



# Transfer Pricing Documentation Process

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# Outline



- Introduction
- Purpose & Aim TP Documentation
- Determinants of pricing
- Contents of TP Document
- TP Documentation
- TP Application in Kenya
- Question & Discussion

# Introduction



- ❑ A transfer pricing study typically aims at
  - ❑ Maximizing the potential for increased after-tax income and/or
  - ❑ Minimizing the likelihood of adverse tax adjustments and penalties
- ❑ There are five broad categories of transfer pricing studies
  - ❑ **Documentation project**
  - ❑ Design project
  - ❑ Audit defense project
  - ❑ Planning project
  - ❑ Advance pricing agreements / rulings

# Purpose & Aim TP Documentation



## Purpose

- Identify, document and establish the arm's length nature of the inter-company transactions under review to ensure that related parties comply with relevant transfer pricing legislation(s)

## Aim

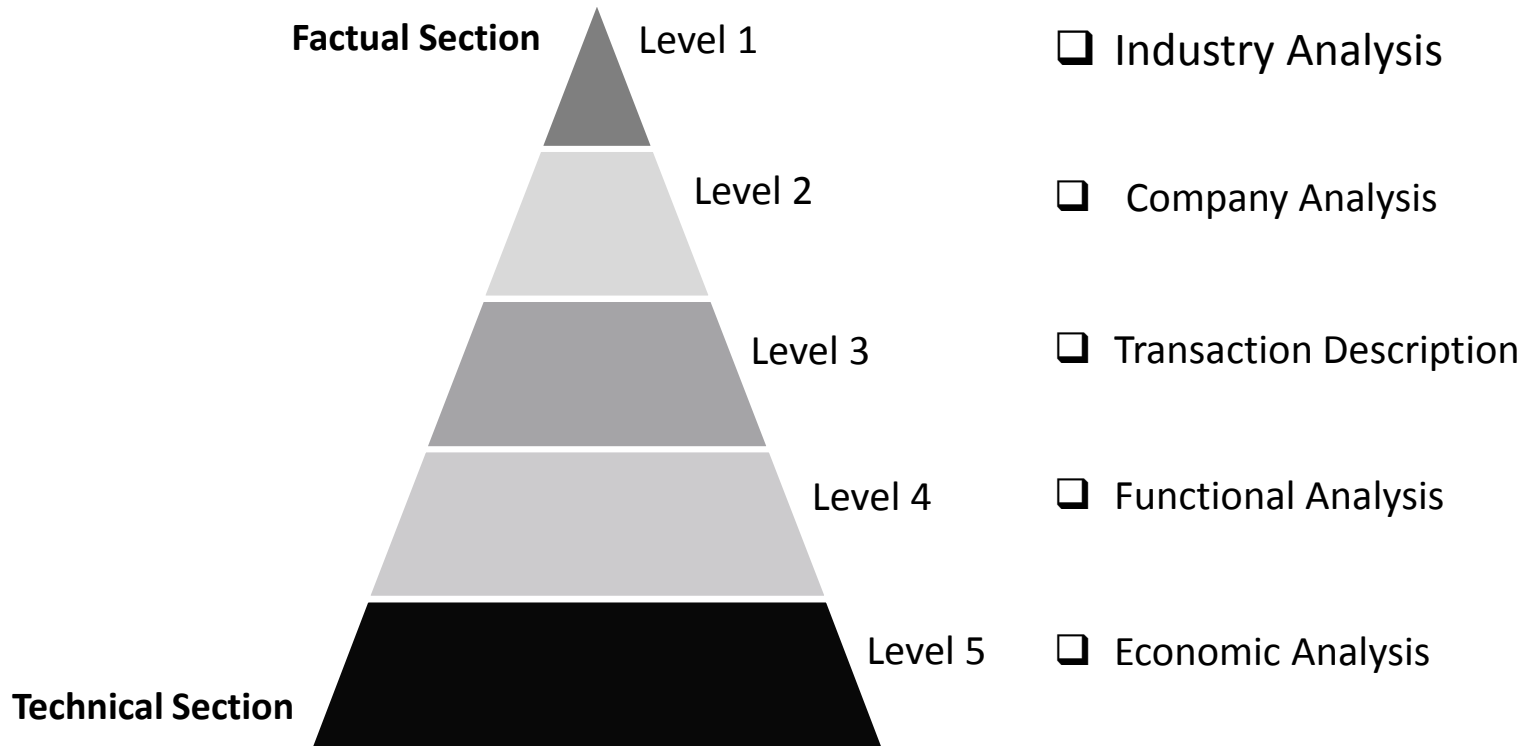
- Avoid additional tax liabilities due to transfer pricing adjustments and/or
- Avoid penalties because of insufficient TP documentation

