

**THE EFFECT OF TRANSFER PRICING ON TAX PLANNING FOR
MULTINATIONAL COMPANIES IN KENYA**

PRESENTED BY

BEATRICE KEBWARO

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DECLARATION

I declare that this project is my original work and has not been submitted for an award of a degree in any other university or Institution of Higher Learning for examination/academic purposes.

Signature:

..... Date:

BEATRICE KEBWARO

REG NO: D61/75967/2012

SUPERVISOR’S DECLARATION

This research project has been submitted for examination with my approval as the University Supervisor

Signature..... Date

.....

DR. ADUDA JOASH

DEAN,

SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

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DEDICATION

This project is dedicated to my Family members. My mother Anna, despite her lack of formal education, she supported and encouraged me throughout the entire period. My twin Boys Frank and Newton and husband with whom I would love to share my success with. My brothers, sisters and friends for the unending support both morally and socially and for all the encouraging words that kept me strong through the entire time of my project.

ABSTRACT

Taxation issues in Kenya have been a hot topic both in the government and in the private entities. Multinational organizations are operating in an environment of unprecedented complexity. The rising volume and variety of intercompany transactions and transfer pricing regulations, accompanied by increased enforcement activities worldwide have made transfer pricing a leading risk management issue for global businesses.

The government on one hand, is tirelessly working hard to uncover all the revenue leakage avenues devised by various businesses to shield themselves from paying taxes while the private sector on the other hand are aggressively engaging the knowledge of the experts in the effort to discover and embrace strategies to protect their revenues from heavy taxation. It emerges that whereas the Kenyan taxpayer diligently bears the heavy tax burden, foreign multinationals appear to get away with payment of taxes with ease. On that note, the Kenya Revenue authority is day in day out working so hard to come up with ways of raising revenues to meet the expenditure demands of the state and to hit the Budget targets.

Transfer pricing is a 20th century phenomenon which came as result of the 2005 Unilever case which evidenced a lack of the transfer pricing Rules. A transfer price is a price charged by a Company supplying goods/ Services to another related party or company. The related party can be a subsidiary, an associate or a joint venture.

The objective of this study was to establish the effect of transfer pricing on tax planning for Multinational companies in Kenya. The study adopted a descriptive study. The study used primary data gathered from a sample of Multinational companies based in Nairobi and its environs. The data was analyzed using SPSS providing various parameters to show the strength of the relationship between the variables under observation.

In summary, the results show indirect evidence that transfer pricing is one of the determinants of tax planning activity among others in MNCs. The study shows a positive relationship between the dependent (tax saved) and independent variables (transfer price adopted & the number of subsidiaries a multinational has). The outcome of this statistics is consistent with earlier studies of Kar and Cartwright-Smith (2008) that have linked transfer pricing practices with tax avoidance.

The recommendations of this study are that Transfer pricing presents many tax, legal and operational challenges. To many taxpayers the magnitude of uncertainties – including the potential commitment of management time to successfully defend a transfer pricing examination – is not an acceptable business risk therefore, The Kenya Revenue Authority should focus more on various tax planning mechanisms adopted by Multinational companies to avoid the revenue leakages of the state. In general conclusion transfer pricing has an effect on tax planning of companies.

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LIST OF ABBREVIATIONS

APA	Advance Pricing Agreements
CTCR	Country to Country Reporting
CPAs	Certified Public Accountants
ETRs	Electronic tax registers
ITA	Income Tax Act
KRA	Kenya Revenue Authority
MNEs	Multinational Enterprises
MNCs	Multinational companies
NGOs	Non-Governmental Organizations
OECD	Organization for Economic cooperation and Development
TP	Transfer Pricing
SPSS	Statistical package for social sciences
US	United States
UK	United Kingdom
VAT	Value Added Tax

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Understatement of income for tax avoidance purposes is a widespread phenomenon. This can be traced back to the works of Srinivasan (1972) who came up with a tax evasion model. He gave a formal analysis of the proportion of income understated derived as a function of the true income. He also argued that given the income distribution, a proportionate tax function in the absence of understatement of income, will yield larger expected revenue in the presence of optimal understatement of income. He finally considered the problem of optimal allocation of resources towards detection of resources towards detection of tax avoidance.

Sonja (2012) noted that MNCs frequently use their foreign operations to avoid income taxation, and ETRs capture this type of tax avoidance. For example, shifting income from a high-tax jurisdiction to a low-tax jurisdiction reduces a multinational corporation's worldwide ETR. The worldwide ETR is reduced because the denominator has remained constant (pre-tax accounting income has not changed), while the numerator is smaller (income taxes currently payable has decreased). In general, firms that avoid income taxes by reducing their taxable income while maintaining their financial accounting income will have lower ETRs, making ETRs a reasonable measure of effective tax planning

Jansky (2013) argued that the low level of tax revenues raised in developing countries is caused by a number of reasons. The existence of large informal sectors, high levels of poverty and the consequent inability of poorer citizens to pay taxes, the abuse of tax incentives (e.g tax holidays) to attract foreign direct investment, and tax avoidance and evasion by corporations and individuals can be identified as the most relevant causes, coupled with the existence of weak institutional capacity to expand the tax base and enforce taxpayers' compliance. Business advisers claim that transfer pricing continues to be, and will remain, the most important international tax issue facing MNEs. This is entirely plausible because transfer pricing enables corporations to minimize tax payments by enabling capital to be exported to more favorable locations.

According to the current OECD (2012) draft discussion paper proposes that there is need for a new two tiered approach to transfer pricing documentation based on the Master file and the Local file. Also, they want to come up with a model template for a country to country reporting (CTCR). The final draft planned to be completed (in June 2014) was likely to come up with a new chapter of transfer pricing guidelines. This would likely have a significant impact over the transfer pricing documentation rules enacted and enforced by various Tax Authorities. Therefore no dispute, TP is a current topical issue bothering many authorities.

It emerges that whereas the Kenyan taxpayer diligently bears the heavy tax burden, foreign multinationals appear to get away with payment of taxes with ease, contrary to Section 45 of the Anti-Corruption and Economic Crimes Act (2003) Traditionally, transfer pricing provisions in the law aimed at ensuring local subsidiaries that are part of a multinational operation pay their "fair" share of taxes. Indeed, according to Deloitte

(2007), the key consideration for multinationals when setting up operations internationally is how best to structure the group for purposes of tax planning.

US Internal Revenue Service(2007) suggest that in response to the uncertainty and risk to which corporations are exposed by transfer pricing, in almost all countries, there are possibilities of avoiding protracted disputes with tax authorities through Advance Pricing Agreements'(APA). These permit corporations and domestic and foreign tax authorities to agree on transfer pricing methods in advance of filing a tax return and thus avoiding considerable uncertainties and possible lawsuits. McKinley et al., (2003) in their study of the multinationals facing a high risk tax accounting, they concluded that no matter how small or aggressive the company is, transfer pricing could have a material impact on a company's financial statements. They recommended that all Certified public accountants (CPAs) should be aware of the implications transfer pricing could have on their client base.

