

**Checkpoint Technologies Kenya Limited v Commissioner of Domestic Taxes (Tax Appeal 1181 of 2022) [2024] KETAT 114 (KLR) (2 February 2024) (Judgment)**

Neutral citation: [2024] KETAT 114 (KLR)

**REPUBLIC OF KENYA  
IN THE TAX APPEAL TRIBUNAL  
TAX APPEAL 1181 OF 2022**

**E.N WAFULA, CHAIR, E NG'ANG'A, RO OLUOCH, CYNTHIA  
B. MAYAKA, AK KIPROTICH & B GITARI, MEMBERS**

**FEBRUARY 2, 2024**

**BETWEEN**

**CHECKPOINT TECHNOLOGIES KENYA LIMITED ..... APPELLANT**

**AND**

**COMMISSIONER OF DOMESTIC TAXES ..... RESPONDENT**

**JUDGMENT**

**Background**

1. The Appellant 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, Check Point Technologies Limited.
2. The Respondent is a principal officer appointed under Section 13 of the *Kenya Revenue Authority Act, 1995*. Under Section 5 (1) of the Act, the Kenya Revenue Authority is an agency of the Government for the collection and receipt of all tax revenue.
3. The Respondent conducted a review of the Appellant's tax records in 2022 covering the periods 2017-2020 covering Corporation tax, PAYE and Withholding tax.
4. Thereafter the Respondent issued a notice of assessment through a letter dated 3<sup>rd</sup> March 2022.
5. The Appellant lodged a late notice of objection manually through a letter dated 27<sup>th</sup> May 2022.
6. The Respondent issued an Objection decision through a letter dated 29<sup>th</sup> August 2022 confirming the assessments of Kshs. 26,933,592.00

**The Appeal**

7. The Appeal is premised on the following grounds as stated in the Appellant's Memorandum of Appeal dated 10<sup>th</sup> October 2022 and filed on 12<sup>th</sup> October 2022:



- a. That the income reported by the company from its dealings with related parties is sufficient and appropriate in line with the company's transfer pricing policy and the requirements of the [Income Tax Act](#)
- b. That the Appellant is not required to adopt the median position in an interquartile range, and that the Appellant fulfils the requirement of the [Income Tax Act](#) by adopting the 25<sup>th</sup> percentile (low quartile) of the arm's length
- c. That the reimbursement of the expenses to employees does not constitute a professional service and is thus not subject to withholding tax
- d. That the Appellant accrual of employee vacation days (leave accrual) is not an employment benefit to the employee and thus is not subject to PAYE
- e. That accrual of staff costs and incentives does not constitute an employment benefit and thus not subject to PAYE
- f. That local medical benefit (incurred in Kenya) is not a taxable employment benefit
- g. That the reimbursement of costs to employees does not constitute an employment benefit and thus not subject to PAYE.

### **Appellant's Case**

8. The Appellant's case is supported with the following documents:
  - a. The Appellant's Statement of Facts dated and filed in 12<sup>th</sup> October 2022 together with the documents attached thereto.
  - b. The Appellant's written submissions dated 23<sup>rd</sup> May 2023 and filed on 24<sup>th</sup> May 2023.
9. That in 2022, the Respondent carried out an in-depth audit of the Appellant's books of account. The review covered the years of income 2017, 2018, 2019 and 2020. The taxes covered were income tax, PAYE and Withholding tax.
10. That on 4<sup>th</sup> March 2022, the Appellant received a letter titled "tax verification for January 2016 to December 2020 Corporate tax, PAYE and WHT assessments". The letter was unsigned and delivered by e-mail by the Respondent's officer. The letter demanded tax as tabulated below: The letter as received by the Appellant was not signed and was shared as an MS Word document.

