AN ASSESSMENT OF THE IMPLEMENTATION OF TRANSFER PRICING AND ITS ROLE ON REVENUE LEAKAGE IN KENYA

BY

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UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

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A Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

SPRING 2018
STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: ___________________________   Date: ___________________________

Lizzie Waruguru Njoroge (ID No: 631378)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: ___________________________   Date: ___________________________

Mr. Kepha Oyaro

Signed: ___________________________   Date: ___________________________

Dean, Chandaria School of Business
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ABSTRACT

The general objective of the study was to examine the transfer pricing regulations in Kenya and assess whether it has affected the implementation of transfer pricing policies by multinationals enterprises in Kenya. The specific objectives of the study were; to determine the inadequacies of Transfer Pricing Rules in Kenya, to establish the effects of Transfer Pricing on revenue generated in Kenya, and to evaluate the challenges that are brought by implementing Transfer Pricing Guidelines.

The study adopted descriptive research design. The study adopted a census technique where the target population consisted of 35 employees working in the International Tax office at Kenya Revenue Authority. A total of 35 questionnaires were distributed for the survey; out of which a total of 34 questionnaires were filled which gave a response rate of 97%. The response rate was therefore adequate and excellent for data analysis. Statistical Packages for Social Sciences (Version.22) was used for data analysis and the findings were presented in form of pie-charts and frequency tables. The data was analyzed using descriptive statistics which included percentages, frequency distribution tables and graphs. The research used inferential statistics, which comprised of regression and correlation analysis that was vital in making sense of the data.

For the analysis of the first objective, it was established there was a significant relationship between inadequacies and transfer pricing policies rules. The study found that majority of the employees tend to agree on the study between the variables such as the use of Arm’s length principle based on OECD Guidelines and adjustments made by the taxman based on transfer prices between multinational entities. The outcome of the second objective revealed employees were in agreement that tax havens create opportunities for multinational corporations to device transfer pricing practices thus making it difficult for Regulatory Authority to monitor transfer pricing activities. The findings of the third objective established that there is a need to tighten OECD Transfer Pricing guidelines by Kenya Revenue Authority and the need to put in place measures to overcome the challenges encountered in implementing transfer pricing by the Authority.

In regard to the first objective, it can be concluded that the existing transfer pricing legislation lacks clarity and gives rise to uncertainty and this tends to be a hindrance to implementation of transfer pricing policies in Kenya. For the second objective; it can be concluded that multinational corporations utilize their global organizational structures to
minimize the reported revenues from certain jurisdictions while declaring more revenue in other jurisdictions. The last objective can be concluded that, the revenue authority is exposed to loopholes in the legal instruments or framework which fueled abuse of tax laws governing transfer pricing in cross-border transfers of goods and services by tax authorities of different jurisdictions. Tax authorities tend to implement transfer pricing policies such as use of Arm's length principle to protect profit shifting of revenue generated locally and minimize the possibility for double taxation.

The study recommends on the first objective that there is need to increase the level of tax compliance by Kenya Revenue Authority by enforcing laws which will enable them to conduct assessment and audits of transfer pricing on companies that fail to comply with the rules. Secondly, there is need for a holistic approach to be used to properly address the issue of revenue generated locally by multinational corporations. Lastly, the study recommends that there is need for the revenue authority to invest on training employees who are working at the international tax office on transfer pricing issues. For further studies, it recommends that a future study should focus on examining the best international practices that can be adopted by KRA that have been found to be effective and efficient in eliminating uncertainties and loopholes brought about by transfer pricing and strengthening of the existing legal framework governing transfer pricing in Kenya in line with international best practices.
ACKNOWLEDGEMENT

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DEDICATION

This project is dedicated to my family for their love and endless support to ensure that I acquire this quality education.
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### ABBREVIATIONS & ACRONYMS

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<th>Abbreviation</th>
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<tr>
<td>ALP</td>
<td>Arm’s Length Principle</td>
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<tr>
<td>APA</td>
<td>Advance Pricing Agreements</td>
</tr>
<tr>
<td>ATAF</td>
<td>African Tax Administration Forum</td>
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<tr>
<td>ITA</td>
<td>Income Tax Act</td>
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<tr>
<td>KRA</td>
<td>Kenya Revenue Authority</td>
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<td>OECD</td>
<td>Organization of Economic Cooperation and Development</td>
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Transfer pricing is defined as the setting of prices for intra group or company transfers of goods and services. Transfer prices are the prices at which an enterprise transfers physical goods and intangible property or services to associated enterprises (Amable, 2012). It has evolved because of the necessity by tax administrations and governments to set the right price (PwC, 2011). In logical terms therefore, transfer pricing means the allocation of profit for tax and other purposes between parts of a multinational cooperate group (OECD, 2010).

In this regard, supposing hypothetically a multinational corporate such as Bata in Switzerland buys leather materials from its own subsidiary in Kenya; to determine the amount the company abroad, it is the transfer price which shall determine how much profit the Bata company in Kenya reports and how much the local tax it pays. If the company in Switzerland pays far below normal market prices, then the Bata company in Kenya, may be in a financial difficulty. Switzerland tax authority may not complain on their end, but their Kenyan tax authorities might have no much profit tax on their side of operation. This problem often arises in cooperation’s with subsidiaries as compared if it were a trade between two independent companies. In such a scenario, one company would pay the market price, and the supplier would pay taxes on its profits in a normal way.

In Kenya, there exists transfer pricing rules which were introduced in 2006, and the substantive law is contained in section 18(3) of the Income Tax Act. The provisions allow the tax authority, in this regard the Kenya Revenue Authority to adjust the profits derived from the resident person from trade conducted in an arms-length set up (Income Tax Transfer Pricing Rules, 2006). The arms-length setup principle was derived from international guidelines by the Organization for Economic Cooperation and Development (OECD) transfer pricing guidelines, located in Article 9 of the OECD Model Tax Convention and is the framework for bilateral treaties between OECD countries and many non-OECD governments too. Kenya is party to this arrangement (PwC, 2012). The arms-length principle provides that companies that have subsidiaries, the transfer price should be the same as if the two companies involved are independent, not part of the same cooperate structure. However, implementing this is not easy as some of these companies with subsidiaries such as Multinational Companies tactfully avoid adhering to the provisions of
transfer pricing, owing to their intention to maximize their profit using complicated organization structures (PwC, 2015).

Other challenges faced are the determination of the standard to apply in determining the Arms-Length Principle and the appropriate adjustments that need to be made in order to recover tax from transfer prices. There are no international accepted tax rates that are binding and therefore it has proved to be difficult especially in developing countries to use profit-based transfer pricing method. However, there are measures taken to create coherence in tax cooperation, such is the African Tax Administration Forum (ATAF), which was created to promote and facilitate mutual cooperation among tax administration with the goal of improving their tax legislation and administration. ATAF was set up by 34 African tax commissioners to provide an African voice in taxation and promote learning and capacity building (Mitchell, 2011).

Through this, together they can be able to build data on independent companies comparable to those functions performed by a controlled party within an MNC. This will assist in benchmarking and analysis of transfer pricing in developing countries. So far, ATAF is in the process of considering purchasing rights to use commercial databases for collective use by its members and also with room to develop their own databases. This will allow the data of African companies to be recognized. Kenya Revenue is a member of ATAF (Mitchell, 2011). Kenya to this end has a transfer pricing unit within the Kenya Revenue Authority and has the capability to come up with simplifying measures which can tackle the complexities. This includes introducing measures such as safe harbors, fixed margins that would allow staff to build technical capacity, while allowing Multinationals to have faith that certain tax positions would be respected. Other ways that can ease the complexities would include taking an industry specific approach in developing methodologies and policies.

Tax is a mandatory contribution of revenue to the state on income of citizens who are working, and business profits and goods and services sold and rendered respectively (Kaplow, 2008). In the words famously articulated in the Holy Scriptures by Jesus to His followers, “Give to Caesar what belongs to Caesar. This phrase was empowered by the recognition that taxes are important to governments so as to provide services to its people. In Kenya, the Kenya Revenue Authority has been tasked, through the act of parliament as a tax collecting agency mandated to collect tax on behalf of the government of Kenya. According to Odundo (2007), Another reason was that it was formed to facilitate widening
of the tax base by streamlining tax expenditure and minimizing tax revenue leakages and enhancing trade by expediting clearance of goods.

In most developing nations, revenue has slumped because of the presence of large informal sectors that greatly live in poverty and the inability of most of them and including others to pay their taxes. Others include the abuse of tax incentives and evasion of tax by multinational companies and individuals. All these issues compounded by the inability to enforce or implement transfer pricing legislation in Kenya, has contributed to massive revenue leakage which has inhibited the tax authority to realize its revenue targets (Odundo, 2007). According to the OECD (2010), tax avoidance by multinational companies raises serious issues of fairness and compliance. Transfer prices play a major role in establishing what are the income for both parties that might be involved in the cross-border transaction. The transfer price, therefore tends to shape the tax base of the countries involved in cross-border transactions.

According to Wafula (2015), indicated that tax lost from trade mispricing robbed Kenya of 8.3% of her total revenue collected. Kenya Revenue Authority, with the introduction of Tax Procedures Act 2015, gives it powers to go after taxpayers who have been using gaps in law to avoid paying taxes without falling foul of the law. The Tax Procedures Act, which became effective on January 2016, gives the taxman the power to charge the taxpayer double the amount that was initially due if a transaction is deemed to have been intentionally structured for purposes of avoiding tax. According to Wangai (2016), a large source of missed revenue or revenue leakage due to mispricing of goods and services that are transferred within multinational cooperation, among the subsidiaries with the sole aim of transferring out profits to low tax jurisdictions. Therefore, states adopt regulations for protecting their income from shifting, in which it would affect the overall revenue performance of the country. In a case involving an India based company in Kenya back in 2012, Kenya Revenue Authority established that as a result of mispricing, the company avoided paying the government of Kenya 11 million dollars corporate income taxes.

Global tax authorities also have raised concern about the loss of tax revenues that may be the result of abusive transfer pricing, for example the U.S. Internal Revenue Service announced a greater focus on transfer pricing to address diminishing tax revenues. This office deals with the highlighted problem of estimating the arm’s length price on intra-firm sales, it relies on a range, which is developed using a variety of analogous companies (De Simone, 2016). In the US, it has been established in the period 2009 to 2010, US
enterprises, belonging to the Fortune 500 companies, 280 of them only paid averagely at the tax rate of 18.5 percent on their corporate income to the U.S. Government. This was reported to be lower, moreover 78 of the 280 companies did not pay corporate tax at all (Qin & Wu, 2011).

In another case, Microsoft Corporation was up to 20 million USD when it established its Chinese affiliate as a sole proprietorship in Beijing in 1995. Although Microsoft is a powerful Multinational in the world, it is odd that its affiliate in China reported hardly any profit since its establishments. This phenomenon raised concern of the tax authority of China, who investigated the tax avoidance of the Chinese affiliate. According to the investigation, every year the subsidiary of Microsoft in China paid more than half of its profit to the parent company in USA as royalty payment. After getting large amount of proof, the tax authority of China pointed out the unreasonableness of this acts, which were finally admitted by the Microsoft Corporation in USA. Microsoft in China compensated for tax alone with interest of total 840 million RMB to the tax authority of China, which becomes the first anti-avoidance case in China (Lin, Zheng, Tang, & Lu, 2016).

Transfer pricing has evolved because of the need by tax authorities and governments to arrive at the right price. The basis behind reforming the transfer pricing legislation is that if not properly checked, a large number of the income of multinational corporations who have affiliates in Kenya, would be shifted to jurisdictions or countries with lower tax rates and deny the host country its fair share of revenue and as such, transfer pricing can be used by multinational corporations to deny governments such as Kenya of their fair share of taxes from international corporations and render multinational corporations of possible benefits derived from double taxation which they are not entitled to (Wangai, 2016).

