



TRANSFER PRICING POLICY VERSUS TRANSFER PRICING DOCUMENTATION

The trend noted with regards to Multi-National Entity (MNE) transactions in the global market is the increase in intra-group transactions. The governments of developing nations have lost significant revenues in form of taxes from transactions by members within the same MNE groups because the nature of these transactions is controlled and thus do not follow the arm's length principle. The arm's length price is the price payable in a transaction between two independent parties, governed by market forces.

Consequently, to manage revenue losses, governments require that any transactions between members of an MNE group should be arm's length. To achieve this in Kenya, the government through the Income Tax Act, Chapter 470 of the Laws of Kenya, provides for Transfer Pricing Regulations. The Regulations purpose to: -

- Provide guidelines for use by related enterprises in determining the arm's length prices of goods and services in transactions involving them, and
- Provide administrative regulations, including the types of records and documentation to be submitted to the Commissioner by a person involved in transfer pricing arrangements.

This newsletter focuses on the administrative regulations.

Administrative Transfer Pricing Regulations

The terms "transfer pricing policy" and "transfer pricing documentation" are generally used interchangeably. However, is there a difference between "a policy" and "documentation"?

The Kenya Income Tax (Transfer Pricing) Rules (2006) allow a taxpayer to choose a method to employ in determining the arm length's price from among the ones set out in the regulations. Where a person avers the application of arm's length pricing, such a person shall, among other things, develop an appropriate transfer pricing policy and avail documentation to evidence their analysis upon request by the Commissioner.

The Tanzania Transfer Pricing Regulations require a taxpayer who participates in a controlled transaction to prepare a transfer pricing document that relates to the period that controlled transaction took place. Such documentation should include items spelt out in the Regulations as well as the non-transfer pricing factors that have contributed to the losses.

The Uganda Transfer Pricing Regulations (2011) demand that affected taxpayers should prepare documentation that must be in place before the due date for filing the income tax return for a particular year. The aforementioned documentation should be in writing, and should contain sufficient information and analysis that verifies that the controlled transactions are in line with the arm's length principle.

One may thus infer that the term "documentation" is much broader than "policy", that, the completion of a policy will lead to the creation of a body of information that would make up the documentation. Therefore, transfer pricing policies are statements of the "mechanics of pricing" i.e., an identification of the types of controlled transactions and how the most appropriate methods will be applied to each transaction type.

With the completion of controlled transactions, the total documentation required keeps increasing. Thus, a transfer pricing policy is a subset of transfer pricing documentation. *What then must transfer pricing documentation include?*

1. A transfer pricing policy

TP Policies are about “methodology”, including justification for certain methods used. The Kenyan rules state that a transfer pricing policy shall include documents relating to:-

- The selection of the transfer pricing method and the reasons for the selection,
- The application of the method, including the calculations made and price adjustment factors considered,
- The global organization structure of the enterprise,
- The details of the transaction under consideration,
- The assumptions, strategies and policies applied in selecting the method, and
- Such other background information as may be necessary regarding the transaction.

Similar content is described in the Tanzania TP guidelines and the Uganda TP regulations.

2. Other documentation to defend the actual prices applied

Some of the documents explicitly spelt out in the different regulations and guidelines in Kenya, Uganda and Tanzania include: -

- Documents that provide the foundation for, or otherwise support, or were referred to in the development of the transfer pricing analysis,
 - Books of accounts,
 - A list of advance pricing arrangements entered into by members of the group to which the taxpayer is a party,
 - Agreements and contracts entered into with related/associated persons or with unrelated persons which may be of relevance to the transactions,
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- Letters and other correspondence documenting any terms negotiated between the related/ associated entities, and
- Any other relevant supporting document that may be prescribed by the Commissioner.

An important question then arises: *when are, taxpayers required to update/revise their transfer pricing policies (methodology documents)?*

In Kenya, there are no rules on the frequency of updating or revising a policy. A taxpayer must however, maintain a relevant or updated policy at all times. Implicitly then, policies must be revised if there are new controlled transactions or material changes to the already documented transactions. If the transactions do not change, it would still be prudent to review the validity of the policy, every two or three years. It is however, possible that at the point when we will have adequate local comparables, policies may very well be updated each year to capture changing economics.

Uganda and Tanzania regulations do not dictate when the policies should be updated, but are very explicit as to the fact that the documentation for a year of income should be in place prior to the due date of filing that year's income tax return. This implies that taxpayers are required to revise their policies annually or create addenda after the end of each year to comply with the requirements for contemporaneous documentation.





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