Income Tax	WHT	PAYE	TOTAL	
Principal	1,640,446	369,519	17,830,056	19,840,021
Penalty	82,022	18,476	891,503	992,001
Interest	346,265	101,152	4,662,153	5,109,569
Total	2,068,733	489,147	23,383,711	25,941,591

11. That on 4<sup>th</sup> March 2022, the Respondent issued assessment orders on the iTax portal as follows:



- a. Assessment number KRA202202891047 brought to charge PAYE valued at Kshs 7,411,114.99 for year of income 2018, with the penalties amounting to Kshs.370,555.70 and late payment amounting to Kshs. 2,964,446.00. The total amount demanded for the year of income 2018 amounted to Kshs. 10,746,116.68
  - b. Assessment number KRA202202890949 brought to charge PAYE valued at Kshs. 5,897,622.00 for the year of income 2019, with the penalties amounting to Kshs. 294,881,00 and late payment interest amounting to Kshs. 1,651,334.16. The total amount demanded for the year of income 2019 amounted to Kshs. 7,843,837.26
  - c. Assessment number KRA202202890863 brought to charge PAYE valued at Kshs 294,881.10 and late payment interest amounting to Kshs 698,313.28. The total amount demanded for the year of income 2020 amounted to Kshs 5,357,652.38.
12. That on 29<sup>th</sup> March, 2022, the Respondent issued assessment orders on the iTax portal as follows:
- a. Assessment number KRA202202900465 brought to charge Corporate Income Tax valued at 707,171.67 for year of income 2020, with the late payment interest amounting to Kshs 57,038.94. The total amount demanded for the year of income 2020 amounted to Kshs 764,210.61.
  - b. Assessment number KRA202202900532 brought to charge Corporate Income Tax valued at Kshs 510,642.52 for the year of income 2019, with the penalties amounting to Kshs 25,532.10 and late payment interest amounting to Kshs 173,618.46. The total amount demanded for the year of income 2019 amounted to Kshs 709,793.07.
  - c. Assessment number KRA202202900583 brought to charge Corporate Income Tax valued at Kshs 239,634.55 for the year of income 2018, with the penalties amounting to Kshs 11,981.72 and late payment interest amounting to Kshs 110,231.60. The total amount demanded for the year of income 2018 amounted to Kshs 361,847.87
  - d. Assessment number KRA202202900643 brought to charge Corporate Income Tax valued at Kshs 164,382.05 for the year of income 2017, with late payment interest amounting to Kshs 80,547.20. The total amount demanded for the year of income 2017 amounted to Kshs 244,929.25.
13. That on 1<sup>st</sup> April 2022, the tax agent's representative, visited the KRA offices at Times Tower to collect the formal assessment served by the Respondent.
14. The Appellant, not content with the assessment, filed its tax objection on-line via the iTax portal on 27<sup>th</sup> May 2022 as follows:
- a. Tax objection number KRA202208229238 against the assessment for PAYE for the 2018 year of income.
  - b. Tax objection number KRA202208230335 against the assessment for PAYE for the 2019 year of income.
  - c. Tax objection number KRA202208231511 against the assessment for PAYE for the 2020 year of income.
  - d. Tax objection number KRA202208235670 against the assessment for Corporate Income tax for 2020 year of income.



- e. Tax objection number KRA202208236541 against the assessment for Corporate Income tax for 2018 year of income.
- f. Tax objection number KRA202208237520 against the assessment for Corporate Income tax for 2017 year of income
15. That on 27<sup>th</sup> July 2022, pursuant to a request for supporting information, the Appellant shared by e-mail all supporting information pertinent to this Appeal to the Respondent.
16. That on 19<sup>th</sup> May 2022, the Respondent issued an agency notice against the Appellant's bank (Citibank NA). The tax demanded by the agency notice was as follows:

Liability details (KES)					
Tax Head	Period	Principal	Penalty	Interest	Total
PAYE	Jun21-Mar22	13,293,770.00	1,843,978.00	4,164,444.00	19,302,192.00
IT	Jan19-Dec19	1,171,002.00	116,693.00	369,902.00	1,657,597.00

