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Transfer Pricing Changes Introduced by the Finance Act, 2022

The Finance Act, 2022 ("the Act") which was gazetted on Friday, 8th July, 2022 has introduced key changes in the transfer pricing (TP) regulatory framework in Kenya which will have extensive implications for taxpayers in Kenya.

- Prior to the Finance Act 2022, the TP regulations in Kenya covered transactions between a taxpayer in Kenya and **non-resident related parties** and/or resident related parties operating in a preferential tax regime ("PTR") in Kenya. However, effective 1st January 2023, the transfer pricing regulations in Kenya will also cover transactions between a taxpayer in Kenya and **non-resident independent parties in preferential tax regimes**.
- The act has also introduced increased reporting requirements for multinational entities (MNEs) operating in Kenya in respect to transfer pricing.

I. Who will be affected by these changes?

As a taxpaying entity in Kenya:

- a) Do you purchase products and/or services from suppliers located in countries such as the United Kingdom (UK), United Arabs Emirates (UAE) or Mauritius?
- b) Do you sell products or services to clients located in countries such as the UK, UAE or Mauritius?
- c) Do you receive financing/loan from lenders located in countries such as the UK, UAE or Mauritius, among other countries?
- d) Do you have any other form of business dealings with suppliers or clients located in countries such as the UK, UAE or Mauritius, among other countries?
- e) Do you trade with a related entity located in a special economic zone (SEZ) or an export processing zone (SEZ) in Kenya?
- f) Are you a constituent entity of a multinational enterprise (MNE)?

If the answer to any of the above questions is Yes, the transfer pricing changes introduced by the Finance Act, 2022 will affect you, among other entities in Kenya.

II. Summary of key changes and their implications

Change introduced	Details	Implications
Transactions with entities located in preferential tax regimes (PTR)	<p>The Act amended Section 18(A) of the Income Tax Act to increase the scope of transactions within the ambit of the transfer pricing legislation in Kenya. Effective 1st January 2023, an entity in Kenya having transactions with the following categories of entities is required to carry out such transactions at arm's length prices.</p> <ul style="list-style-type: none">• A related resident person operating in a preferential tax regime (PTR) in Kenya;• A non-resident person located in a PTR;	<p>The major implication of this change is that transactions between any entity in Kenya and its non-resident independent trading partners or suppliers (or their associates and/or PEs) located in countries considered to be PTRs will fall within the ambit of TP regulations in Kenya.</p> <p>Consequently, a taxpayer in Kenya trading with the any entity located in a PTR will be required to prepare a TP documentation (<i>justifying that the prices of the transactions with the independent</i></p>

- Associated enterprise of a non-resident person located in PTR; or
- A PE of a non-resident person operating in Kenya where the non-resident person is located in a PTR

Definition of a preferential tax regime (PTR)

The Act has defined PTR as:

PTR in Kenya	Any Kenyan legislation, regulation or administrative practice which provides a preferential rate of tax to such income or profit, including reductions in the tax rate or the tax base.
Foreign PTR	A foreign country will be considered as a PTR, if such a country: <ul style="list-style-type: none"> • Does not tax income; • Taxes income at a rate that is less than twenty per cent (20%); • Does not have a framework for the exchange of information; • Does not allow access to banking information; or • Lacks transparency on corporate structure, ownership of legal entities located therein, beneficial owners of income or capital, financial disclosure, or regulatory supervision.

parties operating in PTRs are arm's length) in accordance with the Income Tax (Transfer Pricing) Rules, 2006.

Currently, the corporate income tax (CIT) rate in more than sixty (60) countries is less than 20%. This means that such countries will be considered to be preferential tax regimes. The key ones include **Mauritius** (15%), **United Kingdom** (19%), **Singapore** (17%), **Germany** (15.8%), **Canada** (15.0%), **United Arabs Emirates** (0%), British Virgin Islands (0%), Bahamas (0%) and Bermuda (0%).

In addition, 76 out of 192 countries in the world had not signed the **Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information** as at 05 July, 2022. Consequently, these countries will be considered to be PTRs based on the Act.