1.1.1 Transfer Pricing

Mckinley (2003) describes a transfer price as the price charged between related parties in an intercompany transaction. Although intercompany transactions are eliminated when consolidating the financial results of controlled foreign corporations and their domestic parents, for tax purposes such entities are not consolidated and the transactions are therefore not eliminated. Transfer prices directly affect the allocation of group wide taxable income across national tax jurisdictions. Hence, a company's TP policies can directly affect its after-tax income to the extent that tax rates differ across national jurisdictions.

Garrison et al., (2008) defines transfer price as the price charged when one division or segment provides goods or services to other division or segment of an organization. Arrow (1970) describes transfer pricing as the value at which one company in a group of companies sells goods, services or intellectual property to another company within the same group. Needham (2013) noted that the tax reduction methods used by MNCs have been well known for decades. They include transfer pricing, the use of lower-tax jurisdictions, over-charging entities in higher-tax countries to reduce taxable profit and (legally) completing a transaction in a lower-tax country, different to the country which the business relates to. These actions have been significantly aided by the digital economy and a rise in the value of intangible assets e.g. brands. Tax law appears out of date compared to MNCs' business practices

Allain et al., (2010) suggested that transfer pricing adjustment between associated enterprises would entail VAT consequences. An increase or a decrease of the transfer price of a supply would obviously result in an additional consideration or a credit that should reflect the VAT treatment applied to the original supply.

1.1.2 Tax Planning

Hoffman (1961) introduced the principles and concepts of tax planning that are mostly applicable to tax practitioners. In the case of properly handled tax planning, much gain will be obtained if the process is conducted as a formalized procedure. Tax planning could benefit many tax payers but few are aware of its advantages. tax planning is the exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc., to reduce income and/or capital

gains. Tax planning is a broad term that is used to describe the processes utilized by individuals and businesses to pay the taxes due to local, state, and federal tax agencies. The process includes such elements as managing tax implications, understanding what type of expenses are tax deductible under current regulations, and in general planning for taxes in a manner that ensures the amount of tax due will be paid in a timely manner. A key focus of tax planning is to apply current tax laws to the revenue that is received during a given tax period. Tax planning aims at minimizing tax liability

Needham (2013) noted that there are many methods MNC employ for tax reduction purposes. For developed countries, the methods are well documented, although there is lack of reliable and consistent data. For developing countries these methods are less well understood. These methods revolve around shifting income from higher tax to lower or no tax countries. He described these methods of consisting: profit shifting strategy, Transfer pricing, corporate debt equity, payments for intangibles, shell holding companies, Hybrid entities, company specific tax rulings.

1.1.3 Transfer Pricing for Tax Planning

As noted by Jansky (2013), the adoption of profit-shifting strategies by MNCs is identified as one of the main causes of base erosion. Transfer pricing forms a significant portion of the tax planning strategies. According to the OECD (2012) report, abusive tax avoidance by MNCs raises serious issues of fairness and compliance. Transfer prices serve to determine the income of both parties involved in the cross-border transaction. The transfer price therefore tends to shape the tax base of the countries involved in cross-border transactions

1.1.4 Multinational Companies in Kenya

Hodgetts, et al., (1997), defines multinational businesses as firms having operations in a great deal more than one country, international sales, and nationality mix of managers and owners. Very large multinationals have budgets that exceed those of many small countries. Multinational Corporation is an enterprise operating in several countries but managed from one (home) country. Generally, any company or group that derives a quarter of its revenue from operations outside of its home country is considered a multinational corporation. Currently there are 213(as at 31 Dec 2012) Multinational companies registered in Kenya.

Tax planning in Multinational companies is seen from a corporate perspective as an integral part of business planning. Its scope and priorities depend on the business concepts and business models employed, the global footprints and value chain structures established as well as the tax management and tax risk approach chosen. It is also influenced by the company's legal structure and headquarters/holding parent (Kaeser et al., 2012)

1.2 Research Problem

Hoffman (1961) noted that it is essential for tax planners to note that tax planning could not be sustained for a long-term unless the tax planning activities are flexible i.e in the sense of a continuity of strategies. Therefore, tax planning strategies should be time-oriented and consistent in the sense that consistency requires that the past limit the present and the future but the present must be circumscribed in the light of the tax payer's future requirements (Hoffman, 1961).

Accounting firms are on one hand assisting tax payers in the development and legitimization of tax avoidance measures rather than portraying tax as a contribution to social development and a return on investment made by society to facilitate business activity. Tax experts argue that tax is a cost of doing business so, naturally, a good manager will try to manage this cost and the risks associated with it, and companies are constantly looking to save costs, and tax is a major cost. According to Offe (1984) he noted that for ideological reasons, the state has been largely excluded from direct involvement in capitalist production and plays a minor role in directing investment of private capital. Political processes have also encouraged the belief that the state can meet popular demands, provide social welfare, make investments in social infrastructures and deliver public goods. The private sector taxation is the major source of funds.

There have been some researches done in Kenya in the area of transfer pricing. Mbiuki (2011) examines 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. Nyamori (2012) in his study noted that Kenya introduced 2006 transfer pricing rules to provide guidance that govern TP law and policy. Amable (2012) focused on both legal and administration framework for addressing TP concerns in Kenya. Similarly Mwangi (2008) discussed the Kenyan law in regard to arm's length principle of TP and its applicability. He also evaluated the various methods of achieving the arm's length principle and its applicability. He found that regardless of the method applied in arriving at arm's length price, the decision is tax motivated.

The thread with most authors was a keen interest on the Finance and economics and a few on taxation aspects of transfer pricing. However little research has been done on the area of the effect transfer pricing has on tax planning for MNCs in Kenya. This study will focus more on the effect of Transfer pricing on tax planning for Multinational companies. This study addressed following research question; the effect of transfer pricing on tax planning for Multinational companies in Kenya.

1.3 Objective of the Study

The main objective for this study was to establish the effect of transfer pricing on tax planning for Multinational companies in Kenya.

1.4 Value of the Study

By virtue that TP is a relatively evolving concept globally, this study will contribute greatly to the existing literature and will be very valuable to the academic fraternity and form a basis for further research on transfer pricing.

This study will be of importance to a number of stakeholders. First to the investors and creditors, investors are motivated to invest in areas or regions that promise high returns for their investment. The creditors, who need assurance that their obligations will be met as and when they fall due.

With increase revenue targets by KRA to meet developments and repaying of state debts, this study matters to the income tax authorities, this is because they affect the taxes that it can levy upon corporate profits to finance public goods and thereby secure legitimacy.

