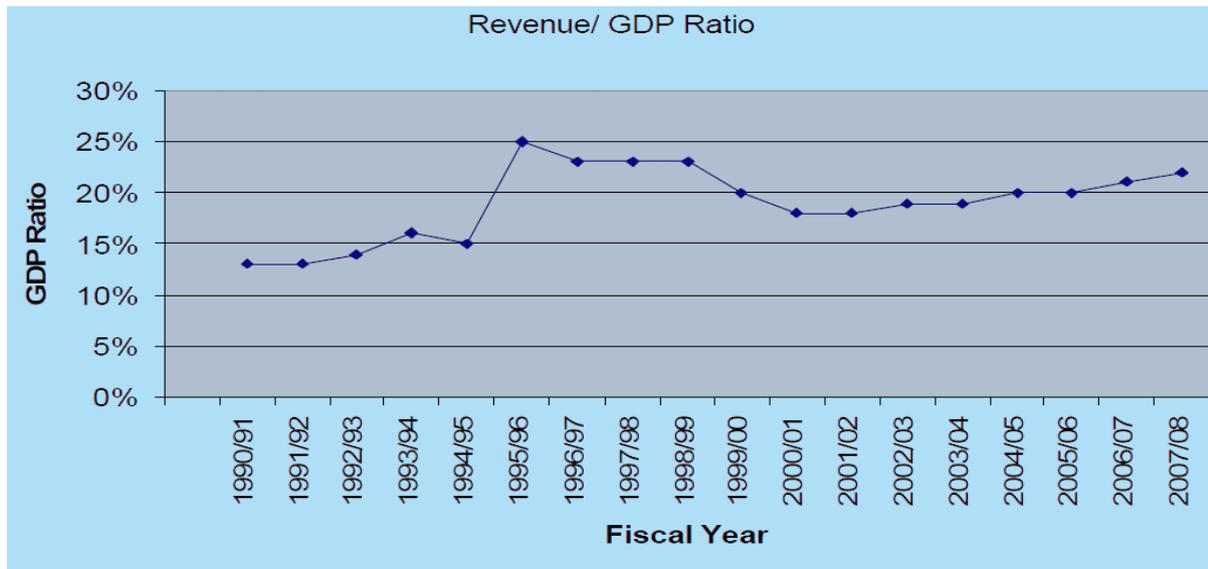
The table below shows the trend.

<sup>13</sup> Kenya National Bureau of Statistics – Economic Survey 2010.

<sup>14</sup> Revenue Administration Reforms in Kenya: Experience and Lessons.

<sup>15</sup> World Bank policy research working paper 4559.

Figure 5



#### 2.2.1.4. *The LTO and Tax Revenue*

The realisation that only about 20 % of taxpayers contributed 80 % of the total Domestic Tax Department's revenue led to the formation of the LTO as a separate department in 2006.<sup>16</sup>

The treasury estimates the contribution of large taxpayers to total tax revenue to be about 75 %. This applies to both direct and indirect taxes.

### 2.2.2. **MNEs and the Tax System**

#### 2.2.2.1. *MNEs and Tax Revenue*

Most of the MNEs operating in Kenya fall under the LTO. Although we did not obtain any specific information on the contribution of these companies to total tax revenue, the general impression is that taxes paid and collected by MNEs make up a sizable amount of total tax receipts.

#### 2.2.2.2. *MNEs and Tax Compliance*

Considering the apparent contribution of MNEs to tax revenues, the extent of their compliance or non-compliance with tax laws could have a significant impact on tax revenues.

<sup>16</sup> Revenue Administration Reforms in Kenya: Experience and Lessons.

### **The position of MNEs**

A majority of MNEs in Kenya state that complying with the tax laws in the countries (including developing countries) in which they operate is a priority for them. As the parent companies are often located in jurisdictions with strict tax administrations and governance structures, tax is considered a high risk area for most of them and the compliance culture of the parent companies is passed down to their subsidiaries in different parts of the world.

It is also clear that MNEs will often seek tax advice and plan their transactions within legally acceptable limits to ensure that they pay only the right amount of tax. In general, however, other non-tax commercial considerations rank higher when making investment decisions.

### **The view of civil society**

Although civil society acknowledges the fact that tax considerations will not usually be the first consideration for MNEs when making investment decisions, it believes there is a high risk that MNEs may not be contributing their fair share of taxes in developing countries as a result of transfer mispricing and other complex tax avoidance schemes.

In its view, the biggest problem with MNEs and their tax contributions in developing countries is the fact that it is difficult for African tax administrators to identify complex schemes and determine whether or not there is actually transfer mispricing.

In his 1 April 2010 lecture, David McNair<sup>17</sup> argues that, when it comes to taxation in the international sphere, developing countries are subject to disadvantage in their inter-related areas: they suffer from asymmetries of power, asymmetries of capacity and asymmetries of information. All of these work to undermine their taxing rights and put them in a position where they are unlikely to get the appropriate taxes from MNEs.

### **The view of the Kenyan government**

The government is of the view that, on average, MNEs will comply when appropriate tax legislation is put in place. It believes that any tax revenue leakages due to transfer pricing have either been significantly addressed with the introduction of the TP rules or will be addressed in due course. The government is also of the opinion that the enhancement of exchange of information agreements will go along way to addressing transfer pricing abuses.

At present, the Government's key focus is promoting investment, eliminating double taxation and generally ensuring a conducive environment for foreign investors.

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<sup>17</sup> Taxing rights: How developing countries can finance their own development, MDG lecture series.

It is, however, noted that the above is based on limited discussions with the Government (specifically the treasury department of the Ministry of Finance) and the position of the KRA on transfer pricing abuses for the purposes of this report is not clear.

#### 2.2.2.3. *MNEs and Tax Planning in Developing Countries*

In its presentation at the IMF-organised seminar<sup>18</sup> “Revenue Mobilisation in Developing Countries”, the South African Revenue Service (“SARS”) opined that some of the more recent features of MNC activities in developing countries (with negative tax consequences) include: the risk stripping of distributors and manufacturers, transfer of locally created intangibles for little or no consideration, over-compliance with developed countries’ TP legislation to the detriment of developing countries etc.

The SARS also observed that there is an increasing occurrence of MNE restructurings which leave local companies as low profit-making entities. While some of these may be perfectly legal, their execution may be such that the local companies are not adequately remunerated and, hence, tax revenue is lost.

Although these sorts of restructurings are currently a global phenomenon, and have even drawn the concern of tax authorities in developed countries, the primary disadvantage faced by developing countries is their inability to appropriately assess these transactions, articulate their responses to them and identify any malpractices.

#### 2.2.2.4. *MNE structures in Kenya*

In Kenya, MNEs are either set up as a branch of a foreign company or incorporated as a subsidiary of a foreign company. Traditionally, MNEs have operated as fully fledged entrepreneurs in Kenya. In the recent past, some MNEs have opted to lower the risk profile of their entities operating in Kenya by transferring major functions such as value addition processes out of Kenya. This is due to centralisation of activities such as manufacturing in more suitable countries like Egypt, South Africa and the United Arab Emirates (“UAE”). There are, however, no statistics available to ascertain the current extent of this practice.

## 2.3. Description of Local TP Regulations

### 2.3.1. **Background**

The statutory framework governing Transfer Pricing in Kenya is enshrined in section 18(3) of the Kenyan Income Tax Act (“ITA”):

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<sup>18</sup> Business taxation issues: IMF seminar on resource mobilisation in sub-Saharan Africa, 22 March 2011, Nairobi, Kenya.

*'Where a non-resident person carries on business with a related resident person and the course of that business is such that it produces to the resident person 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 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 2006, further guidance was provided by the KRA on the application of the arm's length principle through the introduction of the Income Tax (Transfer Pricing) Rules 2006 (hereinafter referred to as the "TP rules").

### 2.3.2. The Income Tax (Transfer Pricing Rules) 2006

The introduction of the TP rules was the Government's response to losing a transfer pricing case that pitted the KRA against the MNE Unilever Kenya Ltd, a subsidiary of the British multinational, Unilever Plc.

The TP rules apply to:

- Multinationals which have an enterprise located in Kenya and another enterprise located outside Kenya;
- Transactions between a permanent establishment and its head office or other related branches. In this case, the permanent establishment is treated as a distinct and separate enterprise from its head office and related branches.

Currently, there is no threshold/materiality of transactions that are subject to TP rules. We attach the TP rules as Appendix 3 to this report.

#### 2.3.2.1. *Transfer pricing methods in Kenya*

The Kenyan TP rules largely borrow from the OECD transfer pricing guidelines for multinational enterprises and tax administrations ("TP guidelines") and some of the methods described in the OECD TP guidelines appear to have been included in the Kenyan TP rules. The rules specify five primary methods which may be used to determine the arm's length nature of goods and services in transactions between related parties.

The rules further empower the Commissioner to prescribe any other method 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 above methods.