17. That the agency notice was lifted on 29<sup>th</sup> June 2022 upon payment of tax amounting to Kshs 20,959,789.00.
18. The Respondent issued its objection decision dated 29<sup>th</sup> August 2022 via an e-mail sent to the tax advisors. The e-mail delivering the objection decision was received by the Appellant on 29<sup>th</sup> August 2022 at 2252 hours.
19. That in its objection decision, the Respondent rejected the Appellant's objection in its entirety on the grounds of lack of supporting documentation.
20. That the taxpayer is a subsidiary of Checkpoint Software Technologies International Limited (CPT-IL) and applies Transactional Net Margin Method (TNMM) with net cost-plus basis adopted as the profit indicator, to align the intercompany transactions to the arm length standard.
21. That the transfer pricing policy determined the arm's length range (interquartile range) for the transactions performed by CPT-KL as being between 4.9% and 7.3% with a median of 5.5%. That under the OECD Guidelines, a taxpayer is allowed to adopt any position within the arm's length range.
22. That the signed agreement between CPT-KL and CPT-IL stipulates the mark up rate for related party dealings as 5%.
23. That imposing the median range of 5.4% range for years 2017-2019 and 5.5% for 2020 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.
24. That the Transfer Pricing Rules enacted under the Kenyan Income Tax have adopted the transfer pricing methods as stipulated in the OECD Guidelines (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations). The transfer pricing rules do not require a taxpayer to adopt the median position and a taxpayer is thus free to adopt any position within the interquartile range.



25. That the Appellant's re-computation of the entity revenue is as tabulated below:

2017	2018	2019	2020	
Pre-sale and marketing support	894,066	3,973,825	4,571,511	348,351
Services				
Administrative and operating	27,260,973	86,568,309	151,558,211	154,499,938
Expenses				
Non-operating costs	9,747			
Finance cost	385,940	(59,379)	838,134	357,943
Total cost:	28,540,979	90,482,755	156,977,603	155,206,232
Mark up according to agreement	1.049	1.049	1.049	1.049
Calculated revenue	29,939,487	94,916,410	164,669,506	162,811,338
Revenue from FS	29,562,791	95,065,459	163,936,210	162,590,704
Difference	376,696	(149,049)	733,296	220,634

26. That the revenue reported in the income statement is within the arm's length range of between 4.9% and 7.3% and thus there is no legally tenable reason for adjustment of the Appellant's income as reported in the financial statements.
27. In regards to reimbursement of costs to employees the Appellant stated that the cost for marketing in 2019 amounting to Kshs. 4,571,511.00 was reimbursements for costs incurred by employees and are therefore not subject to WHT. That reimbursements to employees are not professional services and thus do not qualify for application of WHT under Section 35 of the *Income Tax Act*.
28. That CPT-KL is the sole point of contact for sales for the Checkpoint Software Technology group in Kenya on all matters marketing. That the company does not engage any external marketing consultants within the Country. The marketing costs reported in the books relate to reimbursements made to staff members for expenses incurred by staff members on marketing activities.
29. The taxpayer has already paid the tax conceded in relation to WHT not deducted from professional services paid to vendors.



