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INTERNATIONAL TAX  
**CASE SUMMARY**

**AVIC INTERNATIONAL VS  
KENYA**

NOVEMBER 2024

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# ACADEMY OF TAX LAW

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First Edition Published on 20 January 2025

Published by Academy Of Tax Law

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# HEAD OF ACADEMICS



Welcome to the Academy of Tax Law's case and judgment summaries. These documents have been carefully curated to support professionals, students, and researchers navigating the complex landscape of international tax and transfer pricing. At the Academy, we understand that tax law is ever-evolving, with key rulings continuously shaping its practice.

Each summary you'll find here is designed to provide not just the facts, but the context and implications of pivotal legal decisions. These case summaries are created to serve as a valuable resource for legal teams, multinationals, revenue authorities, and academics, offering insights that go beyond the surface. Our goal is to ensure you remain informed and prepared, whether you are dealing with tax planning, dispute resolution, or risk management.

We believe that knowledge is the foundation of sound decision-making, and with these resources, we hope to empower you in your professional journey. As you delve into the analysis, remember that staying ahead in tax law requires not just understanding the rules but how to apply them in a dynamic, global environment.

Thank you for choosing the Academy of Tax Law as your partner in this ongoing learning experience.

Sincerely,  
Dr. Daniel N Erasmus

# PART 1

# SUMMARY

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# JUDGEMENT SUMMARY

## CASE OVERVIEW

<b>Court:</b>	Tax Appeals Tribunal (Kenya)
<b>Case No:</b>	TAT No. E786 of 2023
<b>Applicant:</b>	AVIC International Beijing (EA) Limited
<b>Defendant:</b>	Commissioner of Domestic Taxes
<b>Judgment Date:</b>	22 November 2024
<b>Full Judgment:</b>	<a href="#">CLICK FOR FULL JUDGMENT</a>
<b>View Online:</b>	<a href="#">CLICK TO VIEW SUMMARY ONLINE</a>

# JUDGMENT SUMMARY

The Tax Appeals Tribunal in Kenya ruled on the case involving AVIC International Beijing (EA) Limited (Appellant) and the Commissioner of Domestic Taxes (Respondent) concerning disputed tax assessments covering Corporation Tax, PAYE, and Withholding Tax (WHT) for the years 2016 to 2023. The Respondent issued an audit notice on 30 July 2021 and finalized its assessments on 29 June 2023, leading to additional tax liabilities of Kshs. 530,528,802, later reduced to Kshs. 514,154,336 after objections.

Key disputes included the appropriateness of the Transactional Net Margin Method (TNMM) as the most appropriate method (MAM) for transfer pricing adjustments, the accuracy of income assessments based on VAT discrepancies, and the double taxation claims related to PAYE and WHT on expatriates and seconded personnel. AVIC argued that the Resale Price Method (RPM) was more suitable given the nature of its transactions and that TNMM overcomplicated the analysis. Further, the Appellant contended that certain assessments extended beyond

the statutory five-year limit.

The Tribunal upheld the use of TNMM as the most reliable method under the OECD Guidelines, noting deficiencies in AVIC's benchmarking and FAR analysis. However, it recognized procedural errors in assessing income discrepancies and PAYE liabilities. The Tribunal dismissed claims of double taxation and ruled on the validity of deemed dividend taxes based on adjustments.

The judgment highlighted the importance of comprehensive compliance with transfer pricing documentation and functional analysis to mitigate disputes, emphasizing adherence to procedural guidelines.

Accenture's claim for repayment of DKK 1,000,000, paid as costs under the Eastern High Court's judgment, was also dismissed. This judgment underscores the importance of comprehensive transfer pricing documentation and highlights the Danish tax authorities' scrutiny of intra-group transactions.

# KEY POINTS OF THE JUDGMENT

## BACKGROUND

AVIC International Beijing (EA) Limited, established in Kenya in 2015, imports and assembles motor vehicle parts. The Kenya Revenue Authority (KRA) audited AVIC for Corporation Tax, PAYE, and WHT from 2016 to 2021, citing discrepancies in declared income and transfer pricing practices. Following pre-assessment findings issued on 1 November 2022, AVIC provided responses disputing the methodology and calculations.

Additional assessments issued in June 2023 imposed Kshs. 530,528,802 in liabilities. AVIC objected, reducing the amount to Kshs. 514,154,336. Dissatisfied with the objection decision, AVIC appealed to the Tribunal, arguing against the extended audit period, the TNMM's application, and double taxation claims.