The above measures target transactions between taxpayers in Kenya and their business partners in countries considered to be tax havens (countries with low effective tax rates). These countries are often considered to fuel tax avoidance.

When trading with independent parties located in PTRs, taxpayers in Kenya may find it challenging to obtain some of the information required to support the TP documentation (such as pricing/costing methodology) since such third parties may be reluctant to provide such information. Consequently, this may jeopardise their compliance effort.

In addition, some of the countries that fall under the definition of PTRs such as UK are Kenya's key trade partners. For example, during the FY 2021, trade in goods and services between Kenya and UK was **£1.1 billion (c. KSH 150 billion)**. The increased TP compliance and reporting requirements and the uncertainty around the same will increase the cost of doing business in Kenya. Consequently, this may discourage investors from doing business in and with Kenya.

Three-tiered Approach to TP Documentation

Kenya has adopted the three-tiered approach to TP documentation under the OECD TP Guidelines.

Effective 1st July 2022, an entity in Kenya that is part of a multinational enterprise (MNE) group with **a group turnover of KSH 95 billion** (including investment and extraordinary income) in each year is required to file the following with the Kenya Revenue Authority (KRA);

- **A country-by-country (CbC) report** showing the financial activities of the MNE group in all countries where the MNE group has taxable presence;
- **Master File** (Master TP Policy); and
- **Local File**

The above three reports shall apply to the tax

Through the Finance Act 2021 and Finance Act 2022, Kenya has introduced key changes to align the transfer pricing framework in Kenya with the international TP guidelines (such as the OECD Transfer Pricing Guidelines.)

The three-tiered transfer pricing reporting requirements for MNE groups is aimed at increasing international tax transparency and enhance access to information regarding allocation of economic activity and resulting income and profits between various entities in an MNE group.

The KRA has indicated that it intends to use the information provided by the MNE groups operating in Kenya as follows:

returns from the year of income 2022 onwards. The **due date** of filing the Master File and Local File is within six months after the last day of the reporting financial year of the MNE group. The CbC report shall be filed within 12 months after the last day of the reporting financial year of the MNE group.

Country-by-country (CbC) report Notification

A taxpayer in Kenya that is part of an MNE group is required to notify the KRA the whether or not it is the ultimate parent entity (UPE) of the MNE group, a surrogate parent entity (SPE), or the identity of a constituent entity which is the UPE and its tax residency status. The notification should be submitted to the KRA *not later than the last day of the reporting financial year of the MNE group*.

Exemptions from filing the CbC report

A MNE group operating in Kenya is exempted from filing a CbC report in Kenya if:

- The UPE or the SPE is required to file the CbC report in the country they are tax resident;
- The country in which the UPE or SPE is tax resident has an international agreement and a competent authority agreement in force with Kenya; and
- Instances of a systematic failure.

- To assess the risk of non-compliance by members of the MNE group with the applicable transfer pricing rules;
- To assess high-level transfer pricing risks and other base erosion and profit shifting related risks in Kenya; and
- For economic and statistical analysis (where applicable).

The introduction of the three-tiered TP reporting requirement will result in additional documentation and reporting requirements for MNEs groups operating in Kenya. Consequently, this is likely to lead to:

- Increased compliance burden and cost on the affected taxpayers; and
- Increased tax and transfer pricing audits from the KRA coupled with prolonged timelines for TP audits.

Should you need specific guidance on how the above changes impact your business, kindly feel free to contact any of the below or your usual RSM contact who will be always available to offer guidance and assistance that you need.

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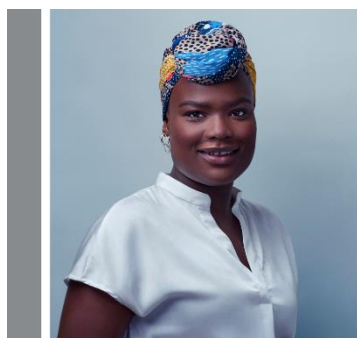
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