30. In regard to the PAYE, the Appellant stated that the taxpayer has, for the years 2017-2020, accrued costs for commissions and vacation as part of the annual salaries expense. The salaries and wages costs for the years 2017 -2020 include the accrued costs. That accrued costs do not attract PAYE as they do not comprise the emoluments paid out to the employees but rather are required by accounting standards (IFRS) to ensure that all costs are properly accounted for.
31. The Appellant asserted that the mark-up rate as per the signed agreement between the Kenya subsidiary and its parent company (5%) was, at all periods covered by the KRA audit, within the arm's length range as per the transfer pricing documentation prepared by the Appellant.
32. That for the years 2017 -2020 Checkpoint Technologies Kenya reimbursed employees for costs incurred daily in running its marketing activities. That reimbursements of expenses incurred in the course of duty are not subject to PAYE.
33. That for the year 2018 the taxpayer provided a medical insurance benefit for its employees and these costs were included as part of salaries and wages expenses. That the insurance benefit paid on behalf of employees is not subject to PAYE since it relates to local medical insurance which is a tax-free benefit under the *Income Tax Act*.
34. The Appellant submitted that the Appellant, was, at all times, trading with its parent entity at prices within the arm's length range and there is thus no requirement for a transfer pricing adjustment.
35. The Appellant averred that the position adopted within EU cases relied upon reaches the following ratio decidendi:
  - a. That the median measure need only be adopted where there are doubts as to the reliability and comparability of the arm's length range as selected from the comparable data set or such other similar defects.
  - b. That the tax authorities are required to document any defects observed in the comparable data set.
  - c. That where a taxpayer's adopted transfer price is within the accepted arm's length range, the measure adopted will not be adjusted unless there are verifiable defects in comparability.
36. The Appellant averred that other countries have adopted legislative measures to outline when an adjustment to median may be imposed thus:
  - a. In India, Rule 10CA (4) of the Income Tax rules requires adjustment to median where: The most appropriate method is a method other than the "profit split method" and "other method", and
  - b. The dataset consists of six or more comparables.
  - c. Where the transfer price adopted falls outside the arm's length range which is defined as being between the 35 and 65 percentile.
37. The Appellant submitted that it is a subsidiary of Checkpoint Software Technologies International Limited (CPT-IL) and applies Transactional Net Margin Method (TNMM) with net cost-plus basis adopted as the profit indicator, to align the intercompany transactions to the arm length standards. The parent company is resident and domiciled in the Republic of Israel.
38. The Appellant submitted that the transfer pricing policy determined the arm's length range (interquartile range) for the transactions performed by CPT-KL as follows:



Period	Lower Quartile	Median	Upper Quartile
2017	4.9%	5.1%	7.2%
2018	4.1%	5.4%	6.7%
2019	4.9%	5.5%	7.3%
2020	4.8%	5.4%	7.0%

39. The Appellant averred that the signed agreement between CPT-KL and CPT-IL stipulates the mark-up rate for related party dealings as 5%.
40. The Appellant asserted that the mark-up rate as per the signed agreement between the Kenya subsidiary and its parent company (5%) was at all periods covered by the KRA audit, within the arm's length range as per the transfer pricing documentation prepared by the Appellant.
41. The Appellant argued that imposing the median measure as the arm's length range 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.
42. The Appellant averred that the Transfer Pricing Rules enacted under the Kenyan Income Tax have adopted the transfer pricing methods as stipulated in the OECD Guidelines (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations) and that the transfer pricing rules do not require a taxpayer to adopt the median position and a taxpayer is thus free to adopt any position within the interquartile range.
43. The Appellant argued that the revenue reported in the income statement is within the arm's length range of between 4.9% and 7.3% and thus there is no legally tenable reason for adjustment of the Appellant's income as reported in the financial statements.
44. The Appellant averred that between the 2017 and 2019 years of income, the aggregate difference between the revenue as reported in the financial statements and revenue as expected from the transfer pricing policies is Kshs. 43,831.00 which is attributable to rounding off differences and exchange differences incurred at the point of invoicing its parent entity.
45. The Appellant relied on the following authorities to support its submission that the lower quartile is an accepted arm's length measure and that taxpayers are under no obligation to adopt the median measure as the arm's length price or margin.
  - i. Spain V Ikea, SAN 1072/2019 -The court ruled that no TP adjustment is required where the tied transaction falls within the arm's length range. The court reiterated that TP adjustment to median, mean or weighted mean are only required where there is a defect in the comparability of information to minimize the risk of error in comparability.
  - ii. The Romania Administrative and Tax Litigations Chamber - Decision No 4702/2020 -The court ruled that for determination of extreme or unusual activity, the lower and upper quartiles may be ignored and the median range may be adopted. If the transfer price adopted by the taxpayer is not included in the comparison range, the competent tax authority shall establish the median value as the transfer price at market price.