AVIC emphasized that its transfer pricing documentation supported the use of the Resale Price Method (RPM), as the method aligned with its business model of importing completely knocked-down (CKD) kits for local assembly and resale. It further disputed the reliability of the Respondent's benchmarking analysis, claiming procedural errors and inconsistent application of data.

The background of this case illustrates the complexities inherent in cross-border transactions and highlights the growing scrutiny placed on MNEs by revenue authorities seeking to ensure compliance with transfer pricing laws. It also underscores the importance of clear and robust documentation in navigating audits and defending disputes.

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# KEY POINTS

## OF THE JUDGMENT

### CORE DISPUTE

The primary contention revolved around the selection of the most appropriate transfer pricing method (MAM) to ensure compliance with the arm's length principle. AVIC contended that the Resale Price Method (RPM) was the most suitable approach due to its operational model of importing CKD kits, assembling them locally, and selling the finished products. The Appellant argued that RPM accurately captured the value addition process and profit margins within its controlled transactions.

The Respondent, however, applied the Transactional Net Margin Method (TNMM), asserting it was better suited to assess the arm's length nature of transactions given the lack of comparable data for RPM. The KRA further pointed out inconsistencies in AVIC's functional analysis and claimed that TNMM provided a more comprehensive evaluation of profitability in relation to assets, functions, and risks.

Additional areas of dispute included:

- Alleged double taxation arising from PAYE and WHT assessments on expatriates and seconded staff, which AVIC claimed had already been taxed in their home jurisdictions.
- Discrepancies in VAT and income tax records, which the Respondent used to justify income adjustments.
- The imposition of deemed dividend taxes on primary transfer pricing adjustments, which AVIC argued lacked a proper legal basis.

The core of the dispute centered on the methodology's suitability and the procedural fairness of the assessments, raising broader implications for how transfer pricing disputes are managed in Kenya.

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# KEY POINTS

## OF THE JUDGMENT

### COURT FINDINGS

The Tribunal's findings were as follows:

#### Transfer Pricing Methodology

The Tribunal upheld the Respondent's application of TNMM, deeming it the most reliable method under the circumstances. It noted that AVIC failed to provide sufficient evidence to support the application of RPM, particularly with respect to comparable data and FAR analysis.

#### Audit Period

The Tribunal ruled that assessments extending beyond the statutory five-year limit under the Tax Procedures Act were invalid unless fraud or willful default was established. It found that the Respondent had not provided adequate justification for extending the audit period for certain PAYE and WHT assessments.

#### Double Taxation

Claims of double taxation were dismissed, with the Tribunal concluding that PAYE and WHT were applied to distinct aspects of remuneration. It emphasized that AVIC's evidence on taxes paid in other jurisdictions was insufficient.

#### VAT and Income Tax Discrepancies

The Tribunal highlighted procedural errors in reconciling VAT and income tax records, which had led to excessive adjustments. It directed the Respondent to recalibrate its assessments based on accurate reconciliation.

These findings underscored the importance of adhering to procedural guidelines and maintaining robust documentation to support transfer pricing positions.

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# KEY POINTS

## OF THE JUDGMENT

### OUTCOME

The Tribunal delivered a balanced judgment, upholding certain aspects of the Respondent's assessments while vacating others. Key outcomes included:

#### **Validation of TNMM**

The Tribunal confirmed TNMM as the most appropriate method for assessing AVIC's related-party transactions. It ruled that the Respondent's reliance on TNMM aligned with OECD Guidelines, which prioritize the method's reliability for complex transactions.

#### **Partial Vacation of PAYE and WHT Assessments**

The Tribunal vacated assessments for periods exceeding the statutory audit timeframe, noting the absence of evidence for fraud or evasion.

#### **Remand of VAT-Related Adjustments**

The Tribunal directed the Respondent to review and recalibrate VAT-related adjustments, citing procedural deficiencies and errors in reconciling records.

#### **Deemed Dividend Tax**

The Tribunal upheld the validity of deemed dividend taxes on adjustments, referencing provisions under the Income Tax Act.

Overall, the judgment reaffirmed the need for procedural compliance and robust documentation to substantiate tax positions. While the Respondent's application of TNMM was upheld, the Tribunal's recognition of procedural lapses highlighted the importance of fairness and transparency in tax administration.