1.2 Statement of the Problem
Kenya's tax law on transfer pricing is not as established as that of other developed countries. The Income Tax Transfer Pricing rules which are sculpted on OECD guidelines were introduced in 2006 budget with the aim of providing clarity to transfer pricing model and the arm's length principle. Inadequacy of the Income Tax Transfer Pricing regulations creates a problem as it is not clear how legally enforceable the regulations are as they seem to be mere guidelines and hence multinational corporations can take advantage of this ambiguity (Ado, 2015).
Multinational corporations are facing constant competitive pressures to structure their universal business operations effectively and efficiently. They are ever seeking tax efficient corporate structures and minimize cost of raw materials so as to meet targets set by stakeholders hence transfer pricing comes into play as it affects their corporate profit and this creates a venue for tax planning and consequently revenue leakage in Kenya (Azemar, 2009). Developing nations are facing enormous acute challenges when dealing with transfer pricing of multinational companies. In this era of globalization, transnational trade is quite high and it is true that two out of three of all business transactions takes place within related parties (World Bank, 2011). In the absence of adequate knowledge in transfer pricing and legislations, tax administrations have inadequate guidance when determining transfer pricing in related party transactions. Kenya is one of those countries that faces such an uphill task.

There has been similar research which have been done in Kenya in the area of transfer pricing. Mbiuki (2011) has examined Transfer pricing legislation in Kenya and in particular the impact of the decision in the Unilever verses the Commissioner of income taxes case. The decision of the case provided guidance on the application of the arm’s-length principle and the policy governing transfer pricing practice in Kenya. Amable (2012) focused on both legal and administration framework for addressing TP concerns in Kenya. Therefore, there has been an increase in relevance of transfer pricing to revenue collection and hence this study seeks to create knowledge in this area. So far, there has not been sufficient literature that seems to address the problem. It is against this background that this paper sought to examine current transfer pricing legal framework in Kenya, the challenges faced by the Kenya Revenue Authority in estimating the transfer prices, the effect transfer pricing has on revenue leakage in Kenya and proposals for addressing them.

1.3 General Objective
The general objective of the study was to determine effects of transfer pricing on revenue leakage in Kenya.

1.4 Specific Objectives
1.4.1 To determine the inadequacies of Transfer Pricing Rules in Kenya.
1.4.2 To establish the effects of Transfer Pricing has on revenue generated in Kenya
1.4.3 To evaluate the challenges that are brought by implementing Transfer Pricing Guidelines.
1.5 Significance of the Study
The ones to benefit from this study are:

1.5.1 Multinational enterprises
The study may enlighten them about transfer pricing and the challenges brought by the implementation of transfer pricing policies. It may also give them the background knowledge of the benefits of implementing transfer-pricing policies in their enterprises.

1.5.2 Scholars and Researchers
The study may also benefit researchers and academicians, who would wait to undertake study in transfer pricing, therefore it seeks to create more literature that maybe valuable to them.

1.5.3 Regulatory Authorities
It will help government officials more so at the Kenya Revenue Authority to identify the loopholes that exist in the current legislation on transfer pricing on the other hand it will allow them to reach revenue targets and prevent revenue leakage.

1.6 Scope of the Study
The focal point of this study was on the assessment of transfer pricing regulations affecting multinational firms operating in Nairobi, Kenya. The study covered the staff in International Tax office at Kenya Revenue Authority. Particular attention was given to cases of multinationals enterprises, which the tax authority (Kenya Revenue Authority) had successfully executed between 2013 and 2017. The limitation of this study was that respondents were not fully open to give out information regarding these cases. Nevertheless, the respondents were assured that the information sought would be treated with a lot of confidentiality.

1.7 Definition of Terms
1.7.1 Transfer Pricing
Transfer pricing is defined as the setting of prices for intra group or company transfers of goods and services. These are the prices charged for movement of goods and services between related parties (Amable, 2012).
1.7.2 Revenue Leakage

These are loopholes or avenues to evade taxes or reduce tax liability by individuals or companies (Odundo, 2007).

1.7.3 Pricing Rules

This refers to the methods and rules for pricing transactions between related parties such as multinational enterprises (Lohse, 2013).

1.7.4 Tax base

This is the amount of economic wealth that is liable to taxation (Talvi and Vegh, 2005). It is the total value of financial assets and incomes on which taxes can be imposed.

1.7.5 Arm’s Length Principle

The Arm’s Length Principle requires that transfer prices charged between related parties are equivalent to those that would have been charged between independent parties in the same circumstances (Wittendorff, 2010).

1.7.6 Tax Convention

This is a unilateral agreement between two countries to resolve disputes arising from double taxation of income in two different jurisdiction (Reimer, 2011)

1.7.7 African Tax Administration Forum

This is an international body that offers a platform for African Tax Authorities to mutually cooperate with each other with the goal of improving their tax legislation and administration (Magashula, 2009).

1.8 Chapter Summary

This chapter introduced the entire study. It brought to light the background and the reasons that made the study necessary, as well as the justification and significance of the study. It also highlighted the research questions that guided the research, which were in line with the significance of the study; which was to assess the implementation of transfer pricing in Kenya and its role on revenue leakage. Chapter two studied the literature review based on the general and specific research objectives in chapter one. Chapter three examined the research design and methodology and chapter four presented results and findings of the research. Lastly chapter five delved into summary, discussion, conclusion and further recommendations.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction
The objective of this chapter was to examine literature on transfer pricing. For each of the three objectives identified, the study looked at the findings of different authors and presented the results of their studies. The chapter specifically looked at the inadequacies of the regulation of Transfer Pricing, The effects Transfer Pricing has on revenue generated in Kenya and the challenges encountered when implementing the transfer pricing policies from the perspective of the Kenya Revenue Authority.

2.2. The Inadequacies of Transfer Pricing Rules
Kenya is among the first countries in Africa that has covered some ground in regard to strengthening enforcement of international taxation rules, including transfer pricing rules (Waris, 2017). According to her, KRA, since 2011, has been involved in litigation with the Indian-owned flower exporter Karuturi, which as at January 2017 was still unresolved (Karuturi Limited v Commissioner of Domestic Taxes, undecided). These are the only TP cases to have reached the courts in Eastern and Central Africa. Transfer pricing first came into the limelight in Kenya through the East Africa Income Tax Act of 1952 at section 4, stated:

“Where an enterprise of one of the territories participates directly or indirectly in the management, control or capital of an enterprise of the other territory, or the same person participate directly or indirectly in the management, control or capital of an enterprise of one of the territories and the enterprise of the other territory, and in either case, conditions are either made or imposed between the two enterprises, in their commercial or financial relations, which differ from those of which would be made between independent enterprises, any profit which would but for those conditions have accrued to one of the enterprises but by reason of those conditions have not so accrued may be included in the profits of that enterprise and taxed accordingly.” Later on, there were improvements that were done in section 18(3) of the Income Tax Act that came into force in 1974. Nevertheless, Article IV of the act, spelt out regulations which targeted transactions between related parties operating in different territories (ITA, 2010).
According to Chege (2013) transfer pricing regulations borrows significantly from OECD guidelines. These guidelines are to be applied by related enterprises in determination of the arm’s length prices of goods and services that is exchanged amongst them. This provision in reference to companies, parties are related where one either participates directly or indirectly in the running, control or capital of the business of another or when a person participates directly or indirectly in the management, control or capital of the business of both of them.

The arm’s length principle is located in Article 9 of the OECD Model tax convention. This was prompted by the increase in the number of multinationals and transactions within the Multinationals themselves. The Kenya’s Income Tax rules define arm’s length price as the price payable between independent enterprises. According to Calderon (2007), the arm’s length principle is determined by analyzing several factors including expected benefits to enterprises such as the Multinationals in adopting a high cost structure. Schon (2012), says that the arm’s length range is a range of figures that is satisfactorily suitable and agreeable in determining whether the conditions of a controlled transaction are at arm’s length and that are derived either from applying the same transfer price method to multiple comparable data or from applying different transfer price methods. On this point, a controlled transaction is a transaction which has is monitored to ensure payment of arm’s length price for goods and services. based

Most Countries in Africa have adopted the OECD guidelines and also pieces of legislations based on the arm’s length principle. Some of these African countries include Kenya, Mozambique, Nigeria, Egypt, South Africa, Tunisia and Uganda. This is not conclusive, for there could be more other countries which have followed suit, following the creation of ATAF, which is an African body for commissioners of revenues bodies across Africa. Seemingly, there is a broad consensus among African countries for the utilization of the arm’s length principle which is made available by the OECD (PwC, 2012).

The substantive law in Kenya, which governs transfer pricing is section 18(3) of the Income Tax Act of 2006. This piece of legislation requires that business carried out in between non-resident and related Kenyan resident to be conducted at an arm’s length. It later adds that the commissioner of Income Tax has been given the powers to adjust the profits of the Kenya resident from that business to the profits which would be expected to have accrued. These rules were greatly used during the Unilever Kenya limited vs The Commissioner of Income tax. During this case, the court recognized the applicability of the
OECD Transfer Pricing guidelines. The court further upheld that in the absence of Kenyan guidelines, OECD guidelines will apply. This has opened more debates concerning what is the interpretation of tax laws by implication or by references to international instruments or other countries guidelines (Mbiuki, 2011).

Mosota (2012) argues out that the court in that famous Unilever case endorsed the use of the OECD guidelines in the absence of detailed guidelines from the Kenya Revenue Authority. He further adds that there is difficulty to regulate Transfer Pricing in Kenya and also in other developing nations. For example, section 18(3) of the Income Tax Act does not tell taxpayers what KRA will accept as an arm’s length or how to prove them or if they are willing to negotiate pricing arrangements. This is one of the gaps that need to be filled through amendment of the Income Tax Act.

The only amendment which was done happened in 2014 and only targeted to address the problem of risk stripping which often comes about because of restructurings. This amendment provided that taxpayers should notify Kenya Revenue Authority in case of any changes in their corporate and business structures (Finance Act, 2015). The Transfer pricing guidelines allows the use of any one or more transfer pricing methods which do not necessarily need to be applied in any order. These transfer price methods include: The comparable uncontrolled price method which compares the price at which the taxpayer supplies goods or services with an associated enterprise against the price at which the taxpayer or an independent individual supplies the same goods or services in a similar transaction with an unrelated party (Ainsworth,2007)

There is also the resale price method which examines the price at which a product has been purchased from an associated enterprise and has been resold to an independent enterprise. The difference between the two prices is reduced through an appropriate gross margin, which includes the taxpayer sales-related costs, other operational expenses and a profit amount which is equal to the functions performed, assets utilized, and risks experienced by the taxpayer. What remains after the deductions is the arm’s length price for the product in the original transaction. The other one is the cost-plus method which calculates the taxpayer cost of production in providing the goods or services to the associated enterprise and adds an appropriate gross profit percentage, determined through comparable transactions entered by the same taxpayer. The second last one is the profit split method which divides the combined profits from the relevant transactions between the related parties based on the relative value of the functions performed by each party and external
data which indicates how independent parties would split the profits between themselves. The last one is the transactional net margin method which compares the net profit margin relative to an appropriate base that a party realizes in a controlled transaction to the net profit margin that the party achieves in uncontrolled transaction involving goods of the same class or kind or the net margin that an independent firm achieves in a comparable transaction (Jovanovich, 2002).

Muchina (2013) did a study on transfer pricing goals and methods among unlisted companies in Kenya and found out that transfer pricing was a major decision issue among top managers. However, proper decisions can’t be made without sufficient knowledge of transfer pricing. He recommends that MNEs taxpayers should improve their efforts in their understanding of what transfer pricing means and should comprehend the challenges and the effects of transfer prices.

When it comes to the utilization of some of the aforesaid transfer pricing methods, there are several challenges that are encountered, some of which include transfer pricing risks that tax authorities need to manage. Some of the cases involving transfer pricing are usually complex and involves extensive gathering of information which often is time consuming (Lantz, 2009). Waris (2017) also noted that since countries have no data with respect to developing economies, the choice of method in a developing a country, becomes an uphill task and as such many countries go back to simple measures. However, in complex transactions, the choice mostly used is the transactional net margin method and the profit split method. The transactional net margin is mostly preferred by developing countries revenue authority. However, it is unclear which method the Kenya Revenue Authority uses.