The authorities will also seek to avoid any leakage of revenue through use of transfer pricing mechanisms that are likely to deny them of their revenue.

This study will also matter to company executives because in most cases their financial rewards are frequently linked to corporate earnings. The finance directors are directly involved in preparations of financial statements that reflect all the Intercompany transactions from which other stakeholders can obtain information.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The purpose of this chapter was to review three theories of taxation and tax avoidance. This chapter reviewed the benefit theory of taxation, the ability to pay theory of taxation and also the optimal taxation theory. It also reviewed some empirical studies that have been done on the area of transfer pricing. It also reviewed a few published articles that are relevant to the research topic. This paper draws attention to various stakeholders on the effect of transfer planning on tax planning. This study did not build on any existing theory but to increase awareness on the effect of transfer pricing on tax planning for Multinationals and also to contribute to the academic literature.

2.2 Theoretical Review of the Study

2.2.1 The Benefit Theory of Taxation

Under the benefit theory, tax levels are automatically determined, because taxpayers pay proportionately for the government benefits they receive. In other words, the individuals who benefit the most from public services pay the most taxes. In analyzing the benefit approach, two models were put forward: the Lindahl model and the Bowen model. According to Lindahl's model, it is assumed that production of social goods is linear and homogenous. This means that different tax payers will pay different proportions for the cost of services and equilibrium will only be reached on a voluntary exchange basis. In Bowen's model, there is more operational significance since it demonstrates that when

social goods are produced under conditions of increasing costs, the opportunity cost of private goods is foregone. The advantage of the benefit theory is the direct correlation between revenue and expenditure in a budget. It approximates market behavior in the allocation procedures of the public sector. (Musgrave, 1999)

The advantage of the benefit theory is the direct correlation between revenue and expenditure in a budget. It approximates market behavior in the allocation procedures of the public sector. However, the benefit theory has difficulties: It limits the scope of government activities, Government can neither support the poor nor take steps to stabilize the economy, Applicable only when beneficiaries can be observed directly (impossible for most public services). Taxation in accord with the benefit principle would leave distribution of real incomes unchanged. (Musgrave, 1999)

2.2.2 The Ability to Pay Theory

The ability-to-pay approach treats government revenue and expenditures separately. Taxes are based on taxpayers' ability to pay. Taxes paid are seen as a sacrifice by taxpayers, this raises the issues of what the sacrifice of each taxpayer should be and how it should be measured. For Equal sacrifice, the total loss of utility as a result of taxation should be equal for all taxpayers (the rich will be taxed more heavily than the poor). For Equal proportional sacrifice, the proportional loss of utility as a result of taxation should be equal for all taxpayers. For Equal marginal sacrifice, the instantaneous loss of utility (as measured by the derivative of the utility function) as a result of taxation should be equal for all taxpayers. This will entail the least aggregate sacrifice (the total sacrifice will be the least). (Musgrave, 1999)

The most popular and commonly accepted principle of equity or justice in taxation is that citizens of a country should pay taxes to the government in accordance with their ability to pay. It appears very reasonable and just that taxes should be levied on the basis of the taxable capacity of an individual. For instance, if the taxable capacity of a person A is greater than the person B, the former should be asked to pay more taxes than the latter. It seems that if the taxes are levied on this principle as stated above, then justice can be achieved. But our difficulties do not end here. The fact is that when we put this theory in practice, our difficulties actually begin. The trouble arises with the definition of ability to pay. The economists are not unanimous as to what should be the exact measure of a person's ability or faculty to pay (Musgrave, 1999).

2.2.3 Optimal Taxation Theory

Tulkens et al., (1971) argued that, there is no tax evasion whatsoever. One conclusion which is classic is that to promote an efficient allocation of resources taxes should be levied primarily on commodities that are inelastic in demand or supply. In particular, it seems to be widely agreed that an income tax is the best means by which to effect a redistribution of incomes if labor is perfectly inelastic in supply. This conclusion stands in obvious need of modification if it is realized that an income tax probably offers much larger opportunities for tax evasion than commodity taxes do. The policy tools available to the government for the purpose of counteracting the tendency to evasion are the tax rates themselves, the penalty rates and the expenditure on investigation, which determines the probability of being detected.

Slemrod et al., (1987) noted that a standard exercise in optimal taxation theory is to describe the tax system that minimizes these costs, or to describe the tradeoff between these costs and the distribution of welfare in the society. In the presence of avoidance and evasion, a broader concept of efficiency cost is needed.

2.3. Review of Empirical Studies

2.3.1 International Empirical Evidence

Several studies have identified the creative use of transfer prices, especially the adjustment of import and export prices that shifts profits from higher tax locations to more desirable locations. The Chinese government's official website stated that, Tax evasion through transfer pricing accounts for 60 percent of total tax evasion by multinational companies. A 2007 survey by the National Bureau of Statistics claimed that almost two thirds of apparently loss-making foreign enterprises had deliberately made false reports and used transfer pricing to avoid paying 30 billion Yuan (US\$4.39 billion) in taxation (Christensen & Murphy, 2004).

China has beefed up its anti-avoidance and transfer pricing regulation and has also become more aggressive in its transfer pricing investigations. The tax authorities reported that before 2005 they investigated around 1,500 cases of transfer pricing annually, but after introducing aggressive audits the figure fell to about 300 cases and yielded additional tax revenue of around 460 million Yuan (Christensen & Murphy, 2004).

Dyreng et al., (2008) in investigating the firm's ability to avoid taxes over a long period of time using a dataset of 2077 U.S. firms for the period 1995 until 2004. The researchers

found a significant fraction of firms that could avoid corporate taxes for the 10-year period. This finding is explained as a long term tax avoidance which might be triggered by management actions in avoiding tax. Firms may be involved in tax planning for a long period but may be limited if the motivation for such activities is based on tax law ambiguities.

Sikka (2010) argued that the mobilization of transfer pricing for tax avoidance, and sometimes evasion, is largely invisible to the public and is difficult and expensive for regulatory authorities to detect. There is indeed a complex game involving numerous actors – corporations, accountants, lawyers, consultants, governments, tax authorities, multinational agencies (e.g. OECD), NGOs and others engaged in establishing and revising the rules of the game with regard to which method(s) of calculating prices is acceptable, and also developing and detecting ways of manipulating, escaping or subverting these rules and methods. As means of enhancing divisional, segmental, product and global profits, the unimpeded use of transfer pricing matters to stock markets as earnings, dividends, share prices and return on capital are all affected. By engaging in transfer pricing planning from day one, the company and its multinational group may be able to take advantage of the tax holiday to shift a supportable level of profit to reduce the multinational group's worldwide tax cost. Reducing taxes is attractive to corporations as it boosts shareholder value, post-tax earnings and returns to shareholders, increases company dividends and executive rewards as these are linked to reported earnings. MNCs are focused on transfer pricing strategies. As a consequence of their implications for taxation, transfer prices are significant not only for the evaluation of performance of corporate divisions, subunits, departments and subsidiaries.