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# TP METHOD

## HIGHLIGHTED (IF ANY)

The Respondent's choice of the Transactional Net Margin Method (TNMM) was central to the dispute. TNMM evaluates the arm's length nature of related-party transactions by comparing the net profit margins of the tested party to those of independent comparables performing similar functions under comparable circumstances.

The Tribunal found TNMM to be the most appropriate method (MAM) for AVIC's transactions, citing deficiencies in the Appellant's application of the Resale Price Method (RPM). Specifically, the Tribunal noted:

#### **Complexity of Transactions**

AVIC's operations involved significant functional differences that required a holistic assessment of profitability rather than focusing solely on gross margins.

#### **Lack of Comparable Data**

The Tribunal emphasized that AVIC failed to provide sufficient external comparables to support the use of RPM. In contrast, the Respondent's application of TNMM relied on broader benchmarks that captured AVIC's functional and risk profile.

#### **Compliance with OECD Guidelines**

The Tribunal upheld TNMM as consistent with OECD standards, particularly for cases involving significant value addition and complex intercompany arrangements.

By affirming TNMM's reliability, the Tribunal reinforced its applicability as a preferred method in transfer pricing disputes involving complex and integrated operations.

# PART 2

## SIGNIFICANCE

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# MAJOR ISSUES

## AREAS OF CONTENTION

The case presented several significant issues that were critical to the Tribunal's deliberations:

### **Appropriate Transfer Pricing Methodology**

The central contention revolved around the selection of the Transactional Net Margin Method (TNMM) by the Respondent instead of the Resale Price Method (RPM), which was advocated by AVIC. The Appellant argued that RPM better reflected its operational model and the arm's length nature of its intercompany transactions. However, the Tribunal found AVIC's documentation to be insufficient to substantiate RPM's reliability, especially in the absence of comparable external data.

### **Audit Timelines and Statutory Limitations**

AVIC disputed the validity of assessments that extended beyond the statutory five-year audit period prescribed under the Tax Procedures Act. The Respondent did not provide evidence of fraud or willful default to justify the extensions, leading to partial invalidation of these assessments.

### **Double Taxation Concerns**

AVIC contended that PAYE and Withholding Tax (WHT) imposed on expatriate and seconded staff resulted in double taxation. However, the Tribunal dismissed this claim, stating that the taxes applied to distinct remuneration components and that AVIC failed to present adequate evidence of taxes paid in other jurisdictions.

### **VAT and Income Tax Reconciliations**

Discrepancies between VAT and income tax records were used by the Respondent to justify significant income adjustments. The Tribunal found procedural errors in the Respondent's calculations, necessitating a recalibration of VAT-related assessments.

These contentious points underscore the importance of thorough documentation, adherence to statutory timelines, and robust benchmarking to support the arm's length nature of transfer pricing arrangements in complex cross-border transactions.



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# EXPECTED OR CONTROVERSIAL?

The Tribunal's decision was a mix of both, reflective of the complexities of transfer pricing cases:

## **Predictability of TNMM Endorsement**

The endorsement of the Transactional Net Margin Method (TNMM) aligned with OECD Guidelines, particularly for cases involving significant value addition and functional complexities. The decision was largely expected given the deficiencies in AVIC's application of the Resale Price Method (RPM) and the lack of comparable data to support its claims.

## **Controversial Aspects**

The procedural lapses identified in the Respondent's audit process, including the extension of assessments beyond statutory limits and errors in reconciling VAT and income tax discrepancies, were areas of contention. These lapses highlighted the need for revenue authorities to adhere strictly to procedural requirements to ensure fairness and transparency.

## **Double Taxation Claims**

The Tribunal's dismissal of double taxation claims raised debates on the fairness of imposing PAYE and WHT on expatriate staff without adequately addressing potential cross-border relief mechanisms. This aspect of the ruling may be viewed as contentious, particularly by MNEs operating in multiple jurisdictions.

## **Broader Implications**

The case underscores the need for MNEs to maintain robust transfer pricing documentation and engage in proactive risk management to navigate the challenges of regulatory audits effectively. The Tribunal's decision serves as a precedent for how Kenyan authorities may approach similar disputes in the future.

While the judgment's overall direction was anticipated, the nuanced findings regarding procedural fairness and double taxation highlight the evolving landscape of transfer pricing enforcement in Kenya.