According to Paudice (2014), multinational corporations are faced with the risk of double taxation due to cross border transfer of goods, services and intangibles such as copyrights, brand names and licences. Double taxation may arise when the same income of an MNE is subjected to tax in two separate tax jurisdictions i.e. the revenue authority in the MNE origin country and the country where the MNEs subsidiary is located, may carry out inter-company and intra-company cost allocations. These cases may involve issues such as adjustments to inter-company pricing, royalty rates, interest, management fees, business expense and gross revenue allocation adjustments. Thus, an MNE may end up being taxed twice on the same transactions. With transfer pricing, this risk is very high and tends to be costly to the MNE.
McKinley (2013) notes that transfer prices directly influence the gathering of wide assessable taxable income over national tax jurisdictions. Therefore, an organization's transfer-pricing policies can specifically influence its after-tax income to the degree that tax rates are different across national jurisdictions. In determining the likelihood that the position will be sustained under audit, or the expected benefits that will be upheld as a result of an audit, several factors can be taken into consideration. Advance-pricing agreements (APAs) are negotiated agreements between the taxpayer and tax authorities pertaining to the transfer pricing on future inter-company transactions, provided that the taxpayer does not violate any part of the agreement by implementing a transfer-pricing policy different from what was specified in the agreement.

Ndirangu (2015) conducted a study to evaluate the transfer price law in Kenya and he argued that taxpayers and tax authorities face the hurdle of securing compliance with the available or current Transfer Pricing Rules. The study recommended for the introduction of Advance Pricing Agreements in Kenya to create sureness in the process when determining the transfer prices between resident persons and MNE’s. He further notes that, tax authority in Kenya, would find it smooth using advance pricing agreements to ensure compliance with transfer pricing rules, since the arm’s length price would have already been agreed upon.

Other literature on Transfer Pricing, arm’s length principle has glaringly pointed out to problems in dealing with Transfer Pricing issues. Tax authorities face difficulties in gathering taxpayers’ information due to the non-existence of documentation requirements and lack of ability to enforce existing requirements (Fjelstad, 2013). According to Chege (2013), who has written on the evaluation of OECD Transfer Pricing Guidelines and their effectiveness in the Kenya’s tax regime as part of his fulfillment of degree exams, indicates that transfer pricing disputes have been catalyzed by the fact that Transfer Pricing regulations, Interpretation of the arm’s length principle and methodologies vary internationally and as a result disputes have increased between tax authorities and Multinationals.

According to Schon (2012), determining the arm’s length price is actually a lengthy process and hence it can cause an administrative burden. In this process, an enterprise or a multinational submits tax returns first and an audit of whether it conforms to the arm’s
length price is conducted. If it is then established that there are transactions that have not been correctly priced, or the enterprise does not classify as a controlled transaction, then the tax authority reviews the prices. If the enterprise or a multinational is not comfortable with this, may decide to seek litigation in court.

According to a research done by Lohse (2013), the assessment of whether and to what extent transfer pricing are efficient in limiting international profit sharing behavior among 26 European countries established that transfer pricing legislations significantly reduced enterprises/multinationals income shifting. In her findings, relative to countries without transfer pricing legislations, implementation of transfer price documentation regimes reduced profit shifting behavior by around fifty percent on average. This actually mean that the application of transfer pricing legislations together with tightening of transfer pricing documentation requirements induces declines in profit shifting behavior.

2.3 Effects of Transfer Pricing on Revenue Generated

2.3.1 Tax Loss through Tax Havens

Tax havens have turned out to be a crucial component of transfer pricing strategies by multinational organizations. Tax havens have created an uneven platform as some multinational corporations are well situated to capitalize on tax havens whereas other businesses, whether small or large companies are incapable of doing the same. As tax generated from Multinational corporations and wealthy individuals fall short, the government is forced to reduce expenditure on essential goods and services or recoup the shortfall in revenue by imposing higher taxes in smaller businesses or sectors thus increasing the inequality gap. Public confidence of a country's taxation system is weakened when big companies and wealthy individuals can avoid taxes and hence there is need to seal tax loopholes created by tax havens (Sikka, 2007).

Products are dispatched physically from one country to another between related parties but contracts are channeled through tax havens. The power of corporations is also strengthened in that under the ideologies of capitalism and nations compete to attract investment funds to stimulate domestic economies. Such competition creates opportunities for entities to devise transfer pricing policies to take advantage of tax differences and effectively play-off one nation against another. Moreover, the possibilities of transfer pricing are increasingly fashioned by the emergence of tax havens. Organizations are continuously enlisting intellectual property and intangible assets in tax havens and consequently charging royalties
and rents to shift profits from one jurisdiction to another. Low tax jurisdictions territories or tax havens have little direct interest in monitoring transfer pricing practices to ensure the parties comply with the arm’s length principle (Sikka, 2007).

There has been a prevalent systematic setting of transfer prices by companies in whichever direction that will aid to avoid paying taxes and consequently boost profits. The widespread of such schemes and practices is sometimes difficult to assess as their use most often than not comes to light through unforeseen circumstances such as corporates collapse, an investigation is carried out, regulatory interventions, whistleblowing or court actions (PWC, 2012). According to Sikka (2010), low tax jurisdictions have used their sovereign legislative powers to preserve secrecy, provide light regulation and impose low/no tax which attract companies seeking to set up skeletal administrative structures. To prevent secrecy, there is need for transparent systems so that tax authorities can ensure all the taxes are paid. Bodies such as Organization for Economic Co-operation and Development has established international standards of transparency for financial transactions for both developed and undeveloped countries through Global Forum on Transparency and Exchange of Information for purposes of tax.

Financial secrecy that many tax havens harbor fuels money-laundering, corruption, manipulation of the economy and political conflict of interest that subsequently creates insecurity and undermines good governance. This secrecy provides an avenue for shell companies to transact and engage in creative transfer pricing schemes that don’t comply with the arm’s length principle. These offshore structures permit businesses to book and route their transactions to avoid paying taxes in other countries. It is not unusual for multinational companies to purchase or create and then hold intellectual property in low tax jurisdictions and charge their related parties for using the same. The benefits derived by subsidiaries and affiliates is that they can claim tax relief on costs while the recipient pays little or no tax on the income (Palan, 2013).

2.3.2 Erosion of Corporate Income Tax

Corporate income tax is tax paid on incomes generated by corporates who are based in Kenya. Local companies are taxed at a standard rate of 30% while non-resident companies are taxed at 37.5%. The Income Tax Act defines a permanent establishment as a fixed business premise a person carries on business and includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other
place of extraction of natural resources, a building site, a construction or installation project which has existed for six months or more where that person wholly or partly carries on business which has existed for six months or more. Corporate tax payable is determined after deducting all the allowable expenses including interests, royalties, management and professional service fees. These expenses are easily utilized by multinational entities to manipulate the amount of tax payable to the government through distortion of the transfer prices (KPMG, 2014).

Sikka (2010) argued that the mobilization of transfer pricing for tax avoidance or tax evasion is largely vague to the public and is often challenging and expensive for regulatory authorities to detect. Transfer pricing is a complex game involving numerous players such as accountants, consultants, lawyers, governments, tax authorities and multinational agencies, NGOs and others involved in creating and revising rules of the game with regard to which methods of calculating prices is acceptable, and also developing and detecting ways of manipulating or sabotaging these rules and techniques. It is only individuals with the greatest financial means that can afford to hire highly competent personnel who can aid in concealing their wealth in tax havens to avoid paying their fair share of taxes. The unrestricted use of transfer pricing greatly affects the stock markets through earnings, dividends, share prices and return on capital. By choosing to engage in transfer pricing planning, the local company and its multinational group strategically place themselves to take advantage of the tax holiday to shift their profits so as to reduce the group’s global tax cost. Reducing taxes is attractive to corporations as it increases shareholder value due to increase in reported earnings and hence are in a better position to give out more dividends to shareholders.

Most developing nations have poor record keeping regarding investigation and prosecution of tax evasion cases. Large taxpayers can afford to evade taxes especially where corruption is widespread and there is lack of political will to address such issues. This deters other willing citizens from paying their share of taxes as they see affluent individuals evading taxes. Over the past few years, developing countries have employed various schemes to attract foreign investments such as lowering of corporate tax rates, granting capital allowances, offering tax holidays and extending tax breaks by creating special economic zones, which are geographical areas with different tax laws from the rest of the nation Morisset (2004).
The Deterrence Theory Model has been developed to depict the relationship between tax rates and tax avoidance by taxpayers. The result of this model was that higher tax rates led to compliance by multinational entities but only if the penalties imposed were equal to tax that had been evaded. The method used by this theory is that higher penalties should be imposed if the chance of being identified is low and if not, low penalties if the chance of being detected is high. In the United States, a range of penalties was increased but the results were negative as compliance did not improve as expected. The tax consultants argued, the taxpayers perceived the increase to be unjustifiable hence deliberately contravening the law of paying all the taxes. When the aspect of complexity was tested, compliance still did not improve as taxpayers resolved to hire tax advisors hence, according to this theory, there is a likelihood of tax payers evading the tax if the penalties are lower than the evasion. The solutions proposed by other studies is that penalties should be used together with rewards. The theory is suitable to multinational corporations in developing countries such as Kenya as they seek to maximize profit and minimize tax. (Choe & Hyde, 2007).

2.3.3 Export of Profits through E-Commerce

Electronic commerce is the buying and selling of goods or services over the internet or a computer network. Technology has affected the way the world operates by altering how information flows and business is conducted. Rapid growth in electronic commerce has made it difficult for tax authorities to collect sales taxes generated from electronic transaction. The government is forced to rely on voluntary compliance by sellers as it is difficult to audit and enforce sales tax from virtual companies and individuals. The normal way of taxation is no longer applicable to e-commerce and there is much need to apply tax models that are international to internet and related e-commerce transactions, which is sometimes an uphill task. Taxation of e-commerce is a major concern for international agencies and tax authorities globally. The relationship between taxation and technological advancement has been interactive, dynamic and complex (Basu, 2008).

According to Basu (2008), government’s authority to tax had always been based on territory and jurisdiction. These systems now face a serious challenge from development of e-commerce. Trading of goods and services over the internet has deeply altered the conventional boundaries and jurisdiction. E-commerce makes the concept of permanent establishment to determine location of business, point of sale to apply relevant tax rates, income classification based on source of income and product classification for appropriate
tax rates difficult to apply. The borderless world of the internet can be used to eliminate any footprints leading to the buyers and seller’s location. Governments are losing millions in tax revenue through the penetration of e-commerce within their jurisdictions and their tax authorities are finding it increasingly difficult to stop this revenue loss (Basu, 2008).

The subject of effectively dealing with intangibles is very important for some developing countries where the key driver for economic growth is the information technology industry, which has experienced a significant growth over the last decade leading to the creation of employment opportunities. It is then critical for developing countries being able to tax profits on certain intangible related transactions such as e-commerce, because the gains realized out of those transactions are derived in that country (KPMG, 2014). According to Wagdy (2002), tax authorities consider e-commerce as a threat to revenue hence they are hard pressed to ensure integrity of their tax system to seal loopholes of tax avoidance or tax evasion. Tax authorities are concerned that the development in communication resulting in the instant transmission of information has made it more difficult to identify and quantify cross border transactions therefore making it harder for them to apply internationally accepted transfer pricing methods e-commerce.

According to Bruce (2007), the issue of international transfer pricing of electronic commerce requires multinationals to redefine their strategies to go hand in hand with the new challenges of information technology in the twenty first century. Electronic commerce may not necessarily bring out new transfer pricing problems but magnifies existing issues such as how to value intangibles and services while complying with the documentation reporting requirements. The Organization of Economic Development believes that existing principles in dealing with electronic transfer pricing transactions are adequate and therefore e-commerce is not a new problem for transfer pricing.

2.4 Challenges of Implementing Transfer Pricing Guidelines

Onsando (2007) noted that most parts of the world are faced with challenges that are as a result of weakness of the OECD Transfer Pricing and therefore calls for innovation as a way of curbing some of the weakness. For example, he recommends improvement of transfer pricing legislations to embrace Advance Pricing Arrangement (APA), to expedite resolution of transfer pricing disputes. Advanced Pricing Arrangement (APA), as articulated in the OECD transfer pricing guidelines for Multinational Enterprises and Tax Revenues’ Authorities, is an arrangement that determines in advance of controlled transactions, an appropriate adjustment thereto, sort of assumptions as to future events for
the determination of transfer price for those transactions over a fixed period of time (OECD 2010). The importance of this is that it allows tax authority such as the Kenya Revenue Authority together with other parties to agree on the conditions for transfer price determination.