Transfer pricing is a well-established topic in accounting textbooks, but the use of transfer pricing to avoid taxes and shift capital has attracted little sustained interest. The burgeoning corporate social responsibility literature is largely silent on the role of transfer pricing in tax avoidance and the flight of capital (Christensen & Murphy, 2004).

Section 172 of the UK Companies Act 2006 requires directors to promote the success of the company for the good of the shareholders as a whole, and in that process have regard for the interests of other stakeholders (e.g. the environment, customers, suppliers, employees and community), i.e. the interest of other stakeholders are subordinated to the pursuit of shareholder wealth maximization. To this end, companies sharpen their competitive advantage by developing new products, services and niches and also squeeze a variety of stakeholders to deliver and increase shareholder value (Kennedy, 2000).

On the End to End as a new strategic approach to TP management, Governments around the globe are focused on transfer pricing enforcement as a preferred method of augmenting tax collections, leading to more aggressive tax and transfer pricing audits for multinational corporations. The prerogative for decision making only exists where there are alternatives to choose from. The transfer pricing scenario is not any different. Though there are several bases from which transfer prices are determined, some authors have concluded that whatever the transfer pricing method management may apply is actually a variation of actual full cost, standard full cost, or Market-based transfer price the ultimate objective for Transfer pricing is the same. (Feinschreiber,2004).It was stated that, revenues are derived from taxation based on wages, savings, profits and consumption, which in turn depend on the activities of the private sector. Since the liberal state's revenues and its survival depends upon the long-run development of the private sector, its

policies are devised to stimulate and sustain economic growth through the expansion of capital by using a variety of contradictory measures, including subsidies, tax shelters, tax incentives and sweeteners such as export subsidies, loans, guarantees and insurances. As rational economic actors corporations exploit these opportunities to maximize their after-tax global income (Emmanuel, 1999).

The darker side of transfer pricing has attracted the attention of NGOs for example, Global Witness, (2005) Action Aid(2009) Christian-Aid (2008, 2009), and non-accounting literatures for example, Baker(2005); Brittain-Catlin (2005) Kar and Cartwright-Smith (2008) have linked transfer pricing practices with tax avoidance, capital flight and poverty. They have even been joined in this by some institutional investors (Henderson Global Investors, 2005a, 2005b). Borkowski (1997) argues that developing countries are highly vulnerable to the use of transfer pricing for tax avoidance and flight of illicit capital (but their ability to check aggressive practices is often handicapped by the lack of financial resources and consequently the possibilities of hiring expert labor to scrutinize corporate practices more closely (Plasschaert, 1985; Christian-Aid, 2008).

In contrast, the role of transfer pricing in tax avoidance, capital flight and its social implications receives little attention in the accounting literature. Indeed, in the accounting literature, there is a deafening silence on the involvement of accounting techniques in widening social inequalities and limiting the resources available for public goods. In contrast, we have placed transfer pricing at the heart of conflicts over the allocation of resources that involve corporations, stock markets, company executives, business advisers and the state. Transfer pricing practices, were argued that they articulate competing claims on economic surpluses in the shape of corporate earnings, rates of

return, dividends, executive rewards, taxes, social welfare rights and the ability of states to provide public goods (Tippett and Wright, 2006; Sikka et al., 2007).

International Monetary Fund (IMF) states that globalization of trade creates problems for national tax authorities deriving from the potential use and abuse of transfer prices by the multinationals, including on loans, the allocation of fixed costs, and the valuation of trademarks and patents. Many tax administrators believe that some of these enterprises manipulate these prices to move profits from jurisdictions with high tax to those with low rates (Tanzi, 2000). Evidence suggests that intra firm trade prices appear to be influenced by the tax-minimization strategies of multinational firms. According to Clausing (2003) there is a tendency for corporations to boost post-tax earnings by reporting higher taxable profits in countries where taxes are lower (Weichenrieder, 1996).

Transfer pricing rules and the arm's length model were first introduced in Russia in 1999. Some of the issues have been given visibility by the trade in oil and gas which are major contributors to the Russian economy. In early 2004, a World Bank report stated that the country's oil and gas exports accounted for 25% of the country's GDP rather than 9% reported in the official data. The major reason for the discrepancy was that corporations exploited a variety of tax loopholes, engaged in transfer pricing including creating a series of on and off-shore trading companies to purchase oil at low cost from production sites and then sell it back again through intermediaries (Ahrend, 2004).

It was noted that World Bank officials stated that many large Russian firms benefit from transfer pricing by employing trading companies to avoid taxation. Companies sell their products to trading subsidiaries at below-market prices; these trading subsidiaries then

sell the product to the end customer at market prices and pocket the difference. Typically shell companies are registered in remote regions and some simply disappear soon after they have concluded as many transactions with end customer as possible (Ruehl&Schaffer, 2004). It was noted that, Russian oil priced for sale internally at US\$10 a metric ton was sold to an exporter's foreign subsidiary at \$10 a metric ton and then resold to foreign buyers at the market price of US\$120 a metric ton, with the profits being booked and retained at external companies. A report by the Russia's Audit Chamber noted that 80% of the coal exported from Russia is sold through offshore entities. The trading companies registered offshore accumulate significant coal revenues as Russian producers sell to them at a discount of 30-54% to global prices. As a result companies avoid taxes because profits are not booked in Russia (Baker, 2005).

India has become a hub for the service industry. Many IT, pharmaceutical and financial services multinational companies have located research and labor-intensive operations in India to take advantage of cheaper labor and local technology. Such activities are controlled from external locations and multinationals provide global advice and infrastructure in return for service agreements and royalty charges. After scrutinizing the transfer pricing practices of over 1,000 companies, the Indian tax authorities demanded additional taxes from 250 companies, including Bank of America, Citibank, Coke, Standard Chartered Bank, American Express Bank, Hero Honda, Johnson & Johnson, H Lever, Microsoft, Samsung and Sony (Sikka, 2010).

In evidence of the US Inland Revenue Service (IRS) stated that taxpayers shift significant profits offshore by manipulating the price of related-party transactions so that the income of an economic group is earned in low-tax or no-tax jurisdictions, rather than the U.S.,

thus reducing the enterprise's worldwide income tax liability. The Transfer of Intangibles and Transfer Pricing issues present significant compliance challenges in the multinational corporate/enterprise tax administration arena. The level of the non-compliance is likely to increase (Eversen, 2006).

2.3.2 Local empirical evidence

Kinuthia (2014) highlighted the following controversies in the effectiveness of Transfer pricing in developing countries: should Kenya adopt an OECD model in setting transfer pricing rules and regulation or it should adopt the UN model? In cases of proof of double taxation by multinationals hence a need for adjustments, which country should compensate the Multinational Company? In terms of comparability, there is an insufficient African focused database hence how will Kenya compare with the developed countries data?