These rules have been described as 'poorly drafted' and 'giving rise to too much uncertainty'.<sup>19</sup>

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<sup>19</sup> Deloitte, Presentation at Revenue Mobilisation in sub-Saharan Africa conference held in Nairobi, Kenya, 21-22 March 2011.

### 2.3.2.2. *Transfer Pricing Documentation*

The rules require a taxpayer to submit transfer pricing documentation where requested by the Commissioner of Tax. This rule has been interpreted by the KRA as imposing an obligation on taxpayers to prepare transfer pricing documentation. However, there is no guidance as to the frequency with which a taxpayer must prepare transfer pricing documentation and the process that a taxpayer should follow in compiling such documentation.

Typically, the KRA requires a taxpayer to submit its TP documentation within a month upon request by the Commissioner. The KRA is, however, amenable to extension requests and some taxpayers have submitted documentation a year after the initial request.

### 2.3.3. **Legislative and Other Reforms Subsequent to 2006**

The KRA has recently amended section 18(3) to ensure that the section is not interpreted in an anti-avoidance context. Prior to this amendment (and in a strict legal sense), there could have been an argument (untested) given the wording of this section that the KRA can only make adjustments to transactions if it can prove that there was an intention to avoid tax. The definition of related parties under the law has also been expanded to include relationships between natural persons.

In 2010, the KRA introduced a schedule to the annual tax return requiring related parties to declare whether they have related-party dealings and, if so, the quantum of such related-party dealings. The schedule also requires the taxpayer to disclose whether they have prepared TP documentation. Although the KRA has verbally stated that this return is in effect for financial years ending December 2010, the schedule appears only to be available where a taxpayer completes their annual income tax returns online.

At present in Kenya, taxpayers have the option of either filing their returns online or manually. The majority of taxpayers still prefer to file manually using hard copy return forms which do not contain this new schedule. Consequently, it is unlikely that this new schedule is currently serving the purpose for which it was intended.

The KRA has also stated in the past that it is in the process of issuing TP practice notes. These notes have not been circulated for comment, however.

### 2.3.4. **The OECD Guidelines and the Kenyan TP rules**

Although the Kenyan ITA and the TP rules do not make express reference to the OECD TP Guidelines, the TP Guidelines are currently believed to be part and parcel of the Kenyan TP regime. Recognition of the TP

Guidelines by the judge in the Unilever Case is deemed to have imported their legal application into the Kenyan legal system via the doctrine of *stare decisis* (“judicial precedent”).

While recognising the applicability of the guidelines in Kenya, Justice Visram said the OECD TP Guidelines

*‘have been evolved in other jurisdictions after considerable debates and taking into account appropriate factors to arrive at results that are equitable to all parties. The ways of doing modern business have changed very substantially in the last 20 years or so and it would be foolhardy for any court to disregard internally accepted principles of business as long as these do not conflict with our own laws. To do otherwise would be highly short-sighted.’*

The OECD Guidelines are therefore applicable in Kenya where the TP rules are silent or do not provide sufficient guidance on the matter under consideration.

### 2.3.5. **Transfer pricing and anti-avoidance**

There is evidence to suggest that the KRA makes sufficient differentiation between transfer pricing issues and anti-avoidance issues. There are clear and express anti-avoidance provisions in the Income Tax Act (“ITA”). In addition, the recent amendments to section 18(3) of the ITA, which, according to the KRA, is intended to eliminate the need for the tax authorities to demonstrate a tax-avoidance motive as a pre-condition to making adjustments to related party transactions, supports this assertion.

### 2.3.6. **TP Dispute Resolution Mechanism**

There is no special mechanism in place for addressing TP disputes. TP disputes are dealt with in the same manner as other disputes arising under other income tax areas. In general, prior to reaching the courts, a dispute will usually be heard by an administrative (or quasi-judicial) tribunal constituted by the Ministry of Finance. A taxpayer may however decide to take his matter to the courts directly under certain circumstances.

The Ministry of Finance is currently developing a bill that will impact the current dispute resolution mechanism.

#### 2.3.6.1. *The Quasi-Judicial Tribunals*

Where, in respect of any assessment issued by the KRA, a taxpayer is unable to reach a satisfactory compromise with the authority, the first recourse is to either **the Tribunal** or **a local committee**.

The 'Tribunal' has jurisdiction to deal with matters relating to tax avoidance. The local committee, on the other hand is responsible for adjudicating on all other income tax disputes. The local committee will therefore typically sit on TP cases.

Taxpayers have in practice circumvented this quasi-judicial process by instituting judicial review proceedings in the High Court in the first instance. Such a process is attractive to taxpayers as it may afford immediate temporary injunctive relief to the taxpayer where the KRA is about to freeze a taxpayer's assets, including bank accounts.

#### 2.3.6.2. *The Courts*

An appeal against the decision of the Tribunal or local committee is to be made to the **High Court**. The Commercial and Tax Division of the High Court is mandated to hear and determine all tax matters lodged by or against the KRA.

The **Court of Appeal** has jurisdiction to hear appeals from the High Court. Consequently, an appeal on transfer pricing from the High Court will be lodged at the Court of Appeal.

#### 2.3.6.3. *Characteristics of the Kenyan Dispute Resolution Process*

The Kenyan dispute resolution system is **adversarial** in nature. The parties to disputes are deeply engrossed in winning the cases as opposed to solving disputes in a principled, cooperative manner that would help find out an amicable solution. The parties may adopt procedural technicalities in their case strategy such as unnecessary injunctions and objections that may only relate to the form as opposed to the substance of the case.

The process is also **time-consuming**. There is a huge backlog of cases in the Kenyan courts. A recent study<sup>20</sup> shows that nearly a total of one million general cases are pending in the Kenyan courts countrywide. The cases take a long time to resolve and the aforesaid study established that there is an undetermined case which was filed in 1984. The Unilever TP dispute with the KRA took more than two years to resolve. The KRA officers may lack any incentive to embrace the current dispute resolution process as the length of time taken may delay their achieving immediate revenue targets.

Judges and members of local committees do not have **specialist experience** in tax and transfer pricing. The members of local committees are not permanent members and are drawn from both the business and professional sectors. In the absence of specialist experience in TP, it may not be possible to come up with well-reasoned, researched precedents.

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<sup>20</sup> Beneah Mutsotso, 'Overview of the Baseline survey on the perils of accessing justice among the vulnerable populations in Kenya'. FIDA, 2010.

## 2.4. Conclusion

Some of the conclusions that can be drawn from this section of this report are:

- The Kenyan economy is largely driven by the private sector and, considering the significant presence of MNEs in most of the key economic sectors, their contribution to GDP is likely to be significant.
- The Kenyan Government's primary source of revenue is tax. About 75 % of it comes from the LTO. MNEs form a sizable %age of the LTO population. It follows that, if there is a prevalence of abusive tax practices by a significant population of taxpayers at the LTO, the implications for revenue generation would also be significant.
- Although there is no conclusive evidence that MNEs in Kenya are engaged in abusive tax and transfer pricing practices, the inability of the tax authorities to effectively assess often complex cross-border transactions puts the authorities at the mercy of the MNEs and in a position where they may not be able to determine if they are receiving the right amount of tax from MNEs.
- The Kenyan TP regime has undergone some positive reform in recent times. There are TP rules in place and the OECD TP Guidelines are recognised. The rules and judicial process are considered to be deficient in some regards, however.

### 3. Experience with the TP Reform process

#### 3.1. Introduction

The KRA commenced legal TP reforms after losing the Unilever Case. The TP rules which were issued in 2006 recommended the use of several methods (borrowed from the pre-July 2010 OECD TP Guidelines) by taxpayers in setting arm's length transfer prices. This section reports on the experience of the KRA and taxpayers since introduction of the TP rules.

#### 3.2. Establishment of a TP Unit

The KRA has established a TP Unit. The TP unit resides within the LTO. The unit was established within the LTO because most MNEs in Kenya fall within the threshold of a large taxpayer as defined by the KRA.

However, it is not clear if this team is a dedicated team or whether members of this TP team have responsibilities for other tax areas as well.

#### 3.3. Capacity Development

Since the establishment of the TP Unit, efforts have been made to build skills and capacity. To this end, the team has obtained training from overseas revenue authorities. It is also a member of the Africa Tax Administrators Forum ("ATAF"). One of the ATAF's primary objectives is to increase the technical capacity of its members through cooperation with technical bodies such as the OECD. Several of the ATAF-organised seminars and training in the recent past have been on the subject of transfer pricing.

#### 3.4. TP Audits

Since 2009, the TP Unit has been aggressively requesting taxpayers to submit TP documentation and has been carrying out TP Audits. It is estimated that over 300 taxpayers have received requests from the KRA to submit TP documentation. The KRA has begun audits of the documentation submitted and may begin to raise assessments in respect of TP issues.

Currently, TP audits are carried out as part of the general/comprehensive audits conducted by the KRA. No special audits are conducted specifically in respect of TP.