- iii. Spain vs Transalliance Iberica SA, November 2022, Audiencia Nacional, Case No SAN 5336/2022 - The court ruled that an adjustment to the median could only be made where the tax authorities established the existence of comparability defects. Since such defects had not been established, the adjustment was reduced to the lower quartile.
- iv. Spain vs XZ SA, May 2021, TEAC, Case No Rec. 2545/2019- The court ruled that an adjustment to median may not be performed where the tax collector fails to substantiate shortcoming in comparability for the taxpayer's arm's length range information.

### **Appellant's Prayers**

46. The Appellant prayed for orders, that this Honorable Tribunal sets aside the Respondent's assessments.

### **RESPONDENT'S CASE**

47. The Respondent's case is premised on the hereunder filed documents: -
  - i. The Respondent's Statement of Facts dated and filed on 23<sup>rd</sup> November 2022 together with the documents attached thereto.
  - ii. The Respondent's written submissions dated 8<sup>th</sup> May 2023 and filed on 10<sup>th</sup> May, 2023.
48. The Respondent stated that it conducted a review of the Appellant's tax records in 2022 covering the periods 2017-2020 covering Corporation tax, PAYE and Withholding tax.
49. That following scrutiny of the transfer-pricing documents provided, 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 policy document. These variations in rate used were noted in the years of income as presented in the per table below:-





2017	2018	2019	2020	Total	
Profit/ surplus/ (loss) before tax	1,021,812	4,582,704	6,958,607	5,795,073	18,358,196
Rated used	0.03	0.05	0.04	0.04	
Rate per TP Policy	5.40%	5.40%	5.40%	5.50%	
Total cost	28,540,979	90,866,579	157,003,177	156,795,631	433,206,366
Cost Plus mark up	30,110,733	95,864,241	165,638,352	165,419,319	457,032,716
Expected Profit	1,569,754	4,997,662	8,635,175	8,623,760	23,826,350
Variance in Profit Declared	547,942	414,958	1,676,568	2,828,687	5,468,154
Income Tax Due	164,383	124,487	502,970	848,606	1,640,446
Penalty	8,219	6,224	25,149	42,430	82,022
Interest	78,904	44,815	120,713	101,833	346,265
Total Tax Due	251,505	175,527	648,832	992,869	2,068,733

50. That for the years under review, various professional services which included legal services, audit services and commissions were procured. A variance was noted in the withholding tax deducted and submitted. This was brought to charge for withholding tax as per table below:



2017	2018	2019	2020	TOTAL	
Accounting fees	1,399,073	1,547,664	1,591,1805	2,372,719	
Legal and Legal and Consultancy fees	95,010				
Marketing	4,571,511				
Total Prof Services	1,399,073	1,547,664	6,163,316	2,467,729	
WHT	69,954	77,383	308,166	123,386	
WHT Paid	63,712	71,958	73,700		
Unpaid WHT	69,954	13,671	236,208	49,686	369,519
Penalty	3,498	684	11,810	2,484	18,476
Interest	33,578	4,922	56,690	5,962	101,152
Total Tax Due	107,029	19,276	304,708	58,133	489,147

51. The salaries and wages booked in the Corporate tax returns were examined and compared with the salaries as per the PAYE returns exposing significant variances that were unsupported. The variances were brought to charge as below:



2017	2018	2019	2020	TOTAL	
Salaries per accounts	19,736,250	70,294,316	122,469,340	134,466,117	
Salaries per PAYE Returns	19,254,570	46,072,278	102,287,736	119,917,919	
Variance	481,680	24,222,038	20,181,604	14,548,198	
PAYE Due	144,504	7,266,611	6,054,481	4,364,459	17,830.056
Penalty	7,225	363,331	302,724	218,223	891,503
Interest	69,362	2,615,980	1,453,075	523,735	4,662,153
Total Tax due	221,091	10,245,922	7,810,8281	5,106,417	23,383,711