Mutua (2012) in his study of transfer pricing management strategies by MNEs concluded that there is an increased level of tax compliance enforcements where KRA would be forced to conduct TP audits and assessments on MNEs that fail to comply with the rules. He noted that KRA has not imposed penalties to companies without TP policies and recommended that there is need for MNE to understand what TP means. He also recommended that increased awareness should be done on the effects of the levels of intercompany transactions with related companies. Mutua recommended a need to establish how performance management is measured in MNEs either it depends on the levels of sales or otherwise.

In Kenya, transfer pricing arrangements are regulated by section 18(3) of the income tax act (ITA) in 2006 which states that "...where a non-resident person carries on business with a related resident person and the course of the business is so arranged that it produces to the resident person no profits or less than the ordinary profits which might be expected to accrue from that business if there had been no such relationship, then the gains or profits of that resident person from that business shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's Length (Income tax act 2006). In the Tax audit procedures beyond the requirement to produce documentation in support of the application of the arm's-length principle, the TP rules do not contain any guidance to taxpayers as to what they may expect in connection with a transfer pricing investigation, and nothing is known of such guidance communicated internally within the KRA. However, the KRA appears to be taking guidance on transfer pricing from the OECD Guidelines. (OECD, 2012)

According to the PWC (2013) report, it was indicated that the KRA is currently requesting transfer pricing documentation from all taxpayers with cross-border-related-party transactions with the intention of risk profiling them for the purpose of conducting transfer pricing audits. All multinationals are potential targets for a transfer pricing audit. They recommended that multinationals should take transfer pricing seriously and develop and maintain properly documented and defensible transfer pricing policies. Kenyans may be losing billions of shillings through well-connected dodgy tax deals involving multinational corporations. Through transfer pricing, the foreign firms avoid taxes, denying the country the much-needed revenues for development

According to a study done by Kinuthia (2014) in India alone in the periods 2001 to 2011 from audits done, there was an adjustment of \$10B to the revenue authority and on average 54% of the cases have TP adjustments. In China, for the period 2006-2010 the tax recovered from the TP audits amounted to \$7.3B. In U.K in the period 2007-2012 TP audits have led to a tax recovery of £4,684M. He noted that TP has been growing over the years and is still growing to most African countries. The challenge is that TP rules have been on draft for long in African countries e.g in Tanzania they have been on draft for over 50years in 2014.

As the introduction of the TP rules in Kenya is fairly recent; the KRA is still in the process of developing capacity to conduct TP audits. It is expected that in the coming years a significant number of transfer pricing adjustments will be made as the KRA will become more experienced and capable of conducting transfer pricing audits. In its other recent developments, From a country perspective, the Government has embarked on the enhancement of the capacity of the KRA in terms of staff skills in the area of transfer pricing, not only for the purposes of keeping abreast of emerging tax planning trends, but also to ensure that adequate measures are put in place to address tax avoidance whenever it arises. The companies had used TP mechanisms to declare losses that effectively disqualified them from remitting taxes. Most of the suspect transactions involved companies and their subsidiaries that operate in tax havens that do not charge tax or whose tax rates are much lower than the 30 per cent tax on income charged in Kenya(Kar et al.,2010).

2.4 Chapter Summary

The area of taxation planning and specifically transfer pricing has attracted many researchers in the recent past. Various studies across the globe have been done on the research topic, various articles have been published with supportive evidence that transfer pricing has an impact on tax planning for both MNC and to the state. From the various international studies, local studies and publications, it is evident that the area of transfer pricing is and will remain a hot topic for both Multinational companies, revenue authorities and to the international tax experts.

Multinationals on one hand aiming at maximizing investor value and the revenue authorities on the other hand working towards maximizing the state revenues. Locally, some studies have been done on implications of transfer pricing methodologies to Financial reporting as well the economics associated with TP. However, there have been minimal documented researches on the area of the effect of Transfer pricing on tax planning for Multinational companies. This will be a focus for this study.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter provides a discussion of the research methodology that was used in the study. It discusses the research design especially with respect to the choice of the design. It will covers on the population of the study, sample and sampling techniques, data collection methods as well as data analysis and data presentation methods that were employed in the study in order to attain the research objectives.

3.2 Research Design

This study adopted a descriptive research design. This approach was appropriate for this study as it described the effect transfer pricing has on tax planning for multinational companies. The purpose of the research design was to ensure that the evidence obtained from the study was to enable us answer the initial research questions as unambiguously as possible. Research design deals with a logical problem but not a logistical problem (Yin, 1987).

The study used regression analysis to find the relationship between transfer pricing in terms of transfer price and number of subsidiaries and the tax planning in terms of the tax saved. Regression was used to distinguish the relationship between parameters to be measured and the dependent variables using statistical package of social sciences (SPSS)

3.3 Population

The target population in the study was the Multinational companies registered in Kenya. Data available from KRA (2012) reveal that there were 213 MNCs in Kenya. Due to the constrained resources, this study focused on 64 MNCs operating in Nairobi. This population will be relevant for this study since it will provide the necessary information needed for the research topic.

3.4 Sampling

Sampling is a means of choosing a representative group of the population to help in testing for particular characteristics to infer to the entire population. The sampling frame for this study was obtained from the listing of multinational companies as at year 2012. The sample consisted of 45 multinationals operating in Nairobi County in various sectors of the economy. The sample forms 21.13% of the population. Since most of the Multinational companies operate in two industries i.e commercial and service, Industrial & allied. Data was sampled from those sectors. This was to ensure adequate representation of all multinational companies.

3.5 Data Collection

This study relied on both Primary and secondary data. The primary data was collected through self-administration of Questionnaires (a sample is attached as Appendix I). The questionnaire was split into two sections. Section one focused will test on general information of the respondents in form of personal and company information. The second section focused on the specific questions on Transfer pricing and Tax planning. The

questionnaire adopted both structured and unstructured questions based on the research objectives.

3.6 Data Analysis

The study used inferential statistics using statistical package for social sciences (SPSS). Data was analyzed by applying Pearson's correlation analysis and a multiple regression analysis. The use of multiple regression analysis was to investigate effect of two independent variables on the one dependent variable. Content analysis was also be used to analyze qualitative data. The findings were presented using tables, percentages, means and variance analysis. This was to give a clear picture of the research findings at a glance.