According to Mitchell (2011), APAs have their own challenges due to different interests between tax authorities and multinational enterprises; even though they do reduce the uncertainties associated with the determination of the arm’s length price between related parties’ transactions. This in most cases can lead to difficulty in negotiations. Sometimes also these multinationals who are also tax payers may also see this process as giving out sensitive tax information to tax authority since they fear that such information could be used against them. Furthermore, Kenya has no provision in the Income Tax Act, nor structures set, in which taxpayers may enter into APAs. APAs could actually be benefitting to KRA and therefore should capitalize on it.

There are also challenges when Multinationals or enterprises become smarter and through loopholes in legal instruments, they decide to evade taxes. This is an abuse of tax laws argued in a UN tax subcommittee working paper in 2013. These multinationals always seek to maintain a higher profit margin and therefore they can always look for ways of shifting their functions and risks to another jurisdiction where tax commitments are reduced. Another way which Tax Authority can lose revenue when there is an interaction of different tax rules from two or more jurisdictions, which can lead to either double taxation or less than single taxation which is best known as base erosion and profit shifting. This basically draws back to the issue of Transfer pricing and enforcing of the arm’s length principle (Brauner, 2013).

Some multinationals or enterprises for that matter may shift their income generated for their group of enterprises to different jurisdictions, and for this case, since Transfer pricing allows, they end up having not a fair advantage by misapplying transfer pricing rules to benefit themselves. Fighting such revenue leakages, governments must often engage international community to tackle such problems, but most importantly conclusive and critical documentation about these enterprises is needed before such action is to be taken (Murphy, 2016). Further challenges which have been highlighted is that developing nations lack well formulated legal framework to enforce Transfer price and sanction non-compliance and misconduct. Another challenge is that a few members of staff in tax authority bodies, like the Kenya Revenue Authority are experienced about Transfer pricing.
In addition, there exist no databases which can allow members of tax authorities to extract information for purposes of verification (PwC, 2012).

Another hurdle that is faced when implementing Transfer Price policies is that many enterprises or the multinationals are afraid of having to face double taxation which may affect their businesses because of price adjustments by tax authorities, especially when doing cross-border transfer of goods and services. However, this problem can always be solved through Advance Pricing Agreements as earlier mentioned (Paudice, 2014). Well, Transfer Pricing provides an opportunity for any government to have a wide base of taxable income over national jurisdictions. However, it tends to be so demanding in terms of resources needed to apply the transfer pricing methods. Most developing nations do not have these resources to fully administer transfer pricing regulations (UN, 2013).

Adding on to the challenges in the implementation of transfer price policies is that there are limited number of multinationals enterprises which are conducting similar operations or economic strength as the enterprises in question and therefore there are no comparable transactions for arm’s length determination. Again, as mentioned in the study, ambiguities brought about poor drafting of Transfer Pricing regulations have contributed to the interpretation of methods of arriving at the arm’s length price and this poses a huge challenge (Wittendorff, 2010).

Sometimes it is also possible that through transfer pricing, the government in one country could lose revenue collected to another jurisdiction. This is because most nations have become so vigilant in the way they monitor tax compliance by enterprises or Multinationals (Schwarz, 2009). According to global transfer pricing survey of Multinationals in 2013, across 26 countries do indicate that most tax authorities have stepped up their enforcement measures, with attention being given to transfer pricing matters. Majority of the respondents, approximately 66%, who were multinationals identified transfer price management as their biggest worry. This shows that most governments experiencing shortfall in their revenues, have focused more on transfer pricing enforcement (Mitchell, 2011). According to EU commission country study of Kenya 2012 taxation is the biggest source of revenue for the government of Kenya and approximately 70% of the country’s tax revenue comes from enterprises or the multinationals. The Transfer pricing unit at Kenya Revenue Authority has so far conducted tax audits on more than sixty multinationals. Kenya, in the recent past has lost about 156 billion in the period 2000-2008
through illicit outflows of capital perpetuated by wealthy business people and multinationals (Wafula, 2015).

Also, in a survey which was done by Earnest and Young in 2007, most of Multinationals have identified transfer pricing as the most significant issue which they faced than any other issue. With 42% and 44% being reported in Europe and Asia Pacific respectively. Moreover, since international cooperation across countries on tax matters remains limited, for example in the area of transparency and exchange of information, it is difficult for individual tax administrations to control transfer mispricing and other tax avoidance practices. This is particularly witnessed in developing countries, where governments have low resources available to deal with capital flight and base erosion (Lovdahl, 2016).

Waris (2017) also states that the process of Transfer Pricing audit by KRA is not at a cutting-edge level, since the capacity of those who conduct these audits is still very low. She argues that transfer pricing audit is only conducted by twelve or so transfer pricing unit, which is under the large taxpayer’s office.

There also some difference which exists between the Kenyan law and the OECD (2010), transfer pricing guidelines. For example, Rule 7 of the Kenyan transfer pricing regulations covers the method to be applied in determination of arm’s length price. Whereas, Rule 8 does not provide preference for any method, but instead gives room for the taxpayer to choose which they consider appropriate. The potential problem here is that, there is the possibility of prescribing a new method which has insufficient details of the methodology to be followed in its application, and further makes the work of the transfer pricing unit at KRA, more complex. This means that there has to be a clear determination of the method to be used. Section 56, Paragraph 9 of the Income Tax Act, gives the power to the commissioner of KRA to call for information from tax payers. However, many taxpayers do not comply when asked to do so. This has been facilitated by the absence of special penalties for failure to give information. The rules are based on the OECD Transfer Pricing Guidelines (OECD, 2010).

According to Waris (2017), most transfer pricing cases are complex, and every assessment raised after conducting transfer pricing audits end up being objected. In addition Section 86(1) of the Income Tax Act gives the taxpayer room to make an appeal to the Tax Appeal Tribunal against the commissioner's determination of the objection. Since most transfer pricing cases gets an appeal by the taxpayers, the cases end up in the Tax Appeal Tribunal.
She notes that there is a general perception that Kenya’s legislative, judicial and administrative bodies are insufficiently skilled to identify and deal with cases of transfer pricing malpractice. Tribunal members are not trained in transfer pricing, and on several occasions have indicated that transfer pricing issues are too complex for their current level of skills in tax. This predisposes some decisions made at the Tribunal to decisions not founded on sound reasoning as this was the case in the Unilever case. The Unilever Kenya Limited versus Commissioner of Income Tax court case delivered in 2005, involved transactions between Unilever Kenya Limited and Unilever Uganda Limited. This was pursuant to a contract which was done, that warranted the Unilever Kenya Company to manufacture and supply goods to Unilever Uganda, and at the same time manufactures and supply goods locally and for exports. KRA, in this case, argued that the prices of goods supplied to the Unilever Uganda Limited was lower than those for domestic and export sales, and were not set accordingly to the arm’s length price.

In summary, while the Income Tax Act provides that KRA and taxpayers should use the arm’s length price in determining the transfer price, it does not offer a procedure for its application. The Income Tax Transfer Pricing Rules which took effect in 2006 are supposed to provide guidelines in determining the arm’s length price of goods and services in transactions involving related enterprises. The rules apply to transactions between associated companies. There is no specialized dispute resolution mechanism for transfer pricing matters in Kenya, so KRA handles such cases through the normal income tax administrative procedures (Waris, 2017).

KRA and taxpayers face several challenges, including the less experience of the transfer pricing unit to negotiate effectively with taxpayers. Secondly, advance pricing agreements are an important mechanism in transfer pricing administration and are a potentially beneficial tool for KRA. One of the best ways for Kenya to battle tax challenges and increase revenue collection is through improved tax revenue regime, which the Authority can achieve through capitalizing on the advantages of advance pricing agreements. The overall benefits of advance pricing agreements according to this study include certainty and predictability for the taxpayers and saving money for KRA (Waris, 2017).

According to Givati (2009), use of advance pricing agreements varies from one jurisdiction to another and it is low in the United States. The reason for the low use of the advance pricing agreement arrangement is because it is lengthy and expensive. Furthermore,
taxpayers could decide to withhold some information regarding their business operation to tax authorities to avoid highlighting potential tax issues which may have been passed over during audit. The study also argued that for an advance pricing agreement to be effective, it must be bilateral or multilateral. Unilateral advance pricing agreements often expose taxpayers to the risk of double taxation. The involvement of several tax authorities complicates the process, since tax authorities are required to negotiate with each other.

### 2.5 Chapter Summary

The chapter analyzed literature of similar nature that was authored by other researchers. The review took systematic approach by looking at the challenges of transfer pricing implementation, the problems of transfer pricing regulations and their effect on revenue leakage at the Kenya Revenue Authority. The next chapter covered research methodology.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
The Chapter places interest in the research methods that were used in the study in order to fulfill the objectives of the Study in chapter one. This chapter looked at the research design, the population of the study, sample size and sampling technique, data collection instrument, pilot testing and data analysis procedures.

3.2 Research Design
Research design is a plan for conducting studies with complete control over factors that may affect the findings. According to Cooper (2013), takes note that, research design is the researchers plan for answering a research question or testing the research hypothesis. The study used descriptive research design to provide a picture of a situation as it really happens. A descriptive study describes existing conditions and attitudes through interpretation techniques and is regarded as one of the best methods for conducting research in human contexts (Mamabolo, 2009).

A descriptive research is concerned with finding out what, where and how of a phenomenon and therefore it will be appropriate of the study as it seeks to determine the inadequacies in the regulations of Transfer Pricing in Kenya, establish the effects of Transfer Pricing has on revenue generated in Kenya and evaluate the challenges that are brought by implementing Transfer Pricing Policies. A descriptive design was therefore appropriate as it helped in collecting data in order to answer the questions raised in the aforementioned objectives.

3.3 Population and Sampling Design
3.3.1 Population
Grove (2012) defines the population as the sum number of units from which data can be collected. The units can be individuals or organization who meet the criteria for inclusion in the study. For example, the target population for this study prioritized 35 employees who are working at the International Tax Office at the Kenya Revenue Authority. The employees consist of majorly four levels; senior and middle management level, supervisory level and officer level.
3.3.2 Sampling Design

3.3.2.1 Sampling Frame

The sampling frame for a study represents all the population who are accessible during the data collection (Smith & Albaum, 2012). A sampling frame is a list of options from which the sample is drawn. This may be the whole population or a segment of it. The sampling frame for this study consisted of 35 individuals who were working at the International Tax Office at the Kenya Revenue Authority.

3.3.2.2 Sampling Technique

According to Etikan (2016), sampling technique refers to selecting from a population. In general, a researcher is required to explain how he or she arrived at sample size based on the target population. This study employed a census technique whereby all employees working at the International Tax Office at the Kenya Revenue Authority were used in this study. Erba, Ternes, Bobkowski, Logan and Liu, (2018) describe a census as the study in which all members of the target population form part of the research study. The advantage of using the census approach is that it increases the reliability and accuracy of the study.

3.3.2.3 Sample Size

According to Etikan (2016), sample size is several units in a population to be studied and sampling means selecting a group of people, events or behavior with which to conduct studies. According to Best (2016), census or complete enumeration is a method in which information is gathered on all the units of a population. In this regard, the study employed census method in collecting data from the target population and hence the researcher was guided by the number of all specialized persons working in the International Tax Office at Kenya Revenue Authority. The merit of using census method is that results obtained are representative and dependable and subsequently any question of error turns out to be almost insignificant.

Table 3.1 Sample Size Distributions

<table>
<thead>
<tr>
<th>Category</th>
<th>Sample Size</th>
<th>Percentage Distribution (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Management Level</td>
<td>3</td>
<td>9%</td>
</tr>
<tr>
<td>Middle Management Level</td>
<td>2</td>
<td>6%</td>
</tr>
<tr>
<td>Supervisory Level</td>
<td>17</td>
<td>49%</td>
</tr>
<tr>
<td>Officer Level</td>
<td>13</td>
<td>37%</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>100%</td>
</tr>
</tbody>
</table>
3.4 Data Collection Methods

According to Harris and Brown (2010), data collection is the systematic process used by the researcher to collect either primary or secondary data for a study. In this regard the study relied on primary data using questionnaires to obtain data from different participants. Cooper and Schindler (2013) describe data collection methods as the various approaches that were employed by the researcher to look for information that can practically be analyzed and entails gathering of facts from target population. They state that data collection may range from either a simple observation based on one location or multiple observations of multinational enterprises all over the world.