# Determinants of pricing



- Capital is invested
- Risk is incurred
- Entrepreneurship needs to be rewarded
- Products are successfully differentiated
- Cost advantages exist
- Excess demand
- Number of suppliers

# Contents of TP Document



# TP Documentation



## Factual sections

- Describe the industry and company
- Describe the transactions under review
- Provide background or context to the transfer prices under review
- Detail the roles and responsibilities of the entities involved in each transaction

# TP Documentation



## Technical sections/ Economic Analysis

- Determination of the appropriate TP method(s)
- Application of the TP method(s)
- Selection of tested party
- Benchmarking Analysis



# Industry & Company Analysis



## INDUSTRY ANALYSIS

- Industry structure
- Nature of competition
- Cost Structure
- Value Drivers
- Comparable

## COMPANY ANALYSIS

- Company Profile
- Strategy
- Value Chain
- Key Assets & Risks
- Financial Performance



# Industry & Company Analysis



- ❑ Details required in an industry and/or company analysis is dependent on:
  - ❑ Scope of documentation(e.g. global vs. local)
  - ❑ The aim(s) of the report (e.g. Compliance, penalty protection or adjustment protection)

# Industry & Company Analysis



- ❑ The Industry Analysis identifies influences on price formation in the relevant markets, through analysis of:
  - ❑ Structural conditions of the industry that determines competition and profitability
    - ❑ e.g. regulatory regimes (e.g. pharmaceuticals)
- ❑ Sources of value creation, competitive advantage and their drivers
  - ❑ e.g. in branded luxury goods industry the owner of marketing IP

# Industry & Company Analysis



- ❑ Major business risks and trends in the industry
  - ❑ e.g. emerging markets entering the market with cheap products
- ❑ Critical Success Factors (“CSFs”), as the capabilities that companies must have to respond to industry trends and structures
- ❑ CSFs are necessary to be profitable within the industry
  - ❑ e.g. strength in R&D
- ❑ Sources of information on comparable transactions and entities