The following analytical model was used in analyzing the relationship between the dependent and independent variables

$$Y = b_0 + b_1X_1 + b_2X_2$$

Where

b_0 is a constant,

b_1 is the first regression coefficient

b_2 is the second regression coefficient

X_1 is the transfer price as an independent variable measured by the price charged to subsidiaries/associates

X_2 is the is number of subsidiaries/associate companies as a control variable

Y is the Tax saved as a dependent variable

To come up with the regression model, the dependent and independent variables were determined by type of data to be collected. The variables of interest were: the transfer price and the number of subsidiaries to measure transfer pricing and the tax saved to measure tax planning.

3.6.1 Test of Significance

Test for significance of regression in case of multiple linear regression analysis was carried out using the ANOVA. The test was used to check if a linear statistical relationship exists between the dependent variable and at least one of the predictor variables. Dependent variable was tax saved and predictors (constants) were transfer price and number of subsidiaries. R is the correlation coefficient which shows the relationship between the study variables. Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable.

3.7 Data Validity and Reliability

The data was controlled for validity and reliability by engaging or collecting data from respondents of relevant departments that are likely to be informed on the research topic. Examples of these are the finance directors and managers for Multinational companies. Tax experts were engaged since they have a wide and international knowledge on the research objectives.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND INTERPRETATIONS

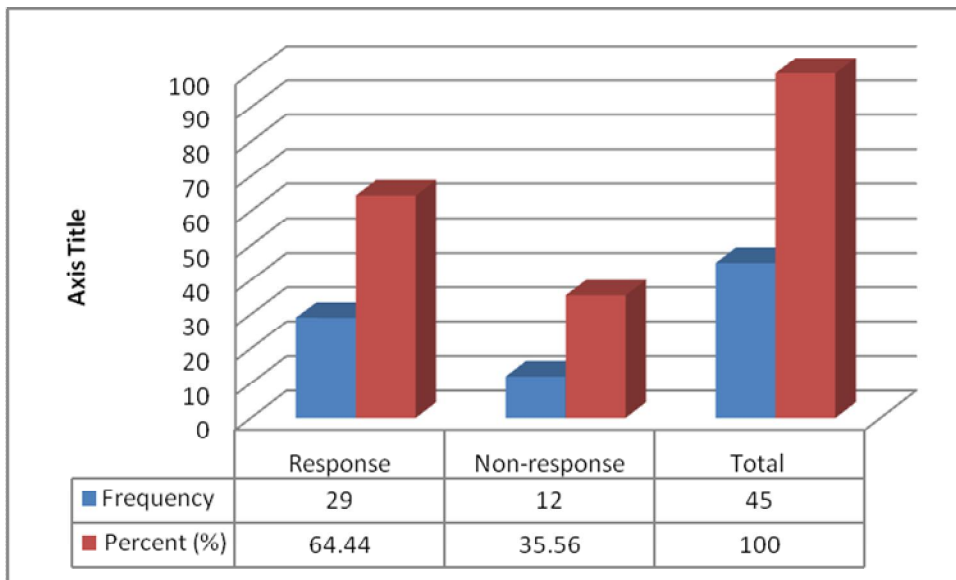
4.1 Introduction

In this chapter, the study provided two types of data analysis; namely descriptive analysis and inferential analysis. The descriptive analysis helps the study to describe the background information of the organizations as the relevant aspects of the phenomena under consideration and provide detailed information about each relevant variable. For the inferential analysis, the study used the Pearson correlation, the data regression analysis and the t-test statistics.

4.2 Response rate

A total of 45 questionnaires were distributed to multinational firms in Nairobi. Out of the 45 questionnaires, 29 were returned. This represents a response rate of 75%. According to Mugenda and Mugenda (1999), 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 also collaborates Bailey (2000) assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very good. This means that the response rate for this study which was 64.44% was good and therefore enough for data analysis and interpretation. This percentage was considered sufficient for this study. The 35.56% who never returned the questionnaires cited busy schedules as the main reason for lacking time to fill them.

Figure 1: Response rate



Source: Research findings 2014

4.3 Findings

From the findings 69% of the respondents agreed that they understand what transfer pricing is with 79.4% of them agreeing that they understood what transfer pricing rules. 83% of the respondents strongly agreed that the transfer price set by a company affect intercompany transactions with related parties with 86.2% of them strongly agreeing that the Transfer prices affect the level of sales/profits achieved by the company. 83.4% of the respondents agreed that companies understate its revenue for tax purposes. 78.4% of the respondents agreed that the intercompany transactions were also found to be based on mutually accepted intercompany agreements between most multinational companies 71.8% of the respondents agreed that performance management is based on the level of sales and profits. Lastly 29% of the respondents strongly disagreed that their companies have been reporting losses due to high costs allocated by the other related parties. As

noted by Jansky (2013), the adoption of profit-shifting strategies by MNCs is identified as one of the main causes of base erosion. From the findings, it is evident that Transfer pricing forms a significant portion of the tax planning strategies.

4.3.1 Descriptive statistics

The study also evaluated the statements of transfer pricing techniques. A 5-point Likert scale was developed, where 1= strongly disagree, 2= Disagree, 3=Not sure, 4=Agree and 5=strongly agree; as per the questions. To this effect respondents were asked to affirm to their opinion on the range of issues asked, as illustrated in table 4.1 below

Table 4.1: Transfer pricing and tax planning

	Mean	Standard deviation
1) I understand what transfer pricing is	3.45 (69%)	1.047
2) I understand what transfer pricing rules are	3.97 (79.4%)	0.734
3) The transfer price set by a company affect intercompany transactions with related parties	4.15 (83%)	1.301
4) The intercompany transactions are based on mutually accepted intercompany agreements	3.92 (78.4%)	0.802

5) Performance management is based on the level of sales& profits	3.59 (71.8%)	1.024
6) Transfer prices affect the level of sales/profits achieved by the company	4.31 (86.2%)	0.802
7)The parent company determines the profit allocation in each subsidiary	3.26 (65.2%)	1.027
8) the company understates it revenue for tax purposes	4.17 (83.4%)	0.734
9) The company has been reporting losses due to high costs allocated by the other related parties	1.45 (29%)	0.597

Source: Research findings 2014

According to the analysis of the findings most of the respondents agreed that they understand what transfer pricing is with a mean of 3.45 and a standard deviation of 1.047. They also went ahead to agree that they understood what transfer pricing rules are with a mean of 3.97 and a standard deviation of 0.734.

The finding of the study indicated that most of the respondents strongly agreed that the transfer price set by a company affect intercompany transactions with related parties with a mean of 4.15 and standard deviation of 1.301 and also that Transfer prices affect the level of sales/profits achieved by the company (4.31) and that the company understates it revenue for tax purposes (4.17). The intercompany transactions were also found to be based on mutually accepted intercompany agreements between most multinational companies as indicated by a mean of 3.92 and a standard deviation of 0.802. The

respondents also agreed that performance management is based on the level of sales and profits (3.59).