52. That the Appellant having not provided the required documents, the Respondent issued a notice of assessment through a letter dated 3<sup>rd</sup> March 2022 based on the tax computations as summarised below:

Detail	Income Tax	WHT	PAYE	Total
Principal	1,640,446	369,519	17,830,056	19,840,021
Penalty	82,022	18,476	891,503	992,001
Interest	346,265	101,152	4,662,153	5,109,569
Total	2,068,733	489,147	23,383,711	25,941,591

53. That the Appellant lodged a late notice of objection manually through a letter dated 27<sup>th</sup> May 2022.

54. The Respondent issued an objection decision through a letter dated 29<sup>th</sup> August 2022 confirming the assessments of Kshs. 26,933,592.00

55. That the Appellant's case is premised on the grounds:-

- i. The income reported by the Appellant from its dealings with related parties is sufficient and appropriate in line with the company's transfer pricing policy and the requirements of the [Income Tax Act](#).
- ii. The Appellant is not required to adopt the median position in an interquartile range, and whether the Appellant fulfils the requirements of the [Income Tax Act](#) by adopting the 25<sup>th</sup> Percentile (lower quartile) of the arm's length range.
- iii. The reimbursement of the expenses to employees constitutes a professional service and thus subject to Withholding tax.



- iv. The accrual of staff costs and incentives does not constitute an employment benefit and is thus not subject to PAYE.
  - v. The local medical benefit incurred in Kenya is not a taxable employment benefit.
56. The Respondent raised the following issues for determination as can be summarized to:
- i. Whether the Appellant lodged a valid objection.
  - ii. Whether the income reported by the company from its dealings with related parties is sufficient and appropriate in line with the company's transfer pricing policy and the requirements of the *Income Tax Act*.
  - iii. Whether the Appellant is required to adopt the median position in an interquartile range.
  - iv. Whether the claimed reimbursement of the expenses to employees constitutes a professional service subject to Withholding Tax.
  - v. Whether the claimed accrual of staff costs and incentives constitute an employment benefit subject to PAYE.
  - vi. Whether the claims for medical benefit are a taxable employment benefit.
57. That in fulfilling its mandate, the Respondent is not bound by the tax returns of the Appellant. The Respondent may assess a taxpayer's tax liability using any information available to the Respondent. Section 24(2) Tax Procedure Act, provides:-
- “The Commissioner shall not be bound by a tax return or information provided by, or on behalf of, a taxpayer and the Commissioner may assess a taxpayer's tax liability using any information available to the Commissioner.”
58. That Section 23 of the *Tax Procedures Act* required the Appellant to keep tax records in a manner that his tax liability can be easily determined. The Appellant was required to avail all documents requested as provided under Section 59 of *Tax Procedures Act*. The Appellant did not avail the documents during the assessment stage and even during the objection stage.
59. That Section 51(3) of the *Tax Procedures Act* provides that:-
- “A notice of objection shall be treated as validly lodged by a taxpayer under subsection (2) if—
- (a) the notice of objection states precisely the grounds of objection, the amendments required to be made to correct the decision, and the reasons for the amendments;
  - (b) in relation to an objection to an assessment, the taxpayer has paid the entire amount of tax due under the assessment that is not in dispute or has applied for an extension of time to pay the tax not in dispute under section 33(1); and
  - (c) all the relevant documents relating to the objection have been submitted”
60. That the Appellant failed to provide the relevant supporting documents as requested for, specifically payrolls, PAYE returns analysis and general ledgers in excel formats. Consequently, the objection was rejected for non-compliance.