# Industry & Company Analysis

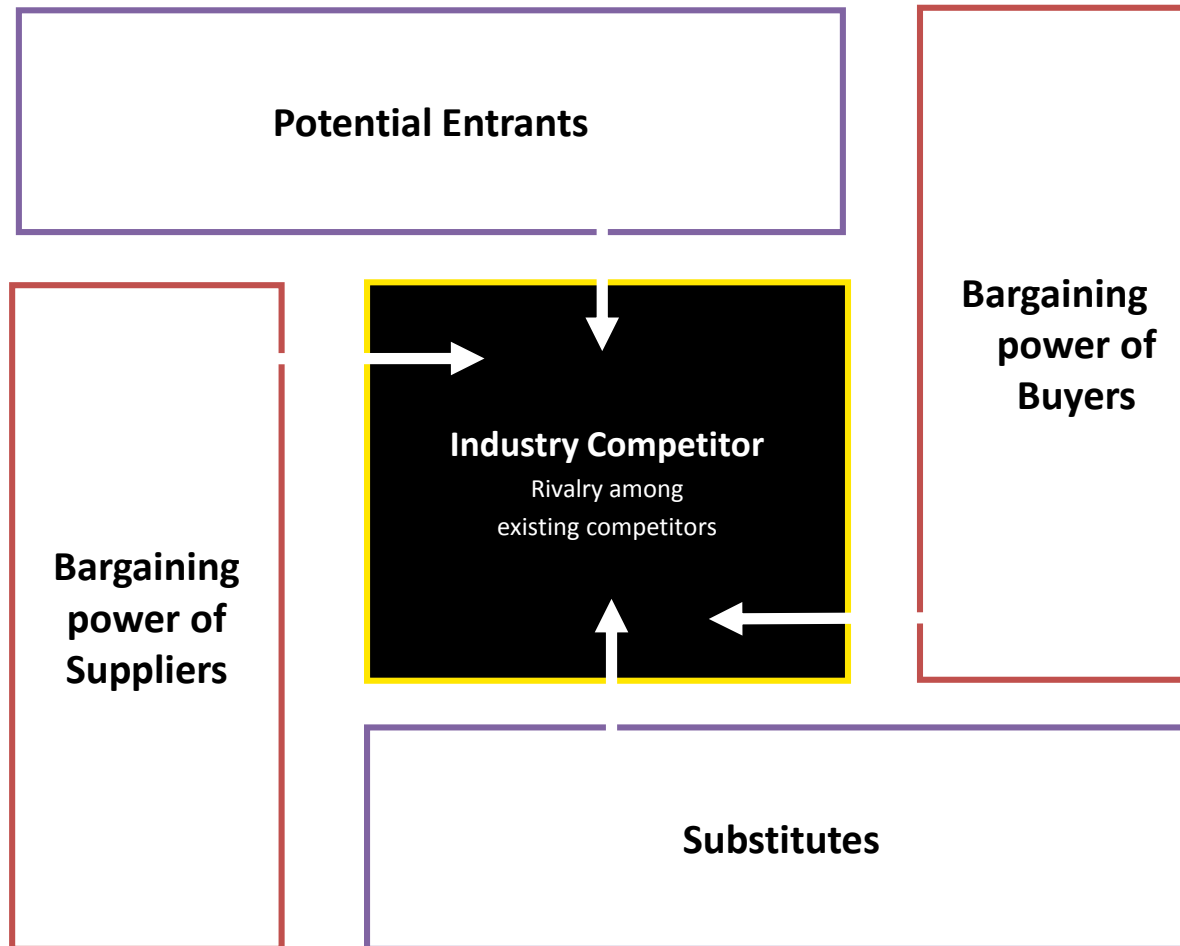


- Industry structure
- Industry value chain
- Cost structure and conditions
- Market and competitor trends
- Technological trends
- Nature of competition
- Regulatory and political trends
- Industry financial performance

# Industry & Company Analysis



## Porter's Five Forces Framework



# Industry & Company Analysis



The Company Analysis gives answers to the questions:

- What is the company's profile (history, products...)?, residual profit, product range
- What is the company's strategy to be profitable?
- What accounts for the company's performance within the industry?
  - Core competencies and capabilities
  - Strength & weaknesses

# Industry & Company Analysis



- Other factors that influences the profitability in the future?
- What are the major risks the company is facing?
- What is the company's value chain?



# Industry & Company Analysis



- ❑ Group's profile
  - ❑ History
  - ❑ Products
  - ❑ Facts and figures
- ❑ Organisational and legal structure
- ❑ Company Strategy
- ❑ SWOT
- ❑ Company's value chain
- ❑ Financial performance

# Functional Analysis



- ❑ Framework for analysing the contributions of the various parties to the related transactions in terms of their value creation within the organization and where risks are borne
- ❑ Describe the functions performed and risks assumed by entities as they relate to material intercompany transactions between such entities
- ❑ It highlights the assets engaged for the various transactions

# Aim of Functional Analysis



- Map the entity's key value-added activities:
  - Strategy / planning
  - Research and development
  - Purchasing and procurement
  - Manufacturing / assembly
  - Sales and distribution
  - Logistics
  - Risks
- Identify critical resources and the revenue or cost drivers at each level of the value chain

# Aim of Functional Analysis



- ❑ Completion of a comprehensive tested party functional analysis provides the basis for
  - ❑ Evaluating the relative contribution to profit of various parties involved in the intercompany transactions
  - ❑ Selecting the transfer pricing method(s)
  - ❑ Establishing comparables search criteria
  - ❑ Identifying the need for tested party segmentation (if appropriate) and financial analysis

# Aim of Functional Analysis



## Business Analysis

- ❑ Characteristics of product/service
- ❑ Economic circumstances
- ❑ Functions/assets /risks
- ❑ Contract terms
- ❑ Business strategies

