



Africa Tax Quarterly Newsletter

Third Edition, September 2019

2019

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In this third edition of our Africa Tax Quarterly Newsletter, we share key insights from three transfer pricing professionals in Nigeria, Kenya and South Africa on the latest developments in their countries.

We welcome Natasha Vaidanis, our Africa Head of Transfer Pricing, as guest editor to this special edition bringing you her thoughts on the transfer pricing landscape in Africa.

As always, if you have any comments, feedback or suggestions of what you would like us to cover in future issues, you are welcome to contact Preshnee Govender at preshnee.govender@kpmg.co.za

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Editor's Note

In recent years as the volume of global trade has been increasing, the quantum of "intra-group" transactions within Multinational Enterprises, such as transfers of goods and services, capital, and intangibles have also been growing. The increase in these transactions have also lead to an increase in the complexities within the transfer pricing environment and in analysing, understanding and articulating such transactions.

The transfer pricing environment in Africa is no different and is constantly evolving with more and more countries introducing legislation to protect their tax base. Transfer pricing is at the forefront of all multinational enterprises expansion strategies as they globalize their operations and maximise their opportunities on the African continent. Staying up to date with the transfer pricing landscape and best practice however can be challenging. This is particularly true in the environment where we are seeing more detailed transfer pricing regulations being introduced, stricter documentation requirements being put in place, the adoption of Country by Country Reporting (CbCR), Master File and Local File requirements and robust audit practices together with penalties for non-compliance. Additionally, taxpayers need to understand transfer pricing from the global perspective, but also need to have

insights into local requirements (i.e. the rules, their practical application and the interplay with the myriad of other local legislation).

Whilst there are significant challenges associated with the implementation of transfer pricing legislation in Africa, it will be a positive outcome if the future benefits are more significant than such challenges. We can expect to see this if successful transfer pricing regimes have the result of increasing much needed tax revenues in Africa and attracting further investment.

This edition of KPMG's Africa Tax Quarterly newsletter is designed to assist multinational companies stay current with transfer pricing trends in Africa and in so doing being able to implement an effective transfer pricing strategy and be proactive in planning, implementation, documentation and dispute resolution.



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Kenya

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Nigeria

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South Africa



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1 Kenya

What are the recent transfer pricing legislative developments and any relevant revenue authority guidance to be aware of?

The last few months have seen significant changes through the introduction of legislative provisions in the Income Tax Bill (May 2018). Whilst the Bill is yet to come into law, it proposes significant changes to the existing Income Tax (Transfer Pricing) Rules, 2006 (TP Rules).

In their current form, the TP Rules primarily provide for the types of transactions covered, methods of determining the arm-length transfer price, documentation requirements and the general obligations of a taxpayer with controlled transactions.

However, the proposed rules provide for CbCR, alternative methods for pricing commodity transactions, imposition of transfer pricing adjustments for transactions that lack economic substance or that are conducted with parties (both related and unrelated) located in preferential tax regimes, the allocation of profits according to risk, among other provisions.

Additionally, the Finance Act 2018 extended the definition of a deemed dividend distribution to include additional taxable income (or reduced assessed loss) of a taxpayer arising from a transfer pricing adjustment. The amounts are, in effect, treated as constructive dividends and are taxable at the applicable withholding tax rate.

Other important changes in the recent past include the broadening of the definition of a "permanent establishment" to include the activities of dependent agents, through the Finance Act 2014. This amendment effectively brings activities of dependent agents into the ambit of the transfer pricing regulations. Further, companies operating in preferential tax regimes (in this case Export Processing Zones (EPZ) and Special Economic Zones (SEZ)) which have transactions with resident companies are also required to transact at arm's-length.

What is the level of transfer pricing audit activity in your country?

With Kenya increasingly becoming the preferred investment destination for multinational entities looking to set up in Africa, transfer pricing has become a point of focus by the Kenya Revenue Authority (KRA) over the last few

years. This is especially with due consideration on the fact that c.75% of the country's tax revenue comes from large taxpayers, of which multinationals form a significant part.

