

THE INCOME TAX (TRANSFER PRICING) RULES, 2006

LEGAL NOTICE No. 67/2006

THE INCOME TAX ACT (Cap 470)

IN EXERCISE of the powers conferred by section 18(8) of the Income Tax Act, the Minister for Finance makes the following Rules -

THE INCOME TAX (TRANSFER PRICING) RULES, 2006

1. Citation and commencement.

These Rules may be cited as the Income Tax (Transfer Pricing) Rules, and shall come into operation on the 1st 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 or 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 out in rule 7.

5. Scope of guidelines.

These guidelines shall apply to –

- (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;
- (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.

6. Transactions subject to Rules.

The transactions subject to adjustment of prices under these Rules shall include—

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

7. Methods.

The methods referred to in rule 4 are the following—

- (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;
- (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;

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);

- (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;
- (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 enterprise 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 transactions, the arm's length price cannot be determined using any of the methods contained in these guidelines.

8. Application of 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 purposes 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 for 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 –

(a) the selection of the transfer pricing method and the reasons for the selection;

(b) the application of the method, including the calculations made and price adjustment factors considered;

(c) the global organization structure of the enterprise;

(d) the details of the transaction under consideration;

(e) the assumptions, strategies, and policies applied in selecting the method; and

(f) such other background information as may be necessary regarding the transaction.

(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.

10. Application of arm's length pricing.

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

(a) develop an appropriate transfer pricing policy;

(b) determine the arm's length price as prescribed under the guidelines provided under these Rules; and

(c) avail documentation to evidence their analysis upon request by the Commissioner.

11. Certain provisions of Act to apply.

The provisions of the Act relating to fraud, failure to furnish returns and underpayment of tax shall apply with respect to transfer pricing.

12. Unpaid tax to be deemed additional tax.

Any tax due and unpaid in a transfer pricing arrangement shall be deemed to be additional tax for purposes of sections 94 and 95 of the Act.

Made on the 15th June, 2006

AMOS KIMUNYA
Minister for Finance