#### 3.5. Legislative Amendments and Other Guidance

As indicated in previous sections, recent amendments to the income tax legislation by the KRA include provisions which have expanded the meaning of related parties to include relationships between natural persons as well as those to ensure that the section requiring related parties to trade at arm's length is not interpreted in

an anti-avoidance context. The KRA has also increased the related-party disclosure requirements in annual income tax returns.

It is our understanding that it is presently in the process of issuing practice notes. However, there is very little information in the public domain about this process.

### 3.6. Assessment and Challenges of Current TP environment

#### 3.6.1. The Income Tax (Transfer Pricing) Rules, 2006

The rules prescribe the transfer pricing methods which taxpayers are to apply to their related-party transactions. Although it is apparent that these methods are intended to mirror the methods prescribed by the OECD Guidelines, a more detailed examination of the methods prescribed by the TP rules reveals several disparities which were probably not intended and reflect a poor understanding (by the draftsmen) of the arm's length standard. This is particularly evident from the manner in which the permitted methods are described in the rules.

The rules as presently worded are unlikely to withstand critical legal scrutiny and could give rise to unnecessary complications in a court of law.

#### 3.6.2. KRA Capacity and Specialist Experience

TP is an area that requires highly skilled personnel. According to John Neighbour of the OECD's Centre for Tax Policy and Administration, "Applying transfer pricing rules based on the arm's length principle is not easy, even with the help of the OECD guidelines."<sup>21</sup>

The feeling among some of the MNEs who have been subject to TP audits by the KRA is that, compared to other tax areas, the KRA is yet to attain the same level of expertise.

This becomes apparent from the quality of the queries raised during TP audits, including unreasonable information requests. In addition, unlike other tax areas, the KRA appears to be slow in zeroing down on TP issues and pursuing them. The paucity of TP-related assessments may also be indicative of this lack of capacity and experience.

Government personnel acknowledge that MNEs generally have more access to specialist TP skills than the KRA does. They are able to either engage TP experts from local consulting firms (these experts are in turn able to leverage on the skills of their wider global network) or source specialist skills through their foreign related parties.

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<sup>21</sup> OECD Observer, 3 July 2008, Transfer pricing: Keeping it at arm's length.

In general, TP capacity remains a challenge for the KRA and other African tax authorities. South African Revenue Agency (“SARS”) estimates the total number of TP specialists within South Africa to be about 40 persons. This number is considered small when compared with similar-sized economies in Europe.

### 3.6.3. **Extent of Compliance with TP documentation requirements**

Following TP documentation requests by the KRA, taxpayers are increasingly preparing sets of TP documentation for their related-party transactions. The time taken to respond to KRA documentation requests (about three months) may, however, suggest that, on balance, voluntary compliance in respect of preparing transfer pricing documentation was relatively low in the period prior to the KRA’s actively inducing compliance.

### 3.6.4. **Quality of documentation and external Comparables**

Most Kenyan taxpayers rely on European Databases such as “Amadeus” in testing the arm’s length nature of their transactions as there are no databases with financial information for local companies. The effect of this is that transfer pricing policies adopted on the basis of the results of foreign comparables may not be accurate as they may not completely reflect the actual circumstances and results of comparable Kenyan businesses.

The absence of data to carry out country adjustments also complicates the benchmarking exercise and could potentially produce inconsistent results.

Although the KRA criticised the non-inclusion of country adjustments in taxpayer TP documentation in a 2010 taxpayer sensitisation seminar, it has not proffered any practical solutions to the challenge of obtaining the data required to include such adjustments.

### 3.6.5. **Appropriateness of the OECD’s arm’s length principle to Kenya**

<sup>22</sup>Members of civil society and economic think-tanks that have been interviewed consider the OECD arm’s length principle to be inappropriate for developing countries like Kenya. The global formulary approach and unitary approach have been suggested as more appropriate alternatives for allocating profits between the various countries with which a MNE has economic interaction. This idea has also been mooted on a global scale but is yet to gain widespread acceptance.

Civil society argues that Kenya needs to make a critical assessment of the dynamics of its economic environment and come up with rules which will best suit it as a developing country rather than adopting rules made by developed countries. Another criticism levied against the arm’s length principle is that it gives room for numerous tax-avoidance schemes. It has also been said to be biased towards developed countries.

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<sup>22</sup> Interviews with TJNA and CPR.

An alternative view is that any bias which may exist is not inherent in the arm's length principle but is rather the result of the complexity in applying the arm's length principle and the fact that tax administrators in developing countries may not be sufficiently skilled to apply it effectively.

This visible lack of capacity could cause MNEs to pay more attention to application of the arm's length principle in developed countries (and possibly risk erring and overcompensating companies in developed countries), where MNEs consider there is likely to be a higher risk of falling foul of the law and tax authorities than in developing countries, where the risks are relatively minimal due to the inability of the tax authorities to effectively police transactions.<sup>23</sup>

### 3.6.6. Information exchange

The lack of information on the trading results of the various companies within an MNE group is considered by civil society to be one of the biggest hindrances to addressing revenue leakage which may occur from transfer pricing. Civil society is of the view that, if MNEs are ordered to make country-by-country disclosures of their activities and results, any incidences of transfer mispricing will be more apparent, and African tax administrators will be in a better position (with the information at their disposal) to begin to query the activities of these MNEs in their countries.

The government also considers the availability of information on the performance and profitability of MNEs outside Kenya as key to effectively assessing transfer pricing risks and addressing their incidence.

<sup>24</sup>The government's solution to this problem is to expand its Double Taxation Treaty ("DTT") network in order to facilitate information exchanges with tax authorities in developing countries. The Kenyan government is currently at different stages of concluding double taxation treaties with Belgium, the Netherlands and Portugal, having recently concluded a DTT with France.

Kenya also has DTTs with Canada, Denmark, Germany, India, Norway, Sweden, the UK and Zambia.

The ATAF also considers the exchange of information as critical to dealing with TP issues in Africa.

### 3.6.7. Impact of TP rules on MNEs and Tax Revenue

MNEs say that the presence of TP rules in a country will generally cause them to pay more attention to their transfer pricing practices in that country. One of the MNEs interviewed mentioned that steps taken to comply with the TP rules have led them to adopt a more consistent approach to their pricing rather than the somewhat arbitrary methods that were applied previously. For some MNEs that accepted prices from their parent company

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<sup>23</sup> Interview with the SARS.

<sup>24</sup> Interview with the Ministry of Finance.

uncritically, the process of localising transfer pricing documentation has created awareness of the price-setting process. This may lead to better negotiations on pricing in future.

Although it is possible (as is believed in some quarters) that, overall, introduction of the TP rules may have improved revenue collection, there are no statistics available to be able to categorically make this assertion. In addition there is a risk that any gains which may have been made by the introduction of these rules may be eroded if the KRA is not viewed as being able to effectively implement them, as MNEs could become less diligent in implementing their TP policies in the wake of the initial push by the KRA.

### **3.7. Conclusion**

The KRA TP reforms have included legislative, administrative and capacity-development initiatives.

The rules as presently worded could create unnecessary complications and become a source of frustration to the KRA if subjected to critical legal scrutiny. In addition, it appears the KRA is yet to attain the same level of expertise in TP as in other tax areas.

The KRA's push for taxpayers to submit TP documentation has increased the number of MNEs preparing TP documentation for their Kenyan activities. This has in turn caused the MNEs to pay more attention to the pricing of their Kenyan related-party transactions. Although it is believed that this may have had a positive impact on tax revenues, there is no information available to substantiate any such claim.

Further, any gains from the introduction of the TP requirements and recognition of the OECD arm's length principles will only be sustainable if the KRA is perceived by taxpayers as being sufficiently skilled to identify cases of malpractice.

The lack of financial information on the performance and profitability of parts of MNE groups outside Kenya and the unavailability of local company comparables have been identified as hindrances to the KRA's ability to effectively identify and address incidents of abusive transfer pricing.

## 4. Appropriateness of TP Reforms and Actions Needed

### 4.1. Appropriateness of TP Reforms

The introduction of the TP rules in 2006 signalled the beginning of TP-related reforms in Kenya. The reforms to date can be broadly categorised into those geared towards capacity-building and administrative effectiveness and those directed at creating an appropriate legislative framework.

Whereas the reforms can be considered to be positive, there are divergent views on the extent of their overall success amongst the various stakeholders. The reforms are summarised in the following sections together with suggestions for improving their effectiveness.

### 4.2. Capacity-Building and Administrative Reforms

According to the ATAF, the primary challenge which African tax administrators will face in enforcing the arm's length principle is a lack of capacity and expertise. Even where watertight legislation is put in place, African countries will not be able to fully maximise the benefits if the expertise required to implement and enforce is lacking.

#### 4.2.1. **Current Status**

The KRA operates the Kenya Revenue Training Institute ("KRATI") in Mombasa, which, in partnership with institutions such as the University of Canberra, delivers specialist training and capacity-building to its staff.<sup>25</sup> Compared to other African countries, the KRA is considered to have made significant strides towards building TP capacity. In spite of this, however, its ability to effectively deal with TP issues is not yet apparent to the various stakeholders who have had cause to engage it on TP issues.