61. That the income reported by the Appellant from its dealings with related parties was neither sufficient nor appropriate in line with the Appellant's transfer pricing policy and the requirements of the [Income Tax Act](#).
62. In regard to whether the Appellant is required to adopt the median position in an interquartile range, the Respondent averred that the rate that should have been used is the one whose benchmarking was done and documented in the Appellant's Transfer Pricing Policy.
63. That the benchmarking 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%.
64. In regard to whether the claimed reimbursement of the expenses to employees constitutes a professional service subject to Withholding tax, the Respondent averred that the Appellant procured various services including legal services, audit services commission without charging withholding tax.
65. That the Appellant failed to provide primary documents to demonstrate that the expenses were reimbursable. That since the expenses were in the account of professional and management, it implied that they were subjectable to WHT. The Appellant did not provide documents to rebut that presumption.
66. As to whether the claimed accrual of staff costs and incentives constitute an employment benefit and is thus not subject to PAYE, the Respondent averred that the Appellant failed to support the accrual staff costs and incentives with evidence.
67. That the salaries and wages examined as compared to salaries as per the PAYE returns established variations in the declarations.
68. The Appellant had alleged that advance payment had been made to cater for the difference. The Appellant did not avail the reconciliations as requested. The same was rejected for lack of supporting documents.
69. As to whether the claimed medical benefit is a taxable employment benefit, the Respondent averred that primary evidence was required to establish the nature of medical benefit before establishing its taxability. The Appellant did not avail the documents requested.
70. The Respondent submitted that the income reported by the Appellant from its dealings with related parties was not sufficient and not appropriate in line with the Appellant's transfer pricing policy and the requirements of the [Income Tax Act](#).
71. 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 policy document.
72. The Respondent argued that this deviation was improper and the Respondent thus made adjustments on the income tax reported by the Appellant.
73. The Respondent contended that Section 23 of the [Tax Procedures Act](#) requires the Appellant to keep tax records in manner that its tax liability can be easily determined. That further, the Appellant is required to avail all documents requested for as provided under Section 59 of [Tax Procedures Act](#). The Appellant did not avail any documents to support its deviation from the benchmarking policy.
74. The Respondent asserted that Section 10 of the Income Tax (Transfer Pricing) Rules, 2006 of the [Income Tax Act](#) provides that: -

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



- (g) develop an appropriate transfer pricing policy;
- (h) determine the arm's length price as prescribed under the guidelines provided under these Rules; and
- (i) avail documentation to evidence their analysis upon request by the Commissioner."

75. The Respondent averred that the Appellant in this case failed to comply with the above provisions of the law and Respondent therefore acted lawfully and procedurally in issuing additional Income tax assessments as guided by the rate applicable in the benchmarking policy, which the Appellant failed to adhere to.
76. Following a scrutiny of the transfer-pricing documents provided, the Respondent averred that it 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 policy document.
77. The Respondent submitted that the Appellant failed to provide documents in support of its objection and claims. That it is the obligation of the Appellant to keep documents in a manner that its tax liability can be easily ascertained and provide the documents whenever required.
78. That the burden lies with the Appellant to prove that the assessments and objection decision is wrong pursuant to Section 56 (1) of the [Tax Procedures Act](#) which provides that:

"In any proceedings under this Part, the burden shall be on the taxpayer to prove that a tax decision is incorrect."

### **Respondent's Prayers**

79. The Respondent prayed that this Honourable Tribunal to:-
- i. Dismiss the Appeal with costs.
  - ii. Uphold the objection decision dated 30th August 2022.

### **Issues for Determination**

80. The Tribunal noted that subsequent to filing the Appeal, the parties entered into a Partial Consent dated 18<sup>th</sup> October 2023 that settled the Withholding tax and PAYE assessments and by consensus referred the transfer pricing adjustments for the Tribunal's determination.
81. The Tribunal has considered the pleadings and documentation filed by both parties as well as the Partial Consent filed and it shall deal with the issue that was referred to it by both parties for determination;
- Whether the assessment for Corporation tax was justified.

### **Analysis and Findings**

82. The Tribunal having determined the issue falling for its determination proceeds to analyse it as hereunder.
83. The genesis of this dispute follows scrutiny of the transfer pricing documents provided by the Appellant to the Respondent. 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 policy



document. That these variations in rate used were noted in the years of income 2017, 2018 2019 and 2020.