A structured questionnaire was used to gather information from the employees at Kenya Revenue Authority as it was deemed to be the most suitable instrument for data collection. The tool proved to be cost effective to administer, relatively quick to collect information from people and objective to give detailed answers from the individuals. The developed questionnaire was checked for its reliability through pilot testing. This gave room to see some of the weaknesses in design and instrumentation. The pre-testing allowed for modification of various questions to rephrase, clarify and clearing up any shortcomings in the questionnaires before they were administered to the actual respondents. In this regard the researcher conducted the pilot study with 5 participants who met the selection criteria.

According to Kim (2010), pilot studies are not usually used in qualitative studies, but novice researchers could conduct interviews as a pre-exercise, to get used to the type of data collection. The questionnaire was divided into four main sections. Section one tackled demographic information of the respondents, section two covered questions regarding the inadequacies in the regulations of Transfer Pricing in Kenya, section three presented the questions on the extents to which Transfer Pricing has impacted on revenue generated in Kenya and lastly section four evaluated the challenges realized by implementing Transfer Pricing Policies. The questions were presented in form of a Likert scale of 5 point where respondents chose the most appropriate response that best describes how much they agree or disagree with a statement.

3.5 Research Procedures

The researcher sought permission from research office in USIU-Africa, to carry out the study. Any well conducted scientific inquiry demands the researchers to develop tools that enable data producers to supply data in the most-relevant and useful formats that when
analyzed will yield accurate and meaningful data to enable them make decision (Cooper & Schindler, 2013). The questionnaires were physically distributed by the researcher to the employees at Kenya Revenue Authority and the method of drop and pick was used in the process because this was a faster way of getting direct response from the target respondents. Cooper and Schindler (2013) advocates for the use questionnaires in descriptive studies because it is less costly and provides an easy method of reaching participants. Further (Cooper & Schindler, 2013) argues that questionnaires also increase the response rate and helps researchers to gather and summarize responses easily.

3.6 Data Analysis Methods
Data analysis is the editing and reducing accumulated data to a manageable size, developing summaries and seeking for patterns using statistical methods (Cooper and Schindler, 2013). The completed questionnaires were reviewed and edited for accuracy, consistency and completeness. The responses were then coded, and entries made into Statistical Package for Social Science (SPSS version 22) and use of Excel tool to generate graphs and tables. The data was analyzed using descriptive statistics which included; percentages, frequency distribution tables and graphs. The research used inferential statistics which included regression and correlation analysis. The dependent variable was Transfer Pricing Rules while the independent variables were; Inadequacies of Transfer Pricing Rules, Revenue Generated, and Challenges that are brought by implementing Transfer Pricing as presented in the regression model below:

\[ Y = a + b X_1 + b X_2 + b X_3 \]

Where \( Y \) = Transfer Pricing Rules,
\( a \) = Constant (Regression coefficient)
\( bX_1 \) = Inadequacies of Transfer Pricing Rules,
\( bX_2 \) = Revenue Generated,
\( bX_3 \) = Challenges in implementing Transfer Pricing,

3.7 Chapter Summary
This chapter covered the complete methodology that was used to undertake this study. It depicts the appropriateness of the research design and further demonstrates the study population, the sample design, the data collection method, the research procedure and the data analysis methods. Chapter four broadly covered the research findings and chapter five outlined the discussions, conclusions and recommendations of these findings.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

In this chapter, the study provided the descriptive and inferential analysis of the data collected. The chapter was further broken down into several sections. Section 4.2 highlighted the general information regarding the study. Section 4.3 was on the inadequacies of transfer pricing rules applicable in Kenya. Section 4.4 discussed the relationship between transfer pricing and revenue generation. Section 4.5 was on challenges faced by the Kenya Revenue Authority in implementing transfer pricing guidelines. Lastly, section 4.6 summarized the whole chapter.

4.1.1 Response Rate

Table 4.1 indicated the response rate of the study. Out of the 35 questionnaires that were distributed to the employees of Kenya Revenue Authority, 34 were filled which represented a response rate of 97% hence representative enough. According to Mugenda and Mugenda (2003), a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. This corroborates Gogo, Okibo and Nyangau (2015) assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very good.

Table 4.1 Response Rate

<table>
<thead>
<tr>
<th>Target Response</th>
<th>Response</th>
<th>Response Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees</td>
<td>35</td>
<td>34</td>
</tr>
</tbody>
</table>

4.2 General Information

This topic includes sub sections of the general information provided by the respondents. The section is categorized according to the specific sections as they appear in the questionnaire namely: gender, age group, the level of education and work experience.

4.2.1 Gender of Respondents

Figure 4.1 indicated the gender of the employees in the organization. The study established that 47% of the population was male while 53% was female. Most of the population therefore was female.
4.2.2 Age Group

The Figure 4.2 indicate the findings from the employees. The sought to know the age of the employees’. Employees with 30 years were represented by 35%, between 31-40 years was 59%, between 41-50 years was 6%, and lastly no employee who was above 50 years hence majority of the respondents was represented by 59% and they were between 31-40 years.

4.2.3 Position in the Organization

Figure 4.3 indicated different levels of management at the International Tax Office. The study established that senior level management was 9%, middle level management was 3%, supervisory level was 50% and lastly, the officer level cadre of employees was 38%.
4.2.4 Educational level of Employees

Figure 4.4 demonstrated the level of education of the respondents. The study showed that 35% of the respondents were Degree holders, 53% had attained a Masters degree and 12% were PhD holders.

4.2.5 Working Experience in the Organization

In Figure 4.5 below, the study sought to understand the number of years the employees have been working for the organization. The study revealed that 35% of the respondents had worked for less than 5 years, 47% had worked for between 5-10 years, 6% had served between 11-15 years and 12% had worked for between 16-20 years.
4.3 Inadequacies of Transfer Pricing Rules in Kenya

4.3.1 Descriptive Statistics on Inadequacies of Transfer Pricing Rules in Kenya

Table 4.2 below indicated the inadequacies of the transfer pricing rules in Kenya. Regarding whether Kenya had fully adopted the use of arm’s length principle based on OECD Guidelines, 62% of the respondents agreed, 30% disagreed while 9% were uncertain. Regarding whether there were any adjustments made by the taxman based on transfer prices between multinational enterprises, 82% of the respondents agreed, 6% disagreed while 12% were uncertain. Concerning the question as to whether lack of detailed transfer pricing guidelines affected revenue collection, 88% of the respondents agreed, 9% disagreed and 3% were not sure. To answer the question on whether one would recommend amendments or improvements on transfer pricing regulations, 94% of the population agreed, 3% disagreed while the remaining 3% were uncertain. Lastly, as to whether the existing globally recognized transfer pricing rules are appropriate for developing countries like Kenya, 56% of the respondents agreed, 31% disagreed whereas 12% were uncertain.
Table 4.2 Inadequacies of Transfer Pricing Rules in Kenya

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>U</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya has fully adopted the use of Arm’s Length Principle based</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>on OECD Guidelines</td>
<td>9%</td>
<td>21%</td>
<td>9%</td>
<td>56%</td>
<td>6%</td>
</tr>
<tr>
<td>There were any adjustments made by the taxman based on transfer</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>prices between multinational enterprises</td>
<td>6%</td>
<td>0%</td>
<td>12%</td>
<td>47%</td>
<td>35%</td>
</tr>
<tr>
<td>The absence of detailed transfer pricing guidelines affected</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>revenue collection</td>
<td>3%</td>
<td>6%</td>
<td>3%</td>
<td>59%</td>
<td>29%</td>
</tr>
<tr>
<td>Would you recommend amendments or improvements on transfer</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>pricing regulations</td>
<td>3%</td>
<td>0%</td>
<td>3%</td>
<td>41%</td>
<td>53%</td>
</tr>
<tr>
<td>The existing globally recognized transfer pricing rules are</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>appropriate for developing countries such as Kenya</td>
<td>9%</td>
<td>24%</td>
<td>12%</td>
<td>41%</td>
<td>15%</td>
</tr>
</tbody>
</table>

4.3.2 Descriptive Statistics on Inadequacies of Transfer Pricing Rules in Kenya

Table 4.3 below regarding if there exist transfer pricing information and lack of ability to enforce existing requirements affected revenue collection: 47% agreed and 35% strongly agreed while the remaining either disagreed or were uncertain on the same. Next question as to whether there has been an administrative burden in determining arm’s length price in controlled transactions, 62% of the respondents agreed whereas 21% strongly agreed. Regarding the question as to whether there has been an implication on revenue collected because of lengthy court litigations, 35% of the respondents were in agreement with the contention whereas 50% strongly agreed. On whether there has been sufficient expertise to recognize the key issues in transfer pricing, 50% of the respondents agreed, 15% strongly agreed while the rest neither disagreed nor uncertain. About the assertion that transfer pricing legislations in Kenya significantly reduced profit, 47% of the employees agreed, 33% disagreed while 21% were not sure.
Table 4.3 Inadequacies of Transfer Pricing Rules in Kenya

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>U</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer pricing information and lack of ability to enforce existing requirements affected revenue collected</td>
<td>3%</td>
<td>0%</td>
<td>15%</td>
<td>47%</td>
<td>35%</td>
</tr>
<tr>
<td>There has been an administrative burden in determining the Arm’s Length Price in controlled transactions</td>
<td>0%</td>
<td>9%</td>
<td>9%</td>
<td>62%</td>
<td>21%</td>
</tr>
<tr>
<td>There has been an implication on revenue collected as a result of lengthy court litigations</td>
<td>0%</td>
<td>0%</td>
<td>15%</td>
<td>35%</td>
<td>50%</td>
</tr>
<tr>
<td>There is sufficient expertise to recognize the key issues in transfer pricing</td>
<td>15%</td>
<td>12%</td>
<td>9%</td>
<td>50%</td>
<td>15%</td>
</tr>
<tr>
<td>Transfer pricing legislations in Kenya significantly reduced profit shifting behavior by multinational enterprises</td>
<td>6%</td>
<td>27%</td>
<td>21%</td>
<td>41%</td>
<td>6%</td>
</tr>
</tbody>
</table>

4.4 Effects of Transfer Pricing on Revenue Generated in Kenya

4.4.1 Descriptive Statistics on Transfer Pricing and Revenue Generated

The second objective of the study was to determine the effect of Transfer Pricing on Revenue Generated in Kenya. The results are presented in Table 4.4 The employees agreed as to whether tax havens create opportunities for multinational entities to device Transfer Pricing practices with 74% strongly agreeing and 20% agreeing. The question on whether tax havens make it difficult for Regulatory Authority to monitor Transfer Pricing practices, majority of the employees agreed with 56% strongly agreeing and 41% agreeing. The next question was if low tax jurisdictions encouraged creative Transfer Pricing schemes. 50% of the respondents strongly agreed while 47% agreed with the assertion. Concerning the extent with which unrestricted use of Transfer Pricing techniques affects revenue generation in Kenya, 29% of the respondents strongly agreed while 56% agreed. This indicated that majority of the respondents agreed that unrestricted use of Transfer Pricing techniques affects revenue generation. About the increase in tax revenue being attributed
to increase in audit and compliance on Transfer Pricing transactions, 35% of the respondents strongly agreed while 24% agreed with the statement.