We understand that the KRA's TP team currently consists of about 15 officers (it is not clear whether this team is a dedicated team or if the members have responsibilities for other tax areas). These persons have received several training sessions on TP issues. It is probable that capacity building initiatives such as training have been carried out intermittently or on an ad hoc basis and have not been consistently focused on the core team.

It is presently estimated that over 300 taxpayers have received demands to submit TP documentation from the KRA. TP audits are presently carried out as part of general tax audits. The KRA has also recently introduced a new requirement for additional related-party disclosures in annual tax returns.

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<sup>25</sup> <http://www.kra.go.ke/krati/>.

#### 4.2.2. **Actions Needed**

The following actions can help improve the existing capacity-building and administrative reform initiatives.

##### 4.2.2.1. *Structured training programme*

It may be appropriate to embark on a more structured training programme focused on the core TP team. This team should not be subject to the usual KRA practice of officer rotations. Training will also need to be hands-on, practical and relevant to the kind of issues the officers are likely to face in the Kenyan TP context so that opportunities for applying the knowledge gained can easily be identified.

##### 4.2.2.2. *Technical assistance and secondments*

The ATAF and the government are of the view that immediate technical assistance in the form of secondments is likely to be more effective in improving TP expertise within the KRA. This will involve the secondment of TP experts from a more advanced tax administration than the KRA.

<sup>26</sup>This is similar to the arrangement which KRA embraced at the time VAT was introduced in Kenya. Officers from the then UK Overseas Development Agency (“ODA”) were seconded to Kenya to work with the KRA team to assist in introducing the VAT system.

There is an ATAF initiative currently in the planning stages which is also likely to contribute significantly to the development of TP expertise within the KRA. The ATAF intends to create a platform through which member tax authorities can have access to external experts and tax advisers such as academics and retired revenue officers from developed countries.

##### 4.2.2.3. *External recruitments*

Similar to the approach adopted by the KRA during the personnel reforms of the late 1990s, it could consider recruiting TP specialists from outside the KRA. It has been reported that the “KRA has reaped widely from the initiative of recruiting top quality professionals from outside the organisation. KRA has benefited immensely from a large cross-section of staff from the private sector who supplemented the skills of those inherited from the Ministry of Finance.”<sup>27</sup>

This approach is likely to help significantly shorten the KRA’s TP learning curve. The general shortage of TP experts in the country and even in Africa as a whole may, however, pose a challenge to this.

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<sup>26</sup> Interview with Ministry of Finance.

<sup>27</sup> Revenue administration reforms in Kenya: Experience and lessons.

#### 4.2.2.4. *Dedicated TP Unit*

It would be ideal for the members of the TP team to be fully dedicated to dealing with TP issues. Where they have other tax-area responsibilities, there may be a tendency for them to focus on addressing taxpayer issues and shortcomings in those areas to the detriment of TP (which may not presently be within their comfort zone).

This situation may be further worsened by the current pressure within the KRA to deliver on immediate revenue targets. This could cause tax officers to focus on quick wins in other tax areas rather than TP, which could require significant time investment without any immediate revenue outcomes. All of this impacts TP expertise and capacity-building negatively.

Where the KRA considers revenue targets a must, it should consider providing long-term revenue targets for the TP team.

#### 4.2.2.5. *Risk-based audit and specialist TP audits*

Conducting TP audits as part of a general audit may not be as effective as specialist TP audits. This is because not all the criteria for selecting general audit subjects may be relevant or ideal from a TP perspective. In addition, the auditors' familiarity with the other tax areas may detract from the focus on TP.

It is also not clear what criteria the KRA has used in making TP documentation requests from taxpayers and what the KRA's objectives in making the demands were, but it is likely that it currently does not have the capacity to review all the documents submitted and that this population represents that of taxpayers with the most significant TP risks.

Given its capacity challenges, adopting a risk-based approach to TP audits would be advisable. That said, it has been reported that the KRA is currently implementing a risk-based case-selection system which is being pioneered at the LTO.<sup>28</sup> The KRA is also implementing a business intelligence database. Where there are tools for collecting and analysing information properly, this database can assist in the risk-analysis process.

### 4.3. Legal and Related Reforms

#### 4.3.1. **Current Status**

Reforms in this area have primarily been in respect of introducing the TP rules and changes made to the primary legislation regarding the definition of related parties and those to prevent section 18(3) being interpreted in an

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<sup>28</sup> Revenue administration reforms in Kenya: Experience and lessons.

anti-avoidance context. We explore some of the possible actions that could make the legal framework for TP in Kenya more robust.

#### 4.3.2. **Actions Needed**

##### 4.3.2.1. *Legislative review – TP rules*

Although it is apparent that the current TP rules were intended to follow the OECD Guidelines, the drafting is poor and could lead to unnecessary legal complications.

The rules should be reviewed with a view to making them conform more accurately with globally accepted TP practice.

##### 4.3.2.2. *Changes to Dispute Resolution Mechanism*

#### **Administrative tribunals**

The Ministry of Finance (with KRA's input) is developing a bill to establish a single dispute resolution body. The bill incorporates the experience of other countries including Uganda and Tanzania.<sup>29</sup> The bill will also look to providing a framework where dispute resolution mechanisms are a necessary step (rather than an option as is currently the case) prior to taking tax matters to court.

It is not yet clear whether this single tribunal will have permanent members or if its membership will vary depending on the type of case being heard. From a TP perspective, the use of a single tribunal with permanent members may not be effective as a result of the significant level of specialisation required to deal with TP cases. It may be advisable for a separate tribunal to be maintained for handling TP and tax avoidance matters or to allow for the composition of the single tribunal to vary depending on the type of matter being heard.

#### **Transfer pricing arbitration**

Recent trends show that Kenya is embracing arbitration as an alternative mechanism to resolve commercial disputes.<sup>30</sup> Arbitrations are carried out within the framework of the Arbitration Act of 1995. The Act follows the UNCITRAL<sup>31</sup> Arbitration model. Kenya has also ratified the New York Convention, the WTO and the WIPO<sup>32</sup> Treaties relating to arbitration.

An increasing number of parties are finding it necessary to include an arbitration clause in their contractual agreements, requiring them to avail of arbitration, before going to court only as a last resort. Article 159(2)(c) of the Constitution of Kenya also provides for the use of alternative forms of dispute resolution, including arbitration.

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<sup>29</sup> Revenue administration reforms in Kenya: Experience and lessons.

<sup>30</sup> Patrick Maguta, 2010, 'The Bright Future of Arbitration'.

<sup>31</sup> United Nations Commission on International Trade Law.

<sup>32</sup> World International Property Organisation.

The current tax framework does not allow for arbitration when there is a dispute between the KRA and a taxpayer.

### **Why Arbitration?**

Arbitration is gaining momentum as the preferred mode of resolving TP disputes. Arbitration provisions are an impetus for faster transfer pricing dispute resolution.<sup>33</sup>

The European Union has adopted a compulsory arbitration mechanism within the framework of the European Community Arbitration Convention of 1995, which has helped a great deal in resolving TP disputes in the region.<sup>34</sup>

Kenya has the requisite legal procedural infrastructure to carry out Arbitration. There is an Arbitration Act, which came into force in 1995. The Chartered Institute of Arbitrators headquartered in London has a Kenyan branch with 300 members. Only two critical prerequisites appear to be lacking:

- The availability of transfer pricing arbitrators;
- Statutory enshrinement of arbitration as a TP dispute resolution mechanism.

#### 4.3.2.3. *Advance Pricing Agreements*

In Kenya, there is presently no mechanism for the KRA and taxpayers to enter into Advance Pricing Agreements (“APAs”). In general, there is reluctance on the KRA’s part to give binding rulings regarding practices or policies adopted by a particular taxpayer or group of taxpayers.

The MNEs interviewed believe APAs would be a welcome new feature of the tax system. Provided the critical assumptions are met, an APA can provide the taxpayers involved with certainty in the tax treatment of the transfer pricing issues covered by it for a specified period of time. This certainty and predictability of tax consequences allows for a tax environment which is favourable to investment. APAs can also provide the opportunity for both tax administrators and taxpayers to consult and cooperate in a non-adversarial spirit and environment.<sup>35</sup>

The primary challenge which the KRA will face if it considers adopting APA programmes is likely to be in terms of resources. According to the OECD Guidelines, an APA programme tends to require highly experienced and often specialist staff and may initially place a strain on transfer pricing audit resources as tax administrators will generally have to divert resources earmarked for other purposes to the programme.

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<sup>33</sup> David Stewart, ‘Transfer Pricing and Apportionment Issues’.

<sup>34</sup> Professor Yitzhak Hadari, ‘Compulsory Arbitration in International Transfer Pricing and other Double Taxation Disputes’, 2009.

<sup>35</sup> OECD Transfer Pricing Guidelines 2010.

Other disadvantages of APAs include the fact that they cannot be used by all taxpayers because the procedure can be expensive and time-consuming and small taxpayers may not be able to afford them, coupled with the tendency to create double taxation complications if the APA is unilateral and not designed to be flexible enough to adapt to changing economic conditions.