Additionally, owing to the highly ambitious revenue target set by the National Treasury to finance the government's development agenda, the KRA has found itself under pressure to seal revenue leakages. Consequently, the KRA has become more assertive in conducting transfer pricing audits on multinationals in Kenya.

In recognition of this central role played by multinational entities in the country's tax system, the KRA has in recent times, formed a specialised international tax and transfer pricing unit within the Large Taxpayers Office (LTO) which is responsible for pursuing and handling transfer pricing issues. Additionally, there has been an increase in collaboration between tax authorities across the wider East African region through initiatives and organisations such as Tax Inspectors without Borders (TIWB), the African Tax Administration Forum (ATAF), among others.

What are your clients doing in response to the above?

The increase in transfer pricing audits from the KRA has significantly raised the awareness of most firms with respect to transfer pricing compliance. Over the last few years, a significant number of firms have shifted their focus to preparing contemporaneous transfer pricing policies, ensuring they have the appropriate documentation in place, updating existing policies on an annual basis, as well as reviewing and monitoring the implementation of such policies.

Furthermore, general tax compliance has become a trending topic in Kenya, following the recent prosecution of large (betting) companies, and in some cases, the denial of the renewal of operating licenses. It is against this backdrop that many firms have engaged professional services firms to conduct tax health checks aimed at assessing their compliance status and any exposure thereof, including transfer pricing compliance reviews.

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2 Nigeria

What are the recent transfer pricing legislative developments and any relevant revenue authority guidance to be aware of?

There are a few recent significant legislative developments in the Nigerian tax and transfer pricing landscape which are driven by the recommendations of the Organization for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project. While these developments are not primarily transfer pricing focused, they have an impact on transfer pricing outcomes.

The developments are as follows:

- **Mutual Agreement Procedure Guidelines**

The Convention on Mutual Administrative Assistance in Tax Matters (the Convention) was jointly developed by the OECD and the Council of Europe to facilitate the entering into bilateral tax information agreements by participating states (signatories to the Convention).

It is the most comprehensive multilateral instrument available for all forms of tax co-operation with the aim of tackling tax evasion and avoidance. Nigeria became a signatory to the Convention in 2015 and issued the Mutual Agreement Procedure (MAP) Guidelines on 21 February 2019.

The MAP Guidelines is aimed at providing guidance and clarity on the procedures for accessing MAP as a means of dispute resolution, pursuant to the Double Taxation Agreement between Nigeria and each of its Treaty Partners.

The MAP is a well-established means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. It is hoped that as transfer pricing audits get to advanced stages in Nigeria, the MAP would prove to be a viable tool for taxpayers to address and resolve tax disputes.

- **Common Reporting standard**

Nigeria signed the CRS Multilateral Competent Authority Agreement (MCAA) in August 2017 and committed to an implementation deadline of 2019 with respect to the OECD's Automatic Exchange of

Information (AEOI) Framework.

Consequently, in September 2019, FIRS issued the Income Tax (Common Reporting Standard (CRS)) Regulations 2019 as well as Guidelines for implementation and compliance. The Regulations lay out the reporting requirements as well as timelines for submission and applicable penalties for default.

The ease of sharing information between tax jurisdictions and co-operation expected under this framework will enable the Nigerian tax authority to tackle alleged offshore tax evasion and protect the nation's tax base.

What is the level of transfer pricing audit activity in your country?

Since the introduction of the revised transfer pricing regulations (revised Regulations) in 2018, the number of transfer pricing audits have steadily increased. Also, it is now relatively clearer how taxpayers should address previously contentious issues raised in transfer pricing audits.

The revised Regulations which took effect from 12 March 2018 contain provisions on new documentation requirements including Master File and Local File, threshold for maintaining contemporaneous transfer pricing documentation, new compliance requirements on procurement transactions and intragroup services, guidelines on the use of quoted prices in determining the pricing for the export and import of commodities, limitation of deduction on royalty payments for intangibles, etc.