Table 4.4 Effects of Transfer Pricing on Revenue Generated

<table>
<thead>
<tr>
<th>Description</th>
<th>SD</th>
<th>D</th>
<th>U</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax havens create opportunities for multinational entities to device transfer pricing practices</td>
<td>0%</td>
<td>0%</td>
<td>6%</td>
<td>20%</td>
<td>74%</td>
</tr>
<tr>
<td>Tax havens make it difficult for Regulatory Authority to monitor transfer pricing practices</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
<td>41%</td>
<td>56%</td>
</tr>
<tr>
<td>Low tax jurisdictions encourage creative transfer pricing schemes</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
<td>47%</td>
<td>50%</td>
</tr>
<tr>
<td>Unrestricted use of transfer pricing techniques affects revenue generation in Kenya</td>
<td>0%</td>
<td>0%</td>
<td>15%</td>
<td>56%</td>
<td>29%</td>
</tr>
<tr>
<td>Increase in tax revenue can be attributed to increase audit and compliance on transfer pricing transactions</td>
<td>15%</td>
<td>12%</td>
<td>14%</td>
<td>24%</td>
<td>35%</td>
</tr>
</tbody>
</table>

4.4.2 Descriptive Statistics on the Effects of Transfer Pricing on Revenue Generated

This section highlighted the effects of transfer pricing on revenue generated. In Table 4.5 below, to answer the question as to whether high penalties imposed on evaded tax deterred multinational companies from practicing Transfer Pricing, most of the employees were not in agreement with 9% disagreeing and 47% strongly disagreeing. On whether applied penalties for tax evasion by multinational companies in Kenya was adequate, majority of the employees were not agreement with 29% strongly disagreeing and 35% disagreeing. On whether lack of permanent establishment in Kenya led to revenue leakage, the response was 21% strongly agreed and 53% agreed. The question as to whether e-commerce is a threat to revenue leakage, 62% of the respondents strongly agreed while 32% agreed that e-commerce is a threat to revenue leakage. The employees were also asked if the existing OECD principles were adequate in addressing Transfer Pricing transactions. The majority of the respondents were not sure with 35% being uncertain and 35% being in disagreement.
Table 4.5 Effects of Transfer Pricing on Revenue Generated

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>U</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>High penalties imposed on evaded tax deter multinational companies from practicing Transfer Pricing</td>
<td>9%</td>
<td>47%</td>
<td>9%</td>
<td>24%</td>
<td>12%</td>
</tr>
<tr>
<td>The applied penalties for tax evasion by multinational companies in Kenya is adequate</td>
<td>29%</td>
<td>35%</td>
<td>12%</td>
<td>21%</td>
<td>3%</td>
</tr>
<tr>
<td>Lack of permanent establishment in Kenya lead to revenue leakage</td>
<td>15%</td>
<td>0%</td>
<td>12%</td>
<td>53%</td>
<td>21%</td>
</tr>
<tr>
<td>E-commerce a threat to revenue leakage</td>
<td>6%</td>
<td>0%</td>
<td>0%</td>
<td>32%</td>
<td>62%</td>
</tr>
<tr>
<td>Existing OECD principles adequate in addressing Transfer Pricing transactions</td>
<td>0%</td>
<td>35%</td>
<td>35%</td>
<td>26%</td>
<td>4%</td>
</tr>
</tbody>
</table>

4.4.3 Correlational Analysis on Transfer Pricing and Revenue Generated

The study sought to establish the correlation between transfer pricing and revenue generated. Correlation analysis sought to establish nature of the relationship between the independent and dependent variables. In addition, coefficient of determination showed the strength of the relationship. The findings in the Table 4.6 below show that there is a strong positive correlation between transfer pricing and revenue generated ($r = 0.505$, $p$-value $<0.05$).

Table 4.6 Correlation Analysis on Transfer Pricing

<table>
<thead>
<tr>
<th>Correlations</th>
<th>Transfer Pricing Rules</th>
<th>Revenue Generated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer Pricing Rules</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.002</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>34</td>
</tr>
<tr>
<td>Revenue Generated</td>
<td>Pearson Correlation</td>
<td>.505**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.002</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>34</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).
4.4.2 Regression Analysis on Transfer Pricing and Revenue Generated

To establish the effect of transfer pricing on revenue generated by the employees of the Kenya Revenue Authority, a linear regression analysis was conducted. The findings are as shown in Tables 4.7, 4.8 and 4.9 below:

**Table 4.7 Model Summary**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.505&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.255</td>
<td>.232</td>
<td>3.47185</td>
</tr>
</tbody>
</table>

<sup>a</sup> Predictors: (Constant), Revenue Generated

**Table 4.8: ANOVA Table**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>132.163</td>
<td>1</td>
<td>132.163</td>
<td>10.965</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>385.719</td>
<td>32</td>
<td>12.054</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>517.882</td>
<td>33</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<sup>a</sup> Dependent Variable: Transfer Pricing Rules

<sup>b</sup> Predictors: (Constant), Revenue Generated

**Table 4.9: Coefficients**

<table>
<thead>
<tr>
<th>Model</th>
<th>Coefficients&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unstandardized Coefficients</td>
<td>Standardized Coefficients</td>
</tr>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>16.371</td>
</tr>
<tr>
<td></td>
<td>Revenue Generated</td>
<td>.577</td>
</tr>
</tbody>
</table>

<sup>a</sup> Dependent Variable: Transfer Pricing Rules
The value of variance $R^2 = 0.255$, shows that 25.5% of revenue generated is affected by transfer pricing rules. The F-distribution is 4.139 which is less than critical value for $F(1, 32) = 10.965$, $p$-value $= 0.002 < 0.05$, shows that transfer pricing is statistically significant predictor of revenue generated by the Kenya Revenue Authority (i.e., the regression model is good fit of the data). Transfer pricing rules are statistically significant ($t=2.489, p$-value$=0.018$), showing it how it affects the revenue generated. The regression model explaining the results in the given table above:

$$\text{Revenue Generated} = 16.371 + \times 0.577 \text{ Transfer Pricing Rules}$$

The model shows that transfer pricing rules affects revenue generated by the organization. Thus, the mean index increase in transfer pricing increases the revenue generated by a positive unit mean index value of 0.577.

### 4.5 Challenges in Implementing Transfer Pricing Guidelines

#### 4.5.1 Descriptive Statistics on Challenges in Implementing Transfer Pricing Guidelines

The third objective of the study was to determine the challenges faced by the Kenya Revenue Authority in implementing transfer pricing guidelines as per the analysis indicated in Table 4.10 below. The first question was if there is need to tighten OECD transfer pricing guidelines. The response was that 32% of the employees strongly agreed while 50% agreed. Therefore, majority of the employees agreed that there is need to tighten OECD transfer pricing guidelines. The question as to whether there were measures in place that can be used to overcome the challenges in implementing transfer pricing, 35% of the respondents strongly agreed while 65% agreed. About the need for the Kenya Revenue Authority to agree on conditions for determining transfer prices of transactions, 9% of the employees strongly agreed with the statement whereas 68% Agreed. The contention that transparency of related parties’ transactions may lead to the exposure of sensitive information of multinational entities, 6% of the respondents strongly disagreed while 47% disagreed. Finally, regarding the loopholes in legal instruments and framework that fueled abuse of tax laws governing transfer pricing, 35% of the respondents strongly agreed with the argument while 50% agreed.
Table 4.10 Challenges in Implementing Transfer Pricing Guidelines

<table>
<thead>
<tr>
<th>Description</th>
<th>SD</th>
<th>D</th>
<th>U</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is need to tighten OECD Transfer Pricing guidelines</td>
<td>0%</td>
<td>6%</td>
<td>12%</td>
<td>50%</td>
<td>32%</td>
</tr>
<tr>
<td>There are measures that can be put into place to overcome the challenges in implementing TP</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>65%</td>
<td>35%</td>
</tr>
<tr>
<td>There is need for KRA to agree on conditions for determining Transfer Prices of transactions</td>
<td>0%</td>
<td>15%</td>
<td>9%</td>
<td>68%</td>
<td>9%</td>
</tr>
<tr>
<td>Transparency of related parties’ transactions lead to exposure of sensitive information of multinational entities</td>
<td>6%</td>
<td>47%</td>
<td>3%</td>
<td>27%</td>
<td>18%</td>
</tr>
<tr>
<td>There are loopholes in legal instruments/framework fueled abuse of tax laws governing Transfer Pricing</td>
<td>0%</td>
<td>6%</td>
<td>9%</td>
<td>50%</td>
<td>35%</td>
</tr>
</tbody>
</table>

4.5.2 Descriptive Statistics on the Challenges of Transfer Pricing

The second section on the challenges in implementing transfer pricing guidelines is indicated in Table 4.11 below. As to whether there is base erosion and profit sharing aggravated by differences in tax rules in various jurisdictions, 44% of the respondents strongly agreed while 38% agreed. The question that unavailability of adequate resources acted as a barrier to deal with capital flight and base erosion in Kenya, 32% of the employees interviewed strongly agreed whereas 50% agreed. The argument that building staff capacity on transfer pricing can reduce revenue leakage, 56% of the employees interviewed strongly agreed while 27% agreed that indeed building staff capacity on transfer pricing can reduce revenue leakage. The contention that there is significant cost implication to the Kenya Revenue Authority attributed to developing transfer pricing capacity, 15% of the respondents strongly agreed while 50% agreed with the argument. Lastly, as to whether courts have adequate skills, knowledge or experience to deal with transfer pricing cases, 38% of the respondents strongly disagreed whereas 56% disagreed.
Table 4.11: Challenges in Implementing Transfer Pricing Guidelines

<table>
<thead>
<tr>
<th>Challenges in Implementing Transfer Pricing Guidelines</th>
<th>SD</th>
<th>D</th>
<th>U</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is base erosion and profit sharing aggravated by differences in tax rules in various jurisdictions</td>
<td>0%</td>
<td>6%</td>
<td>12%</td>
<td>38%</td>
<td>44%</td>
</tr>
<tr>
<td>The unavailability of adequate resources acted as a barrier to deal with capital flight and base erosion in Kenya</td>
<td>0%</td>
<td>0%</td>
<td>18%</td>
<td>50%</td>
<td>32%</td>
</tr>
<tr>
<td>Building staff capacity on Transfer Pricing can reduce revenue leakage</td>
<td>0%</td>
<td>6%</td>
<td>12%</td>
<td>27%</td>
<td>56%</td>
</tr>
<tr>
<td>Significant cost implication to KRA in developing Transfer Pricing capacity</td>
<td>6%</td>
<td>27%</td>
<td>3%</td>
<td>50%</td>
<td>15%</td>
</tr>
<tr>
<td>The courts have adequate skills, knowledge or experience to deal with Transfer Pricing cases</td>
<td>38%</td>
<td>56%</td>
<td>6%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

4.5.1 Correlational Analysis on Challenges in Implementing Transfer Pricing

The study sought to establish the causal relationships between transfer pricing and revenue generated. The findings in Table 4.12 below show that there is a strong positive correlation between transfer pricing rules and challenges that are brought by implementing Transfer Pricing (r = 0.526, p-value 0.001<0.05).

Table 4.12 Correlation Analysis on challenges by implementing TP

<table>
<thead>
<tr>
<th>Correlations</th>
<th>Transfer Pricing Rules</th>
<th>Challenges on Transfer Pricing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer Pricing Rules</td>
<td>Pearson Correlation 1</td>
<td>.526**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed) .001</td>
<td></td>
</tr>
<tr>
<td></td>
<td>N 34</td>
<td>34</td>
</tr>
<tr>
<td>Challenges on Transfer Pricing</td>
<td>Pearson Correlation .526**</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed) .001</td>
<td></td>
</tr>
<tr>
<td></td>
<td>N 34</td>
<td>34</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).
4.5.2 Regression Analysis on Challenges in Implementing Transfer Pricing

The findings are indicated in Tables 4.13, 4.14 and 4.15 on the establishment of the challenges that are brought by implementing transfer pricing and the transfer pricing rules of the employees of Kenya Revenue Authority. Linear regression analysis was conducted.