#### 4.3.2.4. *Prescriptive Transfer Pricing Rules and Safe Harbours*

Prescriptive rules and safe harbours would involve establishing a simple set of rules under which tax authorities automatically accept or are more disposed to accepting transfer prices. Examples of this include prescribing:

- results within the inter-quartile range as acceptable;
- acceptable deviations from the median;
- acceptable interest rates between associated enterprises etc.

Prescriptive rules and safe harbours will generally create legal certainty, reduce compliance costs and allow for a degree of administrative simplicity. These qualities make them desirable given the apparent capacity challenges faced by the KRA.

A major drawback of prescriptive rules and safe harbours appears to be their tendency to cause double taxation. The view of the government is that a model which is too restrictive and rigid may not be conducive to foreign investment and trade.

#### 4.3.2.5. *Documentation Requirements and Penalties*

In order to improve voluntary compliance, the KRA could consider including a requirement in the legislation that TP documentation should be submitted by taxpayers at the time they file their annual tax returns. A penalty clause could also be included for failure to do this.

Currently, taxpayers require making a disclosure that they have prepared TP documentation. And even then, this appears to be restricted to those filing returns electronically.

Requiring TP documentation to be filed along with tax returns is likely to enhance compliance and prevent the current situation where taxpayers only prepare documentation once they have received a query from the KRA.

The main disadvantage would be the cost and administrative burden that this would create for taxpayers. Kenya has been ranked 162 out of 183<sup>36</sup> economies in terms of ease of paying taxes according to the World Bank's

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<sup>36</sup> The World Bank and International Finance Corporation – Paying Taxes 2011, the global picture.

Paying Taxes 2011 survey. Therefore, such a requirement would only worsen Kenya's ranking and would meet with significant resistance from MNEs. Further, where there have been no significant changes in transactions from one year to the next, it is unclear what benefit such a requirement would add.

#### 4.4. Conclusion

The TP reforms to date and current initiatives are considered to have the potential of improving the KRA's ability to deal with TP issues.

Some of the actions which will further improve this ability include: exploring alternative approaches to capacity development including structured training programmes, technical assistance through secondments, and external recruitments; undertaking risk-based and specialist TP audits; improving the current legislative framework to eliminate opportunities for legal meandering; considering changes to the dispute resolution system; exploring the use of prescriptive rules, safe harbours and APAs; and the use of penalties to encourage voluntary compliance with documentation requirements.

## 5. Recommendation for future donor support

### 5.1. Introduction

Capacity challenges have been identified as the most pressing need requiring to be met for the KRA to be able to effectively implement the arm's length principle. To build this capacity, we have identified areas in which donors can play a role in the short term, the medium term and the long term.

### 5.2. Short-term Areas of Support

#### 5.2.1. **Secondments**

Donors can help facilitate the secondment to the KRA (or even employment by it) of experienced TP specialists from more-developed tax authorities. As indicated in the previous chapter, the involvement of secondees during the introduction of VAT in Kenya played a key role in the success of the programme.

#### 5.2.2. **TP training**

Donors can help build a structured transfer pricing training programme for the KRA. They can also assist in identifying the appropriate resource persons to deliver this training.

#### 5.2.3. **Practical manuals**

Beyond the need for periodic training, there is a need for detailed, practical reference materials through which the KRA can leverage on the experience of more-advanced administrations in dealing with similar TP issues.

### 5.3. Medium-term Areas of Support

Donor support in the medium term could be channelled towards:

#### 5.3.1. **Dispute resolution reforms**

Donors could support the current dispute resolution reforms being undertaken by the Ministry of Finance. An efficient, effective dispute resolution system is necessary to ensure that disputes are dealt with speedily and by appropriately qualified persons.

#### 5.3.2. **Legal reforms**

Inadequacies and shortcomings in the legislation could potentially limit the ability of the tax authorities to effectively deal with TP abuse. It is therefore critical that the laws and rules in place can withstand critical legal scrutiny. Donors can provide support to the tax authorities in reviewing the legal framework for TP in Kenya.

## 5.4. Long-term Areas of Support

### 5.4.1. **Development of a comparable database**

Key to application of the arm's length principle is the availability of comparable data from comparable transactions. At present, Kenyan taxpayers rely on data from European companies in assessing the arm's length nature of their transactions.

The actual comparability of the results of these European companies with those of Kenyan companies is generally questionable as the economic environments under which they operate are dissimilar in many regards. The need to have a database with information on the performance of independent companies operating in Kenya and other parts of Africa is therefore key to undertaking a fair assessment of whether MNEs are trading at arm's length.

Donors could sponsor the production of such a database.

## 5.5. Conclusion

In the short term, the main area for which support is needed is capacity building. Training and technical assistance have been identified as areas where donors can contribute. Assistance with legal and dispute resolution reforms are considered as medium-term areas where support can be provided. A critical area for long-term support is in developing a database of local independent companies which can be used as appropriate comparables in evaluating the arm's length nature of related-party transactions.

## 6. Conclusions

This chapter provides a summary of the conclusions reached in the course of the study in line with its objectives.

### 6.1. What is being done in the area of TP in Kenya?

Kenya introduced TP rules in 2006. The rules prescribe the acceptable TP methods as well as the documents required to be kept by taxpayers to support their transfer pricing arrangements. Other initiatives which have been taken subsequent to 2006 include the establishment of a TP unit and the training of TP personnel.

From a legislative perspective, there have been amendments to the Income Tax Act to expand the meaning of related parties as well as to eliminate the requirement for the tax authorities to prove a tax-avoidance motive as a precondition to making TP adjustments. A new requirement for increased related-party disclosures in annual tax returns has also been introduced. It has also been reported that the KRA is currently working on releasing TP practice notes.

From an African perspective, the ATAF has been involved in training and organising TP seminars for African tax administrators. It is looking at completing seven technical development courses in 2011 including a course on the auditing of multinationals and transfer pricing.

On the delivery of technical expertise, one of its key projects is development of a platform through which its members can access external tax advisers such as academics and retired revenue officials from developed countries. The platform will also help members exchange information and discuss common challenges.

### 6.2. What are the preconditions for effective establishment of TP expertise in Kenya and what measures should be taken to introduce proper or appropriate TP rules?

Kenya already has TP rules. However, the rules as currently worded are considered to be poorly drafted and require revisions to ensure that they are able to serve the purpose for which they were introduced.

Although there have been efforts at establishing TP expertise within the KRA, interaction with other stakeholders suggests that the current level of expertise is still relatively low compared to other tax areas.

Technical assistance through the secondment of more-experienced TP experts (to the KRA) who will assist with day-to-day TP issues including audits is considered to have the most potential for improving TP capacity within the KRA.

### 6.3. What are the likely benefits and challenges that Kenya could expect?

#### 6.3.1. Benefits of Introducing TP Legislation

Although there are no available statistics to verify this, the view has been expressed that the introduction of TP rules in Kenya has had a positive impact on tax-revenue generation.

MNEs say that the process of complying with the TP rules has led them to pay more attention to the pricing of their related-party transactions. The result has been the adoption of more-consistent approaches to pricing. Those that previously accepted prices from their parent companies uncritically are now more aware of the price-setting process and are likely to negotiate better prices in the future.

As MNEs are considered to make up a good %age of the large taxpayer population,<sup>37</sup> any increase in tax remittance due to the adoption of arm's length pricing is likely to have a noticeable impact on government revenues.

#### 6.3.2. Challenges of introducing TP legislation

The primary challenge has been identified as the lack of adequate TP capacity (within the KRA) required to effectively monitor and enforce proper application of the arm's length principles by MNEs.

This lack of capacity poses a significant threat to any gains that have accrued or could potentially accrue from the introduction of TP legislation. This is because, if the KRA is perceived as not being able to effectively assess the operations of MNEs from a TP perspective, MNEs that have adopted more-compliant transfer pricing policies may become less diligent in their implementation of such policies.

Other challenges include the lack of access to information on the trading performance of other parts of the MNE group and the unavailability of local comparables. The weaknesses in the current TP legislation are also deemed to have a potential for limiting the gains that can be realised from TP reforms.

### 6.4. What are the best forms of assistance?

Technical assistance is considered the best form of support that can effectively address the immediate TP capacity needs of the KRA. Specifically, the secondment of experienced TP specialists from more-advanced revenue authorities has been suggested.

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<sup>37</sup> Large taxpayers are estimated to contribute up to 75% of total tax revenue.

Other recommended capacity-building initiatives include the development of a structured TP training programme and curriculum for tax administrators as well as the production of practical manuals containing real-life case studies which can be used as reference materials by tax administrators.

Medium-term areas of assistance include help with the review of the TP legislative framework (to comply better with article 9 of the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines) and dispute resolution process. This is to ensure that the gains that will accrue from the KRA's improved ability to address TP issues are not undermined by the inadequacies in the legislation and dispute resolution process.

In the long term, donors could assist with the development of a database which can provide information on local independent company comparables.