The findings of the study indicated that most of the respondents were neutral on the point that the parent company determines the profit allocation in each subsidiary with a mean of 3.26 and a standard deviation of 1.027. Lastly most of the respondents strongly disagreed that their companies have been reporting losses due to high costs allocated by the other related parties with a mean of 1.45 and a standard deviation of 0.597. As noted by Jansky (2013), the adoption of profit-shifting strategies by MNCs is identified as one of the main causes of base erosion. Transfer pricing forms a significant portion of the tax planning strategies.

4.4 Pearson's Correlation Coefficient Analysis for transfer price, number of subsidiaries and tax saved

In this section, the study measured the degree of association between the transfer price set and the tax saved and also the relationship between the number of subsidies and the tax saved. From the priori stated in the previous chapter, a positive relationship is expected between the measures of transfer pricing and the measures of tax planning. Table 4.2 presents the correlation coefficients for all the variables considered in this study.

Table 4.2: Correlation coefficient

The table below shows the correlation coefficient matrix of the predictor variables.

	transfer price	number of subsidiaries/as	Tax saved
Transfer price	1		
Number of subsidiaries/associate	0.8345	1	
Tax saved	0.8507	0.8679	1

Source: Research findings 2014

The study in table 4.2, show that all the predictor variables were shown to have a positive association between them at a significant level of 0.05 and hence included in the analysis. There was strong positive relationship between transfer price set and number of subsidiaries/associates (correlation coefficient 0.8345), Tax saved and transfer price (correlation coefficient 0.8507), and lastly between tax saved and number of subsidiaries/associate (correlation coefficient 0.8679). This implies a possibility of Multi linearity hence this means there could be other factors that explain the tax planning phenomenon. This could form part of a recommendation for further research on the factors that affect tax planning.

4.5 Regression Results

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.918(a)	.843	.805	.51038

Predictors: (Constant), transfer price and number of subsidiaries/associates

Dependent Variable: Tax saved

Source: Research findings, 2014

Analysis in table 4.3 shows that the coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R^2 equals 0.843, that is, transfer price and number of subsidiaries/associate explains 84.3% of observed change in tax planning. The P- value of 0.000 (Less than 0.05) implies that the regression model is significant at the 95% significance level.

4.5.1 Analysis of Variance (ANOVA)

The researcher sought to compare means using analysis of variance.

Table 4.4: Analysis of Variance (ANOVA)

	Sum of Squares	df	Mean Square	F	Sig.
Regression	.852	4	.213	1.242	.000
Residual	20.35	119	.171		
Total	22.64	123			

Predictors: (Constant), transfer price and number of subsidiaries/associates

Dependent Variable: Tax saved

Source: Researcher 2014

ANOVA findings (P- value of 0.00) in table 4.4 show that there is correlation between the predictors' variables (transfer price and the number of subsidiaries /associates) and response variable (Tax saved).

4.5.2 Regression coefficients

The table shows the results of the regression coefficients required to form the multiple regression models.

Table 4.5: Regression coefficients

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	0.903	0.123		7.367	0.000
Transfer price	0.056	0.028	0.158	2.021	0.045
Number of subsidiaries/associates	0.047	0.028	0.147	1.686	0.093

a. Dependent Variable: Tax saved

From the Regression results in table 4.5 above, the multiple linear regression model finally appear as

$$Y = 0.903 + 0.056 TP + 0.047NS$$

The multiple linear regression models indicate that all the independent variables have positive coefficient. The regression results above reveal that there is a positive

relationship between dependent variable (Tax saved) and independent variables (transfer price and number of subsidiaries/ associates). From the findings, one unit change in transfer price results in 0.056 units increase in Tax saved. One unit change in Number of subsidiaries/associates causes 0.047 changes in Tax saved.

The t statistics helps in determining the relative importance of each variable in the model. As a guide regarding useful predictors, we look for t values well below -0.5 or above +0.5.

4.6 Summary and Interpretation of Findings

The findings indicate that price variation of a product for interrelated parties has an implication on the amounts of taxes saved for multinational companies. This implies that most multinational companies shift costs to jurisdictions with higher taxes and revenues to jurisdictions with lower tax rates. This is in the aim of reducing the tax burdens born by the Multinational companies.

From the correlation results, the transfer price has a strong positive relationship with the Tax saved of +0.85. This implies that the tax saved by multinational companies can be explained by the transfer price adapted to its subsidiaries or joint ventures. The amount of tax saved can also be partly explained by the number of subsidiaries a company has. It was evident that those multinational companies with many subsidiaries tend to save more on taxation compared to those with few subsidiaries. Therefore, the study findings show that, the analysis of the transfer price of the product it implies that multinational companies consider cost very crucial in transfer pricing along departments as a motive for profit maximization.

In relation to tax rates, tax minimization may indeed play a role in transfer pricing decisions made by firms, as firms appear to make substantial price adjustments to changes in country tax and tariff rates as indicated by majority.

From the study findings they agree with the studies of by Jansky (2013) who noted that the adoption of profit-shifting strategies by MNCs is identified as one of the main causes of base erosion. Transfer pricing forms a significant portion of the tax planning strategies.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The study aimed at to establish the effect of transfer pricing on tax planning for Multinational companies in Kenya. The findings of the study 83% of the respondents strongly agreed that the transfer price set by a company affect intercompany transactions with related parties with 86.2% of them strongly agreeing that the Transfer prices affect the level of sales/profits achieved by the company. 83.4% of the respondents agreed that companies understate its revenue for tax purposes. The study further sought to determine the extent to which numbers of subsidiaries/associates of Multinational Corporation in Kenya affect tax planning. Form the findings most of the respondents indicated that most of the subsidiaries and associates usually make an independent decision but depending on their number it affects the tax planning of the MNCs.

This implies that the transfer price adopted by the Multinational Company has a significant effect on the tax planning of the group. From the findings, it is evident that subsidiaries and associates usually make an independent decision but depending on their numbers it affects the tax planning of the MNCs. From the correlation matrix in table 4.2, there is strong positive relationship between transfer price set and number of subsidiaries/associates (correlation coefficient 0.8345), Tax saved and transfer price (correlation coefficient 0.8507), and lastly between tax saved and number of subsidiaries/associate (correlation coefficient 0.8679).

5.2 Conclusions

From the findings above, it can be concluded that transfer prices affect the Tax planning of Multinational companies. Transfer pricing enables interrelated parties shift revenues from high tax jurisdictions to low tax jurisdictions. Transfer pricing in most cases has been taken as a tax avoidance mechanism adopted by multinational companies.

This study agrees with the prepositions of Sikka (2010) who argued that the mobilization of transfer pricing for tax avoidance, and sometimes evasion, is largely invisible to the public and is difficult and expensive for regulatory authorities to detect. There is indeed a complex game involving numerous actors – corporations, accountants, lawyers, consultants, governments, tax authorities, multinational agencies. Further majority also agreed that some countries recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits. Further majority of the respondents also agreed that obtaining information across borders is cumbersome since international relations between countries differ.

