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KENYA TAX ALERT – TAX APPEALS TRIBUNAL (TAT'S) RULING ON ARM'S LENGTH PRICE

Tax Appeals Tribunal (TAT) Rules that there should be no Transfer Pricing Adjustment if the Taxpayer's Result are within the Arm's Length Range

Introduction

The Tax Appeals Tribunal (TAT) delivered its verdict in the *Tax Appeal No. 1181 of 2022* where the Tribunal clarified that [where a taxpayer's financial results of an intercompany \(controlled\) transaction are within the arm's length range of results established by a benchmarking study, there should be no transfer pricing adjustment by the revenue authority.](#)

Background of the Case

The Appellant (the taxpayer) is a limited liability company incorporated in Kenya whose principal activities are in ICT and information technology as well as software developers. Further, it provides pre-sale/ and marketing support services to its parent company.

For the provision of pre-sale/marketing support services to its parent company, the Appellant was remunerated based on a mark-up on its cost of providing the service. The transfer pricing policy, prepared by the Appellant determined the arm's length range (interquartile range) for the transactions performed by the Appellant as 4.9% to 7.3% with a median of 5.5%. The intercompany agreement between the Appellant and the parent company provided that the Appellant would be remunerated based on cost plus 5% mark-up.

The Respondent ("KRA") conducted a review of the Appellant's tax records in 2022 covering the periods 2017–2020. The KRA adopted the median mark-up of 5.5% to compute the transfer pricing adjustment. Thereafter the KRA issued a notice of assessment. The Appellant lodged an objection after which the KRA issued an Objection decision confirming the assessment of *KShs 26.9 million*. Dissatisfied with the Objection decision, the Taxpayer lodged an appeal at the TAT.

Appellant's Case

The Appellant presented its case as follows:

- That imposing the median mark-up is contrary to the OECD Guidelines, which allow a taxpayer to adopt any rate within the arm's length range as the basis of related party transactions
- The Transfer Pricing Rules in Kenya have adopted the OECD Guidelines and do not require a taxpayer to adopt a median position and the taxpayer is thus free to adopt any position within the interquartile range
- That the revenue reported in the Appellant's financial statement for the years under audit is within the arm's length range of mark-ups and thus there is no legally tenable reason for the adjustment of the Appellant's income as reported in the financial statements
- That the mark-up as per the signed agreement between the Appellant and its parent company (5%) was, at all period covered by KRA audit, within the arm's length range as per the transfer pricing documentation prepared by the Appellant
- That between 2017 and 2019, the aggregate difference between the revenue as reported in the financial statements and revenue expected from the transfer pricing policy is KShs 43,831 which is attributable to rounding off differences and exchange differences incurred at the point of invoicing the parent entity
- That other countries have adopted legislative measures to outline when an adjustment to median may be imposed

Respondent's Case

The Respondent presented its case as follows:

- That the benchmarking study established that arm's length to be between 4.9% and 7.3% with a median of 5.5% and therefore, the Appellant was required to use the rate of 5.5%
- The Respondent observed that there was a deviation in the margin rates applied from the recommended rate of 5.5% as stated in the Appellant's transfer pricing document
- That this deviation was improper and the Respondent thus made adjustments on the income tax reported by the Appellant

Issues for Determination and Ruling

The key issue of determination was whether the assessment for corporation tax was justified. The TAT noted that the Respondent did not dispute the Appellant's Transfer Pricing Policy, but only disputed the margin rates applied from the recommended rate of 5.5% as stated in the Appellant's transfer pricing document. The TP Rules enacted under the Kenyan Income Tax have adopted OECD Guidelines which do not necessarily require a taxpayer to adopt the median position. A taxpayer is thus free to adopt any position within the interquartile range.

Based on the above, the Tribunal found that imposing the median measure as the arm's length rate is contrary to the OECD Guidelines, which allows a taxpayer to adopt any rate within the arm's length range as the basis of related party transactions.



Conclusion and Our View

This ruling provides clarity to taxpayers that if the TP policy and the benchmarking study are sufficiently prepared, the taxpayer can adopt any point within the arm's length range of result established by the benchmarking study. The taxpayer should perform annual verification check to ascertain that the financial statements reflect the pricing indicated in the TP policy to mitigate the risk of a transfer pricing adjustment.

In cases where the taxpayer does not have a sufficiently prepared TP policy or the results of the intercompany transaction falls outside the arm's length range, the revenue authority would be justified in adjusting the taxpayer's result to the median data point established by a benchmarking study based on various case laws across the world.

Should you need any assistance/clarifications in respect of the above, please reach out to the below or your usual RSM contact.

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