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# SIGNIFICANCE FOR MULTINATIONALS

For multinational enterprises (MNEs), this case underscores the critical need for robust transfer pricing policies and documentation. The Tribunal's validation of the Transactional Net Margin Method (TNMM) as the most appropriate method (MAM) in this case highlights the importance of selecting the correct methodology to align with the arm's length principle.

Key takeaways for MNEs include:

## **Transfer Pricing Documentation**

Comprehensive documentation, including functional analysis and benchmarking studies, is essential to justify the chosen transfer pricing methodology. Insufficient or inaccurate documentation increases the risk of disputes.

## **Benchmarking Studies**

Reliable and comparable external data play a pivotal role in supporting transfer pricing methods. MNEs must ensure that their benchmarking analyses are robust and consistent with international guidelines, such

as the OECD Transfer Pricing Guidelines.

## **Proactive Risk Management**

MNEs must proactively identify and address potential areas of transfer pricing risk. This includes regular reviews of intercompany transactions and tax positions to ensure compliance with local and international regulations.

## **Dispute Preparedness**

The case highlights the importance of being prepared for audits and disputes. MNEs should maintain detailed records of intercompany transactions and be ready to defend their transfer pricing positions if challenged by tax authorities.

By focusing on these areas, MNEs can reduce the risk of transfer pricing adjustments, penalties, and reputational damage. This case serves as a reminder of the growing scrutiny that MNEs face from revenue authorities and the need for proactive compliance measures to navigate the complexities of transfer pricing regulations.



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# SIGNIFICANCE

## FOR REVENUE SERVICES

This case offers valuable insights for revenue authorities, emphasizing the importance of fair and consistent enforcement of transfer pricing regulations. The Tribunal's decision highlights key considerations for revenue services:

### Methodology Selection

The Tribunal's endorsement of TNMM underscores the importance of selecting the most reliable transfer pricing method based on the specific circumstances of a case. Revenue authorities must ensure that their chosen methodology aligns with international guidelines, such as those outlined in the OECD Transfer Pricing Guidelines.

### Procedural Compliance

The Tribunal's criticism of procedural lapses, including the extension of audit periods beyond statutory limits, underscores the importance of adhering to legal and procedural requirements. Revenue authorities must ensure that their audits and assessments are conducted transparently and in compliance with statutory timelines.

### Documentation and Evidence

The case highlights the need for revenue authorities to rely on robust documentation and evidence when challenging transfer pricing positions. Inadequate or inconsistent data can undermine the credibility of assessments and lead to unfavorable outcomes in disputes.

### Capacity Building

Revenue authorities must invest in building their capacity to handle complex transfer pricing cases. This includes training tax officials on the application of transfer pricing methods, functional analyses, and benchmarking studies to ensure effective enforcement of transfer pricing regulations.

By focusing on these areas, revenue authorities can enhance the effectiveness of their transfer pricing audits and assessments. This case underscores the need for a balanced approach that ensures compliance while maintaining fairness and transparency in the administration of transfer pricing regulations.

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# RELEVANT CASES

## UNILEVER VS KENYA

In this case, Unilever Kenya disputed the Kenya Revenue Authority's (KRA) adjustments to its transfer pricing arrangements. The KRA had applied the Comparable Uncontrolled Price (CUP) method to challenge Unilever's intercompany transactions, asserting that the pricing did not align with the arm's length principle. Unilever, however, contended that its chosen method, TNMM, was more appropriate given the lack of comparable data for CUP. The Tribunal ultimately upheld TNMM, emphasizing the importance of selecting the most reliable method based on the specific circumstances of the case. This case underscores the critical role of robust documentation and benchmarking analyses in defending transfer pricing positions.

## COCA-COLA VS INDIA

Coca-Cola India faced transfer pricing adjustments when the Indian tax authorities challenged its intercompany transactions involving royalties paid to its parent company. The tax authorities rejected Coca-Cola's chosen method, RPM, citing insufficient comparable data, and instead applied TNMM. The court ruled in favor of the tax authorities, highlighting the need for MNEs to provide robust and reliable comparables to support their transfer pricing positions. This case demonstrates the importance of aligning transfer pricing methodologies with the functional and risk profiles of intercompany transactions.