## 7. Methodology

### 7.1. Sources of information

The information contained in this report was sourced primarily from interviews with various stakeholders and publications on tax matters in general and transfer pricing specifically. These included government and other publications, papers and articles obtained from the internet and presentations by various stakeholders during the IMF seminar on Revenue Mobilisation in Sub-Saharan Africa held in March 2011.

### 7.2. Interview methodology

#### 7.2.1. Selection of interviewees

In line with the guidelines provided by the EC, we identified relevant stakeholders to be interviewed including persons from the government, economic think-tanks, civil society, the private sector, NGOs and regional tax institutions.

The selection of the specific organisations and persons to be interviewed was based on our knowledge and assessment of their involvement in economic matters, taxation, tax policy issues and transfer pricing in Kenya.

Prior to finalising the selection process, we met with the EC local delegation in Kenya and obtained suggestions and referrals for some of the organisations to be interviewed. We also obtained recommendations on additional organisations to be interviewed from the EC office in Brussels. A list and profile of the organisations/persons interviewed is included as appendix 1a.

#### 7.2.2. Interview process

We obtained the contact details for the interviewees and sent them introductory letters and emails. We also sent them the questionnaires (see appendix 4) we had designed for use in the interviews. The questionnaires were prepared based on the inception report and our preliminary research. For the government representatives, we followed up using the introductory letter which the EC local delegation had sent to the Ministry of Finance in respect of the project.

Nearly all the interviews were face-to-face meetings. Two interviews were held via teleconference (one of them being a follow-up interview after an initial face-to-face interview). We compiled the views of the respondents during the interviews for subsequent inclusion in the report.

### 7.3. Publication and document review

We reviewed publications by several organisations including the KRA and Kenya National Bureau of Statistics. We also reviewed other publications by both local and international authors that were relevant to the subject. Some of these were obtained via internet searches.

In addition, our review included an examination of the relevant sections of the Kenya Income Tax Act, the Kenya TP rules and the OECD guidelines.

A list of the publications and documents reviewed in the course of our research is attached as appendix 1b.

### 7.4. Limitations and challenges

The challenges faced and limitations on the report are presented in this section.

#### 7.4.1. **Inability to engage certain key stakeholders**

We were unable to secure interviews with the Kenya Revenue Authority, who we considered to be one of the primary stakeholders for the project. The KRA declined to participate in the project. We sought assistance from the local EC office, which in turn sought assistance from the Ministry of Finance. These initiatives were not successful and, again, the KRA declined to participate in the project.

As a result of this, we are unable to completely verify the present accuracy of some of the information relating to the KRA, including the current staffing and organisation of the TP unit, the current status of TP initiatives within the KRA, costs and benefits of the introduction of TP legislation etc. Nor were we able to obtain their views on the ideal form of donor support.

In addition, we were unable to engage some of the active think-tanks in Kenya such as the Kenya Institute for Public Policy Research and Analysis (KIPPRA) and the Institute of Economic Affairs (IEA), which were either unavailable or declined our meeting request stating unfamiliarity with the subject as a reason.

#### 7.4.1. **Paucity of publicly available quantitative information**

We were unable to obtain any quantitative information in the public domain on the overall contribution of MNEs to GDP, and to tax specifically. Nor could we obtain any quantitative information on the impact of the introduction of TP rules on tax revenue collection.

#### 7.4.1. **Relative novelty of the subject**

Based on our research, relatively little empirical analysis has been done (either locally or otherwise) on TP and its relevance to developing economies. This posed a challenge in obtaining conclusive information on the impact and extent of transfer mispricing in Kenya, and Africa as a whole.

In addition, from a Kenyan perspective, there has been no previous donor activity in the area of building tax authority TP capacity, and this made it difficult to obtain possible recommendations from the local offices of the various donor agencies.

# Appendices

## 8. Appendices

### 8.1. Appendix 1a: List of interviewees

#	Interviewee	Organisation	Profile
1)	<p><b>Duncan Lee Corrick</b> – TP senior specialist</p> <p><b>Lincoln A. Marais</b> TP specialist</p>	South African Revenue Service & African Tax Administrators Forum	<p>The African Tax Administration Forum (ATAF) is a platform to promote and facilitate mutual co-operation among African Tax Administrations (and other relevant and interested stakeholders) with the aim of improving the efficacy of their tax legislation and administrations.</p> <p>The South African Revenue Service (SARS) currently provides significant human and physical resources support to ATAF and has several of its staff on secondment to the organisation.</p>
2)	<p><b>James Waweru</b> Vice President, Finance, Unilever NAME (North Africa Middle East) and former CFO for Unilever Kenya</p>	Unilever Kenya Limited	<p>Unilever is one of the world's leading Fast Moving Consumer Goods (FMCG) companies with Corporate offices in London and Rotterdam.</p> <p>Unilever Kenya is the Kenyan subsidiary of the group and was the appellant in the 1st transfer pricing case that was decided in the Kenyan courts.</p> <p>James Waweru was the Chief Finance Officer of the company at the time.</p>
3)	<p><b>Tiberius Barasa</b> Managing Director</p>	Centre for Policy Research (CPR)	<p>CPR is an independent, not-for-profit, nonpartisan policy research institution dedicated to innovative research and analysis that promotes global freedom, prosperity, security and good governance.</p> <p>Tiberius Barasa is the Lead Researcher for the Institutional Development Programme</p>

			<p>team at CPR. He was previously the Coordinator of Governance and Development Programme at the Institute of Policy Analysis and Research (IPAR) from 2006 to 2010.</p>
4)	<p><b>Martin Gumo</b> Deputy Director Fiscal Affairs</p>	<p>Ministry of Finance</p>	<p>The Ministry of Finance is charged with the responsibility of formulating financial and economic policies for the Government of Kenya. It is also responsible for developing and maintaining sound fiscal and monetary policies that facilitate socio-economic development.</p>
5)	<p><b>Dr. Atiya Warris</b> Tax Justice Network Africa</p>	<p>Tax Justice Network</p>	<p>Tax Justice Network-Africa (TJN-A) is a Pan-African initiative established in 2007 and a member of the global Tax Justice Network. TJN-A seeks to promote socially just, democratic and progressive taxation systems in Africa, advocating for pro-poor tax regimes and the strengthening of tax regimes to promote domestic resource mobilisation. Attiya Waris is a member of the TJN-A steering committee and currently lectures Law at the University of Nairobi.</p>
6)	<p><b>Justin Archer</b> Managing Director</p>	<p>Sangana Commodities Limited</p>	<p>Sangana Commodities Ltd is a member of the ECOM Agroindustrial Corporation group. ECOM is a leader in the soft commodities industry. The main commodities that it deals in, are cotton, coffee, cocoa, oilseeds and grains.</p> <p>SCL is involved in the purchase (in Kenya) of Coffee and sale to ECOM. It has in the past, been the subject of a TP review from the KRA.</p>

## 8.2. Appendix 1b: Bibliography

### Literature:

- Beneah Mutsotso, 'Overview of the Baseline survey on the perils of accessing justice among the vulnerable populations in Kenya', in *FIDA*, 2010;
- David McNair, 'Taxing rights: How developing countries can finance their own development', in *MDG lecture series*;
- David Stewart, '*Transfer Pricing and Apportionment Issues*';
- John Neighbour, 'Transfer pricing: Keeping it at arm's length', *OECD Observer*, 3 July 2008;
- Patrick Maguta, '*The Bright Future of Arbitration*', 2010;
- Nikhil Hira Deloitte, Presentation at Revenue Mobilisation in sub-Saharan Africa conference held in Nairobi, Kenya, 21-22 March 2011;
- Professor Yitzhak Hadari, '*Compulsory Arbitration in International Transfer Pricing and other Double Taxation Disputes*', 2009;
- Ragnar Gudmundson (IMF Kenya representative) press interview of 2 Feb 2011.

### Legislation:

- Income Tax Act of Kenya
- Income Tax (Transfer Pricing) Rules, 2006
- OECD Transfer Pricing Guidelines 2010.

### Organisations:

- Institute of Economic Affairs – Taxation and Tax Modernisation in Kenya.
- Kenyan National Bureau of Statistics, Economic Survey 2010.
- Kenya Revenue Authority, Revenue Administration Reforms in Kenya: Experience and Lessons.  
<http://www.kra.go.ke/krati/>.
- World Bank policy research working paper 4559.
- South African Revenue Service Presentation Business taxation issues: IMF seminar on resource mobilisation in sub-Saharan Africa, 22 March 2011, Nairobi, Kenya
- United Nations Commission on International Trade Law.
- The World Bank and International Finance Corporation – Paying Taxes 2011, the global picture.
- World International Property Organisation.