Table 4.13: Model Summary

<table>
<thead>
<tr>
<th>Model Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Model</strong></td>
</tr>
<tr>
<td>1</td>
</tr>
</tbody>
</table>

\(^{a}\) Predictors: (Constant), Challenges that are brought by implementing Transfer Pricing

Table 4.14: ANOVA Table

<table>
<thead>
<tr>
<th>ANOVA(^{a})</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Model</strong></td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>Residual</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

\(^{a}\) Dependent Variable: Transfer Pricing Rules

\(^{b}\) Predictors: (Constant), Challenges that are brought by implementing Transfer Pricing

Table 4.15: Coefficients

<table>
<thead>
<tr>
<th>Coefficients(^{a})</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Model</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>Challenges that are brought by implementing Transfer Pricing</td>
</tr>
</tbody>
</table>

\(^{a}\) Dependent Variable: Transfer Pricing Rules

The value of variance \(R^2 = 0.277\), shows that 27.7\% of challenges of transfer pricing is affected by transfer pricing rules. The F-distribution is 4.139 which is less than critical value for F (1, 32) = 12.247, p-value = 0.001<0.05, this shows that transfer pricing is statistically significant predictor of challenges that are brought about by implementation of
transfer pricing rules (i.e., the regression model is good fit of the data). The transfer pricing rules are statistically significant ($t=3.391, \ p-value=0.001$), showing how transfer pricing affects implementations of transfer rules. The model shows that transfer pricing rules affects the implementation of the rules, i.e. a mean index increase in transfer pricing rules increases the implementations of transfer rules by a positive unit mean index value of 0.520. The regression model explaining the results is shown as follows:

$$\text{Challenges on Transfer Pricing} = 18.784 + \times 0.520 \text{Transfer Pricing Rules}$$

4.6 Chapter Summary
The chapter has provided results and findings based on the primary data obtained from questionnaires issued to the staff at the international tax office. The chapter has analyzed the inadequacies of transfer pricing rules in Kenya, relationship between transfer pricing and revenue generation and challenges attributed to transfer pricing guidelines. The next chapter provides the summary, discussions, conclusions and recommendations of the findings.
CHAPTER FIVE

5.0 DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction
This chapter presents a discussion of the findings, conclusions and recommendations for further research on the study topic. The chapter begins with a summary of the study, followed by discussions on the major findings and finally draws conclusions based on the results in chapter four.

5.2 Summary
The purpose of this study was to determine effects of transfer pricing on revenue leakage in Kenya. The specific objectives of the study were: to determine the inadequacies of transfer pricing rules in Kenya; effects of transfer pricing on revenue generated and to evaluate the challenges that are brought about by implementing transfer pricing guidelines. The study adopted descriptive research design. The target population consisted of 35 employees working at the international tax office at Kenya Revenue Authority. Out of the total 35 questionnaires distributed for the survey, 34 were filled and returned indicating a 97% response rate. The response rate was therefore adequate and excellent for data analysis. Statistical Packages for Social Sciences (Ver.22) was used for data analysis and the findings were presented in form of pie-charts, frequency tables. In addition, inferential statistics including regression and correlations analysis were employed on the data collected and this was vital in making sense of the data. Correlation analysis was done to assess the relationship between the variables and to test if the model fits the data.

The study established that majority of the employees at the Kenya Revenue Authority were female at 53% while male employees were 47% of the sample size. Regarding employee representation in the research, the study established that senior level management was 9%, middle level management was 3%, supervisory level management was 50% and finally, lower cadre employees were 38%. Thus, management representation was well distributed. Regarding the level of work experience the employees have within the organization, those who had worked between 16-20 years were 12%, those who had rendered their services between 11-15 years were 6%, those who had served the firm between 5-10 years were 47% and finally, employees who had served the Authority for less than 5 years were 35%. It is therefore evident that most of the employees had worked for the Kenya Revenue Authority for between 5-10 years.
Concerning the first research objective aimed at addressing the inadequacies of transfer pricing rules at the Kenya Revenue Authority, the study found out that most of the employees agreed with the statements contained in the questionnaire such as the use of arm’s length principle based on OECD guidelines, adjustments made by the taxman based on transfer prices between multinational and acknowledging the fact that there were a lot of inadequacies in the implementation of transfer pricing.

Regarding the second research objective which focused on the effects of transfer pricing on revenue generated, the study found out that there was statistically strong relationship between transfer pricing and revenue generated. Most employees agreed with this contention for instance, tax havens create opportunities for multinational entities to device transfer pricing practices, low tax jurisdictions encourage creative transfer pricing schemes, lack of permanent establishment in Kenya lead to revenue leakage and existing OECD principles were adequate in addressing transfer pricing transactions.

On the third and final research objective which focused on transfer pricing rules and challenges that are brought about by the implementation of transfer pricing guidelines, most of the respondents agreed on the following: there is need to tighten OECD transfer pricing guidelines, transparency of related parties’ transactions lead to exposure of sensitive information of multinational entities, erosion and profit sharing was aggravated by differences in tax rules in various jurisdictions, unavailability of adequate resources acted as a barrier to deal with capital flight and base erosion in Kenya and courts have inadequate skills, knowledge or experience to deal with transfer pricing cases.

5.3 Discussions

5.3.1 Inadequacies of Transfer Pricing Rules in Kenya

The first objective was to understand the inadequacies of transfer pricing rules in Kenya. The adoption and use of arm’s length principle based on OECD guidelines attracted 62% support by the respondents. Transfer pricing disputes have been catalyzed by the fact that their regulations, interpretation of the arm’s length principle and methodologies used vary from one country to another and as a result, disputes have increased between tax authorities and multinationals. According to Fjelstad, (2013), transfer pricing and arm’s length principle have been used to point out some of the problems associated with transfer pricing.
Tax authorities face difficulties in gathering taxpayers’ information due to the non-existence of documentation requirements and lack of ability to enforce existing requirements. Regarding adjustments made by the taxman based on transfer prices between multinationals, 82% of the respondents agreed while the remaining disagreed. According to OECD (2010), arm’s length principle is determined by analyzing several factors including expected benefits to the firm. Such benefits include multinationals adopting a high cost structure. According to Mbiuki (2011), arm’s length range is a range of figures that is satisfactorily suitable and agreeable in determining whether the conditions of a controlled transaction are at arm’s length and that are derived either from applying the same transfer price method to multiple comparable data or from applying different transfer price methods. On this point, uncontrolled transaction is a transaction which is monitored to ensure payment of arm’s length price for goods and services.

To answer the question regarding absence of detailed transfer pricing guidelines being a factor affecting revenue collection, 88% of the respondents agreed while the remaining disagreed. On the recommendations of amendments on transfer pricing regulations where 94% of the employees agreed, they were also asked if there exist globally recognized transfer pricing rules appropriate for developing countries such as Kenya. 56% of the respondents agreed. On the issue of transfer pricing information and lack of ability to enforce existing requirements affected revenue collection, 82% of the respondents agreed that there is lack of requirements enforcement on the transfer pricing and if there has been an administrative burden in determining the arm’s length price in controlled transactions, 83% agreed. On whether there has been implication on revenue collected because of lengthy court litigations, 85% of the employees agreed. This is consistent with Mbiuki (2011) who argued out that the court in that famous Unilever case endorsed the use of the OECD guidelines in the absence of detailed guidelines from the Kenya Revenue Authority. He further adds that there is difficulty to regulate transfer pricing in Kenya and in other developing nations.

On whether there is sufficient expertise to recognize the key issues in transfer pricing, 65% of the employees agreed, regarding argument that transfer pricing legislations in Kenya has significantly reduced firm profit, 47% of the employees agreed. This is consistent with a research done by Lohse and Riedel (2013) on the assessment of whether and to what extent transfer pricing are efficient in limiting international profit sharing behavior among 26 European countries. This study established that transfer pricing legislations significantly
reduced enterprises profit. In her findings, relative to countries without transfer pricing legislations, implementation of transfer price documentation regimes reduced profit shifting behavior by around fifty percent on average. This meant that the application of transfer pricing legislations together with tightening of transfer pricing documentation requirements induces declines in profit shifting behavior. From the study findings it clear that legislations influence profitability. However, most of the respondents were not quite sure hence disagreed with the contention that legislation reduces profit.

5.3.2 Effects of Transfer Pricing on Revenue Generated in Kenya

Regarding the second objective to test the relationships between transfer pricing and revenue generated, 74% of the employees strongly agreed while 20% agreed that tax havens create opportunities for multinational entities to device transfer pricing practices. About whether tax havens make it difficult for the Authority to monitor transfer pricing practices, 56% of the respondents strongly agreed while 41% agreed. With respect to whether low tax jurisdictions encourage creative transfer pricing schemes, 50% strongly agreed whereas 47% agreed. This is in line with Sikka (2010) who asserts that mobilization of transfer pricing for tax avoidance or tax evasion is largely vague to the public and is often challenging and expensive for regulatory authorities to detect. Transfer pricing is a complex game involving numerous players such as accountants, consultants, lawyers, governments, tax authorities and multinational agencies, NGOs and other stakeholders involved in creating and revising rules of the game about which methods of calculating prices is acceptable and developing and detecting ways of manipulating or sabotaging these rules and techniques. As regards to whether the unrestricted use of transfer pricing techniques affects revenue generation in Kenya, 29% of the workforce strongly agreed while 56% agreed. As to whether increase in tax revenue can be attributed to increase in audit and compliance on transfer pricing transactions, 35% strongly agree while 24% agreed.

To address the question on whether high penalties imposed on evaded tax deter multinational corporations from practicing transfer pricing, 47% of the respondents disagreed while 9% strongly disagreed. On whether tax penalties imposed by the Authority on multinationals operating in Kenya are adequate, 35% of the respondents disagreed while 29% strongly disagreed. On whether lack of permanent establishment in Kenya led to revenue leakage, the response was 21% strongly agreed while 53% agreed. As to whether e-commerce is a threat to revenue leakage, 62% of the workforce strongly agreed whereas 32% agreed. A study conducted by Basu (2008) asserted that Governments were losing
millions in tax revenue through the penetration of e-commerce within their jurisdictions. Tax authorities are finding it increasingly difficult to stop this revenue loss. According to Wagdy (2002), tax authorities consider ecommerce as a threat to revenue leakage hence they are hard pressed to ensure integrity of their tax system to seal loopholes of tax avoidance or tax evasion. Tax authorities are concerned that the development in communication resulting to instant transmission of information has made it more difficult to identify and quantify cross border transactions therefore making it harder for them to apply internationally accepted transfer pricing methods to e-commerce.

Finally, with regards to whether the existing OECD principles are adequate in addressing transfer pricing transactions, 35% of the respondents disagreed while 35% were uncertain. The findings show that there is a strong positive correlation between transfer pricing and revenue generated. The transfer pricing is statistically significant predictor of revenue generated by the Authority.

5.3.3 Challenges in Implementing Transfer Pricing Guidelines

There was a positive relationship between transfer pricing and challenges brought by the implementation of transfer pricing guidelines. As to whether there was need to tighten OECD transfer pricing guidelines, 32% of the respondents strongly agreed whereas 50% agreed. This was consistent with Onsando (2007) who noted that most parts of the world are faced with challenges associated with weakness of the OECD transfer pricing. This therefore calls for innovation as a way of curbing some of these weaknesses regarding whether there are measures that can be put into place to overcome the challenges in implementing transfer pricing, 35% of the workforce strongly agreed and 65% agreed. On whether there is need for the Authority to agree on conditions for determining transfer prices of transactions, 9% of the employees strongly agreed and 68% agreed. On whether the transparency of related parties’ transactions led to exposure of sensitive information of multinational entities, 6% of the employees strongly disagreed while 47% disagreed. Concerning whether loopholes in the legal instruments and framework fueled abuse of tax laws governing transfer pricing, 35% of the respondents strongly agreed while 50% agreed. Developing nations face well formulated legal framework to enforce transfer pricing and sanction non-compliance and misconduct (PwC, 2012).

As to whether base erosion and profit shifting is aggravated by differences in tax rules in various jurisdictions, 44% of the Authority’s workforce strongly agreed and 38% agreed.
Tax Authority can lose revenue when there is an interaction of different tax rules from two or more jurisdictions, which can lead to either double taxation or less than single taxation. Brauner (2013) describes this by the term base erosion. This draws back to the issue of Transfer pricing and enforcing of the arm’s length principle.

As to whether the unavailability of adequate resources acted as a barrier to deal with capital flight and base erosion in Kenya, 32% of the respondents strongly agreed while 50% agreed. To answer the question on whether building staff capacity on transfer pricing can reduce revenue leakage, 56% of the workforce strongly agreed and 27% agreed. It is important to note that only a few members of staff at the Authority are experienced with matters on transfer pricing. In addition, there exist no databases which can allow members of tax authorities to extract information for the purposes of verification (PwC, 2012).

On whether there is significant cost implication to the Authority in developing transfer pricing capacity, 15% of the respondents strongly agreed whereas 50% agreed. To address the issue of whether the Kenyan courts have adequate skills, knowledge or experience to deal with transfer pricing cases, 38% of the employees strongly disagreed and 56% disagreed. There was a strong positive correlation between transfer pricing rules and challenges that are brought by implementing transfer pricing guidelines.