The revised Regulations also include very steep penalties for various categories of default. FIRS has been very busy in the last few months in penalizing companies that are found to be in default. With the recent regulatory changes, FIRS' now has greater access to information on the global activity of multinational enterprises. Further, the FIRS has taken an aggressive stance towards revenue generation and collection. Hence, it is expected that the number of audits will keep increasing in the months ahead.

2 Nigeria (cont.)

What are your clients doing in response to the above?

In 2013 when the Nigerian transfer pricing regulations were first introduced, and transfer pricing practice was in the nascent stages, there was little drive on the part of most taxpayers to comply. However, since the introduction of the revised Regulations as well as the newly issued CbCR Regulations, companies now give adequate attention towards full compliance.

In addition, tax managers and other professionals have a renewed interest in keeping abreast of transfer pricing issues and audit trends. Most companies are also taking steps to close compliance gaps to minimize exposure to penalties and strengthening their preparedness for transfer pricing audits.

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3 South Africa

What are the recent transfer pricing legislative developments and any relevant revenue authority guidance to be aware of?

The South African transfer pricing legislation was overhauled with effect for years of assessment commencing on or after 1 April 2012 to align more with the OECD Transfer Pricing Guidelines. Thin Capitalisation rules were removed and an overall arm's length approach towards intra group financial assistance transactions was introduced. Local Thin Capitalisation guidance was retrospectively removed with effect from 1 April 2012, in August 2019.

Although South Africa is not a member of the OECD, South Africa has been actively involved in OECD Working Party processes. South Africa generally follows the OECD Transfer Pricing Guidelines, but there are certain deviations and reservations.

New South African transfer pricing guidance is expected to be released in the near future.

In terms of transfer pricing documentation rules, South Africa has implemented BEPS Action 13 compliant transfer pricing documentation requirements. This includes a CbCR requirement, as well as the need to prepare and file Master File and Local File transfer pricing documentation, if a monetary threshold of R100 million potentially affected transactions (cross-border connected person transaction) has been met. In addition, transfer pricing documentation retention rules are applicable, subject to the R100 million threshold.

Other Southern African countries, for example Botswana, Mozambique, Zambia, have also introduced transfer pricing documentation rules in line with OECD requirements.

What is the level of transfer pricing audit activity in your country?

Transfer pricing legislation was introduced in South Africa in 1995, but transfer pricing audit activity only commenced from about 2000. The South African Revenue Service (SARS) has a full team of transfer pricing specialists.

Audit activity was somewhat limited, and it is said that this was due to capacity restraints at the authority. However, more recently, increased activity has been observed. With the recently introduced transfer pricing documentation requirements, more, relevant, information is being provided to SARS.

In addition, the use of risk assessment and similar IT tools has further improved capabilities.

Since mid-2019, a significantly increased focus on transfer pricing has been experienced by taxpayers and SARS has announced that it will focus on transfer pricing reviews to combat base erosion and profit shifting.

It has also been observed that SARS recently relooked at querying taxpayer matters where a transfer pricing review was performed earlier, but which, at the time, was then not further pursued. However, these tax payers are now being reviewed in respect of transfer pricing documentation just prior to, and post the new transfer pricing documentation rules.

Similar Revenue Authority activity is being

experienced in other Southern African countries. Focused approaches are being followed and it seems that initiatives such as by the African Tax Administration Forum and Tax Inspectors Without Borders are very much active.

What are your clients doing in response to the above?

Taxpayers are allocating significantly more resources on transfer pricing documentation and compliance in general. Transfer pricing implementation, i.e. the preparation of transfer pricing policies, checking of implementation thereof, updating of transfer pricing agreements, reviewing of the margins achieved etc., has become one of the most important transfer pricing related exercises.

Transfer pricing tools and processes are being rolled out to assist local Multinational Entities and transfer pricing controversy planning has been added by many to the list of tax related items for discussion at board level.

The recent surge in transfer pricing case law in Sub-Saharan Africa has certainly increased awareness.

While most taxpayers try to comply with tax rules in any event, it is clear that transfer pricing has become one of the more focused areas, and this applies to the whole of Southern Africa and Africa in general.

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