## 8.3. Appendix 2a: Tax revenues on the recurrent account

Description	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
<b>Amounts are in KShs Million</b>					
<b>Taxes on income, profits and capital gains</b>	<b>114,629</b>	<b>130,719</b>	<b>165,078</b>	<b>184,446</b>	<b>220,281</b>
Income tax from individuals (PAYE)	60,485	69,575	85,953	98,602	116,626
Income tax from corporations ( other income tax )	54,144	61,144	79,125	85,844	103,655
<b>Taxes on property</b>	<b>190</b>	<b>253</b>	<b>332</b>	<b>337</b>	<b>342</b>
Immovable property	11	27	62	63	63
Financial and capital transactions	179	226	270	274	279
<b>Taxes on VAT</b>	<b>79,926</b>	<b>96,497</b>	<b>111,905</b>	<b>126,854</b>	<b>148,353</b>
VAT on domestic goods and services	46,093	51,341	58,277	66,216	75,673
VAT on imported goods and services	33,833	45,156	53,628	60,638	72,680
<b>Taxes on other goods and services</b>	<b>61,710</b>	<b>76,111</b>	<b>80,736</b>	<b>91,845</b>	<b>100,626</b>
Excise taxes	46,646	56,123	61,906	69,872	78,066
Royalties	354	402	188	156	176
Taxes on goods and services collected as AIA	12,161	18,016	18,505	21,345	21,591
others	2,549	1,570	138	472	793
<b>Taxes on international trade transactions</b>	<b>32,215</b>	<b>42,983</b>	<b>50,394</b>	<b>55,886</b>	<b>62,938</b>
Custom duties	20,511	27,927	32,944	36,181	40,600
other taxes	9,350	12,308	12,913	15,021	17,146
Other taxes not elsewhere classified	2,353	2,748	4,536	4,684	5,192
<b>Total tax revenue</b>	<b>288,479</b>	<b>346,310</b>	<b>408,113</b>	<b>459,031</b>	<b>532,198</b>

Average exchange rate	0.0111	0.0107	0.0103	0.0095	0.0091
Description	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
Amounts are in Euro Million					
<b>Taxes on income, profits and capital gains</b>	<b>1,271</b>	<b>1,401</b>	<b>1,700</b>	<b>1,750</b>	<b>2,006</b>
Income tax from individuals (PAYE)	671	746	885	935	1,062
Income tax from corporations ( other income tax )	600	655	815	814	944
<b>Taxes on property</b>	<b>190</b>	<b>253</b>	<b>332</b>	<b>337</b>	<b>342</b>
Immovable property	11	27	62	63	63
Financial and capital transactions	179	226	270	274	279
<b>Taxes on VAT</b>	<b>886</b>	<b>1,034</b>	<b>1,153</b>	<b>1,203</b>	<b>1,351</b>
VAT on domestic goods and services	511	550	600	628	689
VAT on imported goods and services	375	484	552	575	662
<b>Taxes on other goods and services</b>	<b>684</b>	<b>816</b>	<b>832</b>	<b>871</b>	<b>916</b>
Excise taxes	517	601	638	663	711
Royalties	4	4	2	1	2
Taxes on goods and services collected as AIA	135	193	191	203	197
others	28	17	1	4	7
<b>Taxes on international trade transactions</b>	<b>357</b>	<b>461</b>	<b>519</b>	<b>530</b>	<b>573</b>
Custom duties	227	299	339	343	370
other taxes	104	132	133	143	156
Other taxes not elsewhere classified	26	29	47	44	47
<b>Total tax revenue</b>	<b>3,198</b>	<b>3,711</b>	<b>4,204</b>	<b>4,355</b>	<b>4,847</b>

Source: Kenya National Bureau of Statistics – Economic Survey 2010

8.4. Appendix 2b: Tax and GDP <sup>38</sup>

<i>Tax and GDP ratios</i>										
	2005		2006		2007		2008		2009	
Avg Exch Rates (Kshs/Euro)	0.011295		0.010877		0.010557		0.010045		0.008929	
	Kshs (m)	Euro (m)								
GDP at market prices	1,415,825	15,992	1,622,592	17,649	1,828,788	19,307	2,077,434	20,868	2,273,685	20,302
Total tax revenue	288,479	3,258	346,310	3,767	408,113	4,308	459,031	4,611	532,198	4,752
CIT revenue	54,144	612	61,144	665	79,125	835	85,844	862	103,655	926
Tax / GDP	<b>20%</b>		<b>21%</b>		<b>22%</b>		<b>22%</b>		<b>23%</b>	
CIT / GDP	<b>4%</b>		<b>4%</b>		<b>4%</b>		<b>4%</b>		<b>5%</b>	

<i>Tax Composition</i>						
Description/Year of Income	2005/06	2006/07	2007/08	2008/09	2009/10	Weighted average
Personal Income Tax (PAYE)	21%	20%	21%	21%	22%	21%
Corporate Income Tax	19%	18%	19%	19%	19%	19%
Value Added Tax	28%	28%	27%	28%	28%	28%
Excise and other taxes on goods and services	21%	22%	20%	20%	19%	20%
Custom duties and related taxes	11%	12%	12%	12%	12%	12%

<sup>38</sup> GDP and tax figures from Kenya National Bureau of Statistics Economic Survey 2010. Tax figures are July to June figures

## 8.5. Appendix 3: Transfer Pricing rules

LN No. 67 15 June 2006	The Income Tax (Transfer Pricing) Rules 2006  In the Exercise of the powers conferred by Section 18(8) of the Income Tax Act, the Minister for Finance makes the following Rules:-
1) Citation and commencement	These Rules may be cited as the Income Tax (Transfer Pricing) Rules, and shall come into operation on the 1 <sup>st</sup> July, 2006.
2) Interpretation	In these Rules, unless the context otherwise requires:-  “arm’s length price” means the price payable in a transaction between independent enterprises;  “comparable transactions” means transactions between which there are no material differences, or in which reasonably accurate adjustments can be made to eliminate material differences;  “controlled transaction” means a transaction which is monitored to ensure payment of an arm’s length price for goods or services;  “related enterprises” means one or more enterprises whereby:-  (a) one of the enterprises participates directly or indirectly in the management, control or capital of the other; or  (b) a third person participates directly or indirectly in the management, control or capital of both.
3) Purpose of Rules	The purposes of these Rules are:-  (a) to provide guidelines to be applied by related enterprises, in determining the arm’s length prices of goods and services in transactions involving them, and  (b) to provide administrative regulations, including the types of records and documentation to be submitted to the Commissioner by a person involved in transfer pricing arrangements.
4) Person to choose method	The taxpayer may choose a method to employ in determining the arm’s length price from among the methods set down in Rule 7.

5) Scope of guidelines	<p>These guidelines shall apply to:-</p> <ul style="list-style-type: none"> <li>(a) 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;</li> <li>(b) 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.</li> </ul>
6) Transactions subject to Rules	<p>The transactions subject to adjustment of prices under these Rules shall include:-</p> <ul style="list-style-type: none"> <li>(a) the sale or purchase of goods;</li> <li>(b) the sale, purchase or lease of tangible assets;</li> <li>(c) the transfer, purchase or use of intangible assets;</li> <li>(d) the provision of services;</li> <li>(e) the lending or borrowing of money; and</li> <li>(f) any other transactions which may affect the profit or loss of the enterprise involved.</li> </ul>
7) Methods	<p>The methods referred to in rule 4 are the following:-</p> <ul style="list-style-type: none"> <li>(a) the comparable uncontrolled price (CUP) method, in which the transfer price in a controlled transaction is compared with the prices in an uncontrolled transaction and accurate adjustments made to eliminate material price differences;</li> <li>(b) the resale price method in which the transfer price of the produce is compared with the resale price at which the product is sold to an independent enterprise;</li> </ul> <p>provided that in the application of this method the resale price shall be reduced by the resale price margin (the profit margin indicated by the reseller);</p> <ul style="list-style-type: none"> <li>(c) the cost plus method, in which costs are assessed using the costs incurred by the supplier of a product in a controlled transaction, with a mark-up added to make an appropriate profit in light of the functions performed and the assets used and risks assumed by the supplier;</li> </ul>

	(d)	the profit split method, in which the profits earned in very closely interrelated controlled transactions are split among the related enterprises depending on the functions performed by each enterprise in relation to the transaction, and compared with a profit split among independent enterprises in a joint venture;
	(e)	The transactional net margin method, in which the net profit margin attained by a multinational enterprises in a controlled transaction is compared to the net profit margin that would have been earned in comparable transactions by an independent enterprise; and
	(f)	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 these guidelines.
8) Application methods	(1)	The methods set out in rule 7 shall be applied in determining the price payable for goods and services in transactions between related enterprises for the purpose of section 18(3) of the Act.
	(2)	A person shall apply the method most appropriate for his enterprise, having regard to the nature of the transaction, or class of transaction, or class of related persons or function performed by such persons in relation to the transaction.
9) Power of Commissioner to request information	(1)	The Commissioner may, where necessary, request a person to whom these Rules apply for information, including books of accounts and other documents relating to transactions where the transfer pricing is applied.
	(2)	The documents referred to in paragraph (1) shall include documents relating to:- <ul style="list-style-type: none"> <li>(a) the selection of the transfer pricing method and the reasons for the selection;</li> <li>(b) the application of the method, including the calculations made and price adjustment factors considered;</li> <li>(c) the global organisation structure of the enterprise;</li> <li>(d) the details of the transaction under consideration;</li> </ul>