Using the analysis of variance, the study established that transfer pricing was statistically significant as a predictor of challenges that are brought about by implementation of transfer pricing guidelines. The model shows that transfer pricing rules affects the implementation of transfer pricing rules. Many enterprises and multinationals shy away from double taxation since it affects their bottom-line because of price adjustments by tax authorities, especially when doing cross-border transfer of goods and services. This should be resolved through Advance Pricing Agreements as earlier noted (Paudice, 2014). Many jurisdictions have implemented strict penalty regimes that encourage taxpayers’ compliance with these new procedures.

Multinational enterprises are faced with a myriad of challenges in preparing documentation to demonstrate compliance with transfer pricing rules across the globe in accordance with the expectations of each jurisdiction continue to grow. Most countries/territories have now established documentation rules that require companies to state clearly and with supporting evidence why their transfer pricing policies comply with the arm’s- length standard. Many of the world’s major tax jurisdictions have established aggressive audit teams to review
compliance with these requirements and are exhibiting a new-found willingness to pursue transfer pricing adjustments through administrative appeals procedures and even litigation. Non-compliance comes with a significant risk of being assessed with material adjustments and penalties.

5.4 Conclusions

5.4.1 Inadequacies of Transfer Pricing Rules

Transfer pricing rules have not adequately addressed the complexities of transfer pricing and appear to have been adopted without considering their suitability and adaptability to the Kenyan market. The inadequacies in the legal framework governing transfer pricing has made it easy for multinational corporations to take advantage of the existing loopholes to deny the host country (Kenya) its fair share of revenue generated from its local operations. The existing transfer pricing legislation further lacks clarity and gives rise to uncertainty that tends to be a hindrance in implementing transfer pricing policies in Kenya.

5.4.2 Effects of Transfer Pricing on Revenue Generated

The study concluded there was strong relationship between the revenue generated by the tax authority and transfer pricing. The research also identified that the variables do not fully explain the changes in the reported revenues generated and this means that there are other factors that explain the changes in the reported revenues generated. These other factors for instance include inflation levels, foreign direct investments, compliance levels, prevailing tax rates among others. Finally, it can be concluded that multinational corporations utilize their global organizational structures to minimize the reported revenues from certain jurisdictions while declaring more revenue in other jurisdictions.

5.4.3 Challenges in Implementing Transfer Pricing Guidelines

The Revenue Authority is faced with challenges when executing transfer pricing legislations owing to the dynamic and complexity of cross border transactions. It involves extensive gathering of information which is often time consuming and multinational entities may not be willing to share all their related parties transactions due to exposure of sensitive information. Given the global nature of transfer pricing, it is imperative to develop internationally shared principles to help each nation fight profit shifting by multinational entities while at the same time limiting the risk of double taxation of those profits. This can best be achieved through use of arm’s length principle. The government should come up
with a clear law or legislation on transfer pricing that will protect tax revenue while not hindering foreign direct investment and cross-border trade.

5.5 Recommendations

5.5.1 Recommendation for Improvement.
5.5.1.1 Inadequacies of Transfer Pricing Rules

From the study findings, it is evident that the country has to raise part of its taxes from the area of transfer pricing which has shown to have loopholes for revenue leakage. Therefore, there is a need to align transfer pricing rules to international best practices so as to cater for cross border transactions and ensure that multinational entities are aware how their profits and incomes will be treated. It is equally essential for Kenya Revenue Authority to increase tax compliance levels by enforcing the laws through conducting assessments and audits of transfer pricing on companies that fail to comply with the rules.

5.5.1.2 Effects of Transfer Pricing on Revenue Generated

From the findings, there exists a relationship between transfer pricing and revenue generated by Kenya Revenue Authority. The study recommends for a holistic approach to be used to properly address the issue of revenue generated by KRA especially on matters pertaining to transfer pricing. Government actions should be comprehensive to deal with all the different aspects of the transactions involving related parties both revenue and expense transactions by multinational corporations so that the authority can generate more revenue.

5.5.1.3 Challenges in Implementing Transfer Pricing Guidelines

Transfer pricing presents numerous tax, legal and operational challenges to both the Revenue Authority and multinational entities. The magnitude of uncertainties as well as the potential commitment of management time to successfully defend a transfer pricing scrutiny is an undesirable business risk to MNEs. From the research findings, it will require the Revenue Authority to invest much on training employees who are working at the international tax office on transfer pricing issues. It further needs to work closely with other revenue authorities from across the world for best practices. There is also a need for taxpayers to avail information regarding their organizational management and reporting structures to KRA so as promote transparency, which deters practices such as transfer pricing within the domestic market.
5.5.2 Recommendations for Further Studies

The research recommends that a future study should focus on examining the best international practices that can be adopted by KRA that have been found to be effective and efficient in eliminating uncertainties and loopholes brought about by transfer pricing. There is also a need to strengthen the existing legal framework governing transfer pricing in Kenya in line with international best practices. KRA further needs to invest more in building staff capacity to equip employees with the necessary skills to enable them detect and deal with complex matters on transfer pricing.
REFERENCES


Harris, L.R., & Brown, G.T. (2010). Mixing interview and questionnaire methods: Practical problems in aligning data.


PricewaterhouseCoopers (PwC). (2011). *Transfer pricing and developing countries*. PwC.


APPENDICES

APPENDIX 1: COVER LETTER

Lizzie Waruguru Njoroge
P.O BOX 14634 - 00800
Nairobi
Dear Respondent,

RE: REQUEST FOR YOUR PARTICIPATION IN MY ACADEMIC RESEARCH PROJECT

I am a student currently pursuing a course towards conferment of Master of Business Administration (MBA) from United States International University – Africa.

In partial fulfilment of the requirements of the award of the degree, I am conducting a research project on the assessment of the implementation of transfer pricing and its role on revenue leakage in Kenya. In this regard, you have been selected to participate in this study and your participation will be highly appreciated.

The research project is targeting internal auditors who are involved in auditing transfer pricing cases. Kindly complete all sections of the questionnaire to enable me to complete my research project.

Please note that the information you provide will be treated as confidential and will only be used for the purpose of this research.

Yours Sincerely,

Lizzie Waruguru Njoroge
APPENDIX 2: QUESTIONNAIRE

This research is a partial fulfillment for the requirement for the degree of Masters in Business Administration (MBA). The purpose of this study is to examine the assessment of the implementation of transfer pricing and its role on revenue leakage in Kenya for the period 2013-2017. Please note that any information you give will be treated with utmost confidentiality and will never be used for any other purpose other than for this project. Your cooperation and participation will be highly appreciated. I look forward to your swift response.

SECTION A: BIO DATA

Kindly answer all the questions either by ticking in the boxes or writing in the spaces provided.

1. Gender? Male ☐ Female ☐

2. Age Group?
   - Below 30 years ☐
   - 31-40 years ☐
   - 41-50 years ☐
   - Above 51 years ☐

3. What is your current position?
   - Senior level management ☐
   - Supervisory level ☐
   - Middle level management ☐
   - Officer level ☐
   - Other (Specify): ____________________________

4. Education
   - Certificate/Diploma ☐
   - Masters ☐
   - Bachelor’s Degree ☐
   - PhD ☐
   - Other (Specify): ____________________________

5. How many years have you worked for this organization?
   - Less than 5 years ☐
   - 5-10 years ☐
   - 11-15 years ☐
   - 16-20 years ☐
   - Above 20 years ☐
SECTION B: THE INADEQUANCIES OF TRANSFER PRICING RULES/REGULATIONS IN KENYA

Kindly indicate the extent to which you agree or disagree with the following statements where 1 - Strongly Disagree, 2 - Disagree, 3 - Uncertain, 4 - Agree, 5 - Strongly Agree. Please (✔) tick appropriately on a scale of 1-5.

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<tr>
<th></th>
<th>Strongly Disagree</th>
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<th>Uncertain</th>
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<td>1</td>
<td>Do you think Kenya has fully adopted the use of Arm’s Length Principle based on OECD Guidelines?</td>
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<td>2</td>
<td>Have there been any adjustments made by the taxman based on Transfer Prices between multinational enterprises?</td>
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<td>3</td>
<td>Has the absence of detailed transfer pricing guidelines affected revenue collection?</td>
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<td>4</td>
<td>Would you recommend amendments / improvements on Transfer Pricing Regulations?</td>
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<td>5</td>
<td>Are existing globally recognized Transfer Pricing rules appropriate for developing countries such as Kenya?</td>
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<td>6</td>
<td>Is the difficulty faced in gathering Transfer Pricing information and lack of ability to enforce existing requirements affected revenue collection?</td>
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<td>7</td>
<td>Has there been an administrative burden in determining the Arm’s Length Price in controlled transactions?</td>
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<td>Is there an implication on revenue collected as a result of lengthy court litigations?</td>
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<td>9</td>
<td>Is there sufficient expertise to recognize the key issues in Transfer Pricing?</td>
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<td>10</td>
<td>Has Transfer Pricing legislations in Kenya significantly reduced profit shifting behavior by multinational enterprises?</td>
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SECTION C: THE EFFECTS OF TRANSFER PRICING ON REVENUE GENERATED IN KENYA.

Kindly indicate the extent to which you agree or disagree with the following statements where 1- Strongly Disagree, 2- Disagree, 3- Uncertain, 4- Agree, 5- Strongly Agree. Please (✔) tick appropriately on a scale of 1-5.

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<th>Statement</th>
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<tr>
<td>1</td>
<td>Do tax havens create opportunities for multinational entities to device Transfer Pricing practices?</td>
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<td>Do tax havens make it difficult for Regulatory Authority to monitor Transfer Pricing practices?</td>
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<td>Do low tax jurisdictions encourage creative Transfer Pricing schemes?</td>
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<td>4</td>
<td>Does unrestricted use of Transfer Pricing techniques affect revenue generation in Kenya?</td>
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<td>5</td>
<td>Can the increase in tax revenue be attributed to increase audit and compliance on Transfer Pricing transactions?</td>
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<td>Do high penalties imposed on evaded tax deter multinational companies from practicing Transfer Pricing?</td>
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<td>7</td>
<td>Are the applied penalties for tax evasion by multinational companies in Kenya adequate?</td>
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<td>8</td>
<td>Has the lack of permanent establishment in Kenya lead to revenue leakage?</td>
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<td>9</td>
<td>Is e-commerce a threat to revenue leakage?</td>
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<td>10</td>
<td>Are the existing OECD principles adequate in addressing Transfer Pricing transactions?</td>
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**SECTION D: CHALLENGES OF IMPLEMENTING TRANSFER PRICING GUIDELINES**

Kindly indicate the extent to which you agree or disagree with the following statements where 1- *Strongly Disagree*, 2- *Disagree*, 3- *Uncertain*, 4- *Agree*, 5- *Strongly Agree*. Please (✔) tick appropriately on a scale of 1-5.

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<tr>
<td>1</td>
<td>Do you think there is need to tighten OECD Transfer Pricing guidelines?</td>
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<td>Are there measures that can be put into place to overcome the challenges and obstacles in implementing Transfer Pricing guidelines?</td>
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<td>Is there need for KRA and multinational enterprises to agree on conditions for determining Transfer Prices of transactions?</td>
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<td>4</td>
<td>Does transparency of related parties’ transactions lead to exposure of sensitive information of multinational entities?</td>
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<td>5</td>
<td>Have loopholes in legal instruments/framework fueled abuse of tax laws governing Transfer Pricing?</td>
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<td>6</td>
<td>Is base erosion and profit sharing aggravated by differences in tax rules in various jurisdictions?</td>
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<td>7</td>
<td>Has the unavailability of adequate resources acted as a barrier to deal with capital flight and base erosion in Kenya?</td>
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<td>8</td>
<td>Do you think building staff capacity on Transfer Pricing can reduce revenue leakage?</td>
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<td>9</td>
<td>Is there significant cost implication to KRA in developing Transfer Pricing capacity?</td>
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<td>10</td>
<td>Do you think the courts have adequate skills, knowledge or experience to deal with Transfer Pricing cases?</td>
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THANK YOU FOR TAKING YOUR TIME TO COMPLETE THE QUESTIONNAIRE