## 3M SINGAPORE VS SINGAPORE

In this case, the Inland Revenue Authority of Singapore (IRAS) challenged 3M Singapore's transfer pricing arrangements, particularly its use of RPM for intercompany transactions involving intangibles. IRAS argued that TNMM was more appropriate given the complexity of the transactions and the lack of comparable data for RPM. The court sided with IRAS, emphasizing the importance of using a methodology that accurately reflects the economic substance of the transactions. This case highlights the growing scrutiny on transfer pricing arrangements involving intangibles and the need for robust documentation.

# PART 3

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# PREVENTION

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Engaging transfer pricing experts is essential for MNEs to navigate the complexities of cross-border transactions and regulatory compliance. Experts provide critical insights and support in the following areas:

- 1. Methodology Selection:** Transfer pricing experts assist MNEs in selecting the most appropriate methodology for their intercompany transactions, ensuring alignment with international guidelines and local regulations.
- 2. Documentation and Benchmarking:** Experts help prepare comprehensive transfer pricing documentation, including functional analyses and benchmarking studies, to support the chosen methodology and mitigate the risk of disputes.
- 3. Dispute Resolution:** In cases of audits or

disputes, transfer pricing experts provide strategic guidance and representation, helping MNEs defend their positions and negotiate favorable outcomes with tax authorities.

- 4. Risk Management:** Experts play a crucial role in identifying and mitigating transfer pricing risks, ensuring that MNEs are prepared for regulatory scrutiny and minimizing the likelihood of adjustments and penalties.

By engaging transfer pricing experts, MNEs can navigate the complexities of transfer pricing regulations with confidence and ensure compliance with international and local standards. This proactive approach minimizes risks and enhances the efficiency of transfer pricing arrangements.

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# PREVENTATIVE

## MEASURES TO AVOID SIMILAR CASES

### TAX RISK MANAGEMENT PROCESS

To avoid disputes similar to the AVIC International case, MNEs should implement robust preventative measures, such as:

**Comprehensive TP Documentation:**

Ensure detailed and up-to-date transfer pricing documentation, including functional analyses, benchmarking studies, and justifications for the selected transfer pricing method. This demonstrates compliance with the arm's length principle and strengthens the company's position during audits.

**Proactive Tax Risk Management:**

Develop a tax risk management framework to identify, assess, and mitigate potential transfer pricing risks. Regular internal audits and reviews of intercompany transactions can help address discrepancies before they escalate.

**Alignment with OECD Guidelines:**

Ensure alignment with international standards, such as the OECD Transfer Pricing Guidelines, particularly in selecting and applying the most appropriate transfer pricing methodology.

**Regular Training and Expert Engagement:**

Train internal teams on transfer pricing regulations and engage transfer pricing experts to provide guidance on complex transactions, documentation, and dispute resolution strategies.

By adopting these measures, MNEs can reduce the risk of disputes, improve compliance, and maintain a robust defense against potential challenges from revenue authorities.

### DOWNLOAD FREE BOOK

[TAX INTELLIGENCE: THE 7 HABITUAL TAX MISTAKES MADE BY COMPANIES](#)

Tax Intelligence: The 7 Habitual Tax Mistakes Made by Companies” by Dr. Daniel N. Erasmus is a must-read for businesses seeking to navigate the intricate world of tax compliance and risk management. By highlighting common pitfalls and offering strategic solutions, Erasmus equips companies with the knowledge to improve their tax practices and secure financial stability.

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# PREVENTATIVE

## MEASURES TO AVOID SIMILAR CASES

### TAX STEERING COMMITTEE

Establishing a tax steering committee can help ensure that tax policies are aligned with the broader business strategy and that transactions are vetted for both commercial and tax implications. A tax steering committee can:

- Review all significant cross-border transactions before they are executed.
- Ensure that tax decisions are made in the context of overall business objectives, not solely for tax savings.
- Monitor changes in international tax laws to ensure ongoing compliance and avoid disputes like this case.

### DOWNLOAD FREE E-BOOK

[DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF THE TAX STEERING COMMITTEE](#)

The eBook “Driving Tax Compliance: The Essential Role of a Tax Steering Committee” by Prof. Dr. Daniel N. Erasmus, Renier van Rensburg, and Gilbert Ferreira, emphasizes the critical importance of establishing a Tax Steering Committee (TSC) within multinational corporations to ensure tax compliance and manage tax-related risks effectively.

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