	<p>(e) the assumptions, strategies and policies applied in selecting the method; and</p> <p>(f) such other background information as may be necessary regarding the transaction.</p> <p>(3) The books of accounts and other documents shall be prepared in, or be translated into, the English language, at the time the transfer price is arrived at.</p>
10) Application of arm's length pricing	<p>Where a person avers the application of arm's length pricing, such person shall:-</p> <p>(a) develop an appropriate transfer pricing policy;</p> <p>(b) determine the arm's length price as prescribed under the guidelines provided under these rules; and</p> <p>(c) avail documentation to evidence their analysis upon request by the Commissioner.</p>
11) Certain provisions of Act to apply	<p>The provisions of the Act relating to fraud, failure to furnish returns and underpayment of tax shall apply with respect to transfer pricing.</p>
12) Unpaid tax to be deemed additional tax	<p>Any tax due and unpaid in a transfer pricing arrangement shall be deemed to be additional tax for purposes of sections 94 and 95 of the Act.</p> <p style="text-align: right;">Made on the 15<sup>th</sup> June 2006 AMOS KIMUNYA, Minister of Finance</p>

## 8.6. Appendix 4: Interview Questionnaire

<b>Tax environment and perspectives of MNE tax treatment in Kenya</b>	
Tax environment	<ul style="list-style-type: none"> <li>- What is the general perception of MNEs in the tax environment?</li> <li>- What is the attitude of the tax authority to Multi National Enterprises ("MNEs")?</li> <li>- Are MNEs considered to be socially responsible from a tax perspective?</li> <li>- Are MNEs considered to be constantly pursuing aggressive tax reduction strategies?</li> <li>- What are the objectives for introducing TP rules? Do they include exchange control objectives?</li> <li>- What challenges does the tax authority anticipate in regard to the implementation of these rules? What are the recommendations to mitigate such risks?</li> <li>- Do MNEs consider the introduction of TP rules to be beneficial?</li> </ul>
Tax structure	<ul style="list-style-type: none"> <li>- What are the typical legal structures adopted by MNEs in Kenya?</li> <li>- What are the typical functions performed or purported to be performed through local related parties?</li> <li>- Do these reflect the substance of the transactions?</li> <li>- What are the typical types of transactions between local and overseas related parties?</li> <li>- What is the broader interaction of the MNE group with the Kenyan economy?</li> <li>- What other types of economic interactions do the overseas related parties have with Kenya?</li> </ul>
Economic sector	<ul style="list-style-type: none"> <li>- In what sectors do the MNEs play in primarily?</li> <li>- What is the significance of these sectors to the economy?</li> <li>- In your estimation, what is the current contribution of these sectors to the economy?</li> </ul>
Role/share of MNEs in GDP	<ul style="list-style-type: none"> <li>- What is the extent and form of MNE contribution to the GDP?</li> </ul>
Estimation of possible changes in revenues after introduction of TP regulations	<ul style="list-style-type: none"> <li>- Has there been an improvement in MNE tax remissions since the introduction of TP rules?</li> <li>- To what extent can these be attributable to the introduction of TP rules?</li> <li>- Are there further improvements expected? Will these be one-off or recurrent?</li> <li>- Will these be as a result of audits? Or increased compliance?</li> <li>- What is the estimated expected increase in tax revenues?</li> </ul>

<b>Overview of the current TP legislation and audit practices</b>	
Overview of existing TP rules	<ul style="list-style-type: none"> <li>- What is your general assessment of the existing TP rules?</li> <li>- How do these rules compare with globally recognised rules?</li> <li>- What amendments / improvements would you recommend?</li> <li>- What is the view on Advance Pricing Arrangements? Are they considered desirable? What needs to be put in place to make them workable?</li> </ul>
Other provisions for arm's length principle	<ul style="list-style-type: none"> <li>- Are existing globally recognised TP rules appropriate for developing countries such as Kenya?</li> <li>- Any suggestions on more appropriate rules or methodologies that should be adopted?</li> </ul>
Analysis of audit practice of TP	<ul style="list-style-type: none"> <li>- What is the current practice in respect of TP audits?</li> <li>- What is the approach of the revenue authority?</li> <li>- How often are assessments made?</li> <li>- How frequent are the audits?</li> <li>- How extensive are the audits?</li> <li>- Are they methodical?</li> <li>- Is there sufficient expertise to recognise the key issues?</li> <li>- What is the frequency of successful resolutions to TP disputes?</li> </ul>
Analysis of effectiveness of mechanisms to reduce double taxation	<ul style="list-style-type: none"> <li>- Any experience with double taxation issues?</li> <li>- Are the authorities sensitive to this issue?</li> <li>- Are there mechanisms in place to reduce double taxation?</li> <li>- What mechanisms with respect to dispute resolution are there? How effective are these in practice?</li> <li>- What is the view on Mutual Agreement Procedures? Are they considered desirable? Has there been any experience with this? What are the challenges? How can they be overcome?</li> </ul>
<b>Experiences with TP reform processes: legal reforms and capacity development</b>	
Summary of countries' key approaches to build up TP capacity	<ul style="list-style-type: none"> <li>- What initiatives/reforms are currently being carried out to build the TP practice?</li> <li>- What are the benefits expected from the TP reforms?</li> <li>- What is being done to ensure TP reform is successful and achieves objectives?</li> <li>- What more needs to be done to achieve these objectives?</li> <li>- What has/is being done in the area of capacity building?</li> <li>- Where has the focus been? Training, recruitment.?</li> <li>- Why is a particular approach favoured over others?</li> </ul>

	<ul style="list-style-type: none"> <li>- What are the challenges to building capacity?</li> <li>- To what extent is technical assistance being sought from external sources?</li> <li>- What is the current state of play on technical cooperation between regional tax authorities?</li> </ul>
Analysis of challenges encountered when having introduced TP	<ul style="list-style-type: none"> <li>- What challenges have been faced since the introduction of TP rules?</li> <li>- What are the challenges with applying the rules?</li> <li>- What are the obstacles to achieving the objectives for which the rules were established?</li> <li>- Are there infrastructural challenges? What kind of infrastructure is required?</li> </ul>
Mapping of different strategies & best practices in dealing with such challenges	<ul style="list-style-type: none"> <li>- What can be done to overcome the challenges and obstacles?</li> <li>- What is best practice?</li> <li>- How can resource gaps be bridged?</li> </ul>
Estimation of potential challenges & recommendations	<ul style="list-style-type: none"> <li>- What are the future challenges that may arise?</li> <li>- How can these be forestalled?</li> <li>- Is the judiciary sufficiently knowledgeable to oversee TP cases?</li> <li>- How can this challenge be addressed?</li> <li>- How can the challenges with obtaining local comparables be dealt with?</li> <li>- To what extent are comparables obtained from commercial databases considered suitable?</li> </ul>
Required legislative basis on which TP regulations are based	<ul style="list-style-type: none"> <li>- Is the existing legal framework for TP considered adequate?</li> <li>- What are the strengths and weaknesses?</li> <li>- What improvements are being considered?</li> <li>- How relevant are detailed practice notes?</li> <li>- Is it ideal to have direct references to the work of established authorities in the law? E.g. the OECD TP guidelines?</li> <li>- The current TP rules do not apply to transactions between local companies, is this considered a risk? Is there any intention to extend the coverage?</li> </ul>
Estimated costs and benefits of introducing and enhancing TP rules	<ul style="list-style-type: none"> <li>- What have been the costs of introducing and trying to develop TP capacity?</li> <li>- What additional costs are anticipated?</li> <li>- What benefits have there been?</li> <li>- What are the anticipated benefits?</li> </ul>
<b>Development cooperation support to the development of TP reform processes</b>	
Summary of activities of donors & international organisations and initiatives	<ul style="list-style-type: none"> <li>- What donor and international agencies have been involved in this arena?</li> <li>- In what ways have they been involved?</li> <li>- What methods have they applied?</li> </ul>

	<ul style="list-style-type: none"> <li>- How effective have these been? What results have been achieved?</li> <li>- Is there any coherence?</li> <li>- How can these be made more effective?</li> </ul>
Best forms of assistance & effectiveness and efficiency	<ul style="list-style-type: none"> <li>- How best can these organisations contribute to TP reform?</li> <li>- What is the ideal form in which these contributions should be made? Financial, technical, training, people secondment/development etc.</li> </ul>
Identification & analysis of best practices	<ul style="list-style-type: none"> <li>- What is best practice?</li> <li>- Will this be effective in a developing country context?</li> </ul>
Comment on the role of further existing initiatives	<ul style="list-style-type: none"> <li>- What other initiatives exist in this arena?</li> </ul>
Outline of need for further discussions and/or additional analysis & recommendations	<ul style="list-style-type: none"> <li>- What areas need to be further examined?</li> </ul>