84. The Tribunal has noted that the Respondent did not dispute the Appellant's Transfer Pricing Policy, the Respondent only disputed the margin rates applied from the recommended rate of 5.5% as stated in the Appellant's transfer pricing document.
85. The Tribunal observes that the Transfer Pricing Rules enacted under the Kenyan Income Tax have adopted the transfer pricing methods as stipulated in the OECD guidelines (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations) 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.
86. The Tribunal is guided by Article 3.6 of the OECD guidelines in the absence of local legislation to the contrary, and it prohibits adjustments where the transfer price or margin complies with the OECD regulations and is within the arm's length range. Which states that:

“If the relevant condition of the controlled transaction (e.g. price or margin) falls outside the arm's length range asserted by the tax administration, the taxpayer should have the opportunity to present arguments that the conditions of the controlled transaction satisfy the arm's length principle, and that the result falls within the arm's length range (i.e. that the arm's length range is different from the one asserted by the tax administration). If the taxpayer is unable to establish this fact, the tax administration must determine the point within the arm's length range to which it will adjust the condition of the controlled transaction.”

87. The Tribunal observes that the variances between the 2017 and 2019 years of income, the aggregate difference between the revenue as reported in the financial statements and revenue from the transfer pricing policies of Kshs. 43,831.00 was attributable to rounding off differences and exchange differences incurred at the point of invoicing its parent entity.
88. The Tribunal notes that the signed agreement between CPT-KL and CPT-IL stipulates the mark up rate for related party dealings as 5% and therefore finds that that the mark-up rate as per the signed Agreement between the Kenya subsidiary and its parent company was, at all periods covered by the KRA audit, within the arm's length range as per the transfer pricing documentation prepared by the Appellant.
89. Based on the above analysis, the Tribunal finds that imposing the median measure as the arm's length range 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. This conclusion is supported by Article 3.63 of the OECD Guidelines which states that:

“In determining this point, where the range comprises results of relatively equal and high reliability, it could be argued that any point in the range satisfies the arm's length principle. Where comparability defects remain as discussed in paragraph 3.57, it may be appropriate to use measures of central tendency to determine this point (for instance the median, the mean or weighted averages, etc., depending on the specific characteristics of the dataset), in order to minimise the risk of error due to unknown or unquantifiable remaining comparability defects.”



90. The Respondent's decision to impose a median range of 5.4% range for years 2017-2019 and 5.5% for 2020 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.
91. Accordingly the Tribunal finds and holds that the revenue reported by the Appellant in its income statement is within the arm's length range of between 4.9% and 7.3% and there was reasonably no justification for the Respondent to adjust the Appellant's income as reported in its financial statements.
92. In other words, the Tribunal agrees with the Appellant's assertions that the income which it had reported from dealing with related parties was in line with the Company's Transfer Pricing Policy and the requirements of the OECD Guidelines (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations).
93. The Respondent's decision to assess the Appellant's Corporation tax using a method that is not known to law was not justified.

### **Final Decision**

94. In view of the foregoing, the Tribunal, save for the Part Judgment entered on 9<sup>th</sup> November 2022 following the Consent executed by the parties on 18<sup>th</sup> October 2022 finds that the Appeal is merited and accordingly proceeds to make the following Orders;
  - a. The assessment in relation to Corporation tax covering the years 2017-2020 is hereby set aside.
  - b) Each party to bear its own costs.
95. It is so ordered.

**DATED AND DELIVERED AT NAIROBI THIS 2<sup>ND</sup> DAY OF FEBRUARY, 2024**

**ERIC NYONGESA WAFULA - CHAIRMAN**

**EUNICE NG'ANG'A - MEMBER**

**DR RODNEY O. OLUOCH - MEMBER**

**CYNTHIA B. MAYAKA - MEMBER**

**ABRAHAM K. KIPROTICH - MEMBER**

**BERNADETTE GITARI - MEMBER**