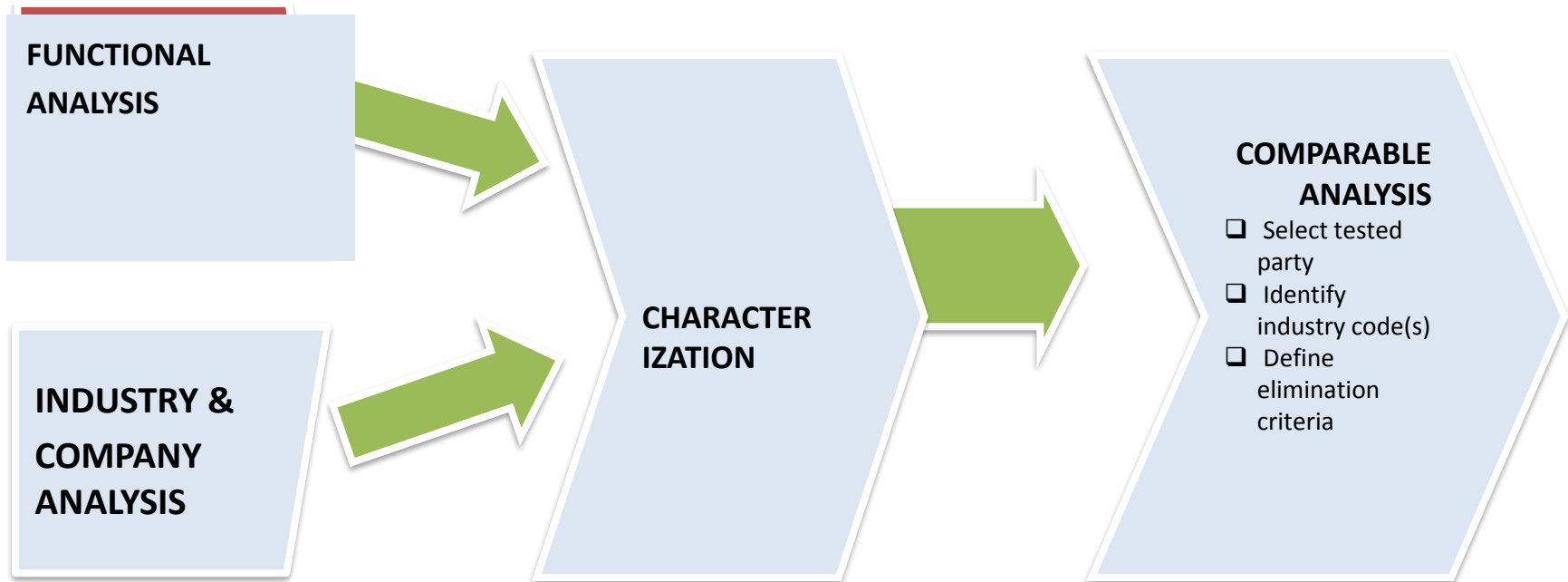
## Comparable Analysis

- ❑ Gather, evaluate and adjust Data on com-parable transaction and companies

## Evaluation

- ❑ Compare results of different methods
- ❑ Select transfer pricing method

# Aim of Functional Analysis



Key factors for comparability analysis: **Characteristics of Property or services , Functional Analysis, Contractual Terms, Economic Circumstances, Business Strategies**

# TP Application in Kenya



**Prior to  
2006**

- General provision providing for compliance to the arm's length principle for cross border controlled transactions

**FY 2006**

- Transfer pricing rules legislated to provide guidance on compliance with the arm's length principle  
Landmark Unilever TP ruling delivered

**2006 to  
2009**

- KRA building capacity in transfer pricing to enforce the transfer pricing legislation

# TP Application in Kenya



**2010  
onwards**

- Increased number of transfer pricing audits by KRA
- Increased involvement in international tax matters such as OECD, BEPS project, ATAF

**2017**

**2**

- Extension of the arm's length coverage to include transactions between preferential tax regime entities and related entities in the normal tax regime

**2018**

- Overhaul of Income Tax Act, Inclusion on new guidelines



# TP Application in Kenya



- ❑ Transfer Pricing in Kenya is based on section 18 (3) of the Income Tax Act, Chapter 470 of the laws of Kenya.
- ❑ This section requires business carried on between a Kenyan resident and a related non-resident person
- ❑ Includes transactions between a PE and the Head Office
- ❑ The transaction need to be conducted at arm's length
- ❑ The Income Tax (Transfer Pricing) Rules 2006



**Thank You!**