This research was motivated by several factors such as few empirical researches relating the transfer pricing effect on Tax planning, methods, goals and factors affecting the transfer pricing choice in Kenya among unlisted companies. The study also concludes that managers are not sufficiently involved in setting transfer prices which means it remains a prerogative of the board.

5.3 Recommendations Policy and Procedure

From the study findings it's evident that if the country has to raise its revenues from taxation then the area of transfer pricing has shown to have a loophole for revenue leakages. Therefore, there is an increased need for the level of tax compliance.

From the study findings it's evident that if the country has to raise its revenues from taxation then the area of transfer pricing has shown to have a loophole for revenue leakages. Therefore, there is an increased need for the level of tax compliance enforcements where KRA would be forced to conduct TP audits and assessments on MNEs that fail to comply with the rules. As concluded by Christensen & Murphy, 2004 that tax evasion through transfer pricing accounts for 60 percent of total tax evasion by multinational companies. The results for Kenya could be surprising if aggressive TP audits can be effectively done.

From the study findings, the management of Multinational companies are insensitive to the ability of internal factors to influence transfer pricing decision and would rather pursue other goals rather than the ones explicit in transfer pricing.

Most Multinational companies have got the Transfer pricing documentation which they claim guide them in the transfer pricing decisions. Given that the nature of transfer pricing decisions across borders is proving to be complex, it will be appropriate for the Kenya Revenue authority with the help of the international tax experts to review all those

documentations to ensure that they can highlight areas that are likely to create the loophole for tax evasion and amend as appropriate.

Transfer pricing presents many tax, legal and operational challenges. To many taxpayers the magnitude of uncertainties – including the potential commitment of management time to successfully defend a transfer pricing examination is not an acceptable business risk.

It will also require the KRA to invest much on Training expertise on the transfer pricing issues as most of them may be practising in the field but they actually do not fully understand on what they need to focus on.

5.5 Limitations of the study

From the questionnaires filled some companies were holding some information since they thought that by responding to the questionnaire they would be exposing themselves to their competitors and the tax authority.

From the study some companies didn't fill the questionnaires since they felt that sharing such information is not in line with their group policy. This had an effect on the coverage of the companies and the response rate for adequate representation of the Multinational companies.

In some companies the employees did not fully understand the concept of transfer pricing and some felt intimidated by the questions asked. Transfer pricing presents many tax, legal and operational challenges. To many taxpayers the magnitude of uncertainties – including the potential commitment of management time to successfully defend a transfer pricing examination – is not an acceptable business risk.

From the research findings, it will also require the revenue authorities and Multinational companies to invest much on training expertise on the transfer pricing issues. This is likely to cost companies a lot of money which some of them could not be ready to spend.

5.6 Areas of further research

This study focused only on the effect transfer pricing has on tax planning. This study was not exhaustive as there are other factors that explain the tax planning of a company.

Therefore, there is need for further research undertaken on other factors like environmental and social political factors which may affect the operations of Multinational companies in Kenya.

There is also need to study on how the regulations of the Multinational companies affect the tax authorities. The study focused on the effect transfer price set by MNCs has on the tax saved by the Multinational companies. There are other forces that are equally important to determine the transfer pricing mechanisms improvised and adopted by the MNC by fact that they are operating in the environment whereby the politics of the country determines the business operations. Therefore other studies should focus on how politics of a country affect the tax planning of Multinational companies.

Since the APAs allow taxpayers to proactively achieve greater certainty via advance agreements on their transfer pricing methods with one or more tax authorities. Tax experts like Deloitte have experience with the APA process which spans the entire history of all the national programs. Their historical knowledge of how to achieve successful results helps companies manage their transfer pricing issues particularly the risk of double taxation on a prospective basis. Therefore there is need to establish on how these

Advance pricing agreements are arrived at and how far multinational companies are complying with them.

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APPENDICES

APPENDIX I: QUESTIONNAIRE

THE EFFECT OF TRANSFER PRICING ON TAX PLANNING FOR MULTINATIONAL COMPANIES IN KENYA

This questionnaire is designed to collect information on the effect transfer pricing has on tax planning for Multinational companies in Kenya.

The information obtained will be used for academic purposes only. Confidentiality of the information and the respondents will be highly observed.

This questionnaire will be completed by the Financial Manager or a person in similar roles.

SECTION 1: GENERAL INFORMATION

- 1) Name (optional)
- 2) Name of the Company.....
- 3) Holding company and country head
office).....
- 4) Industry of the company(please tick one)
Agriculture () Energy and petroleum () commerce and service ()
industrial and allied ()
- 5) Total number of subsidiaries/associate companies.....

SECTION 2: TRANSFER PRICING AND TAX PLANNING

Please indicate the extent to which you agree or disagree with the below statements. The scale of 1-5 will be used where 1=Strongly agree 2= Agree 3=Neutral 4= Disagree & 5=Strongly disagree

	Strongly agree	Agree	Neutral	Disagree	Strongly Disagree
1) I understand what transfer pricing is					
2) I understand what transfer pricing rules are					
3) The transfer price set by a company affect intercompany transactions with related parties					
4) The intercompany transactions are based on mutually accepted intercompany agreements					
5) Performance management is based on the level of sales & profits					
6) Transfer prices affect the level of sales/profits achieved by the company					

7)The parent company determines the profit allocation in each subsidiary					
8) the company understates it revenue for tax purposes					
9) The company has been reporting losses due to high costs allocated by the other related parties					

- a) What is the price of product A in Ksh. (one of your products) in the Local market (Kenya)?
- b) How much do you charge in ksh for product A above(a) to your subsidiary (please name the Subsidiary)
- c) The price charged to the subsidiary is
 - I. Higher than in Kenya
 - II. Same as Kenya
 - III. Lower than in Kenya
- d) How do rate the tax rate in the country of location of your subsidiary in (b) above with that of Kenya?
 - I. Higher than in Kenya
 - II. Lower than in Kenya
 - III. Equal to that of Kenya

Thank you.

APPENDIX II: LIST OF MULTINATIONAL COMPANIES

Company	Industry
BlackBerry Ltd	Commerce and service
Cisco Systems	Industrial and allied
Coca Cola	Commerce and service
General Electric	Industrial and Allied
GSM Association	Commerce and service
Heineken	Commerce and service
Huawei	Commerce and Service
IBM	Industry and allied
Intel Corporation	Industrial and allied
Kaspersky Lab	Commerce and industry
LG	Commerce and service
Pfizer	Industry and Allied
Rockefeller Foundation	Commerce and

	service
Sony	Industry and Allied
Toyota	Industrial and allied
Scania AB	Industrial and Allied
RTI International	Industrial and allied
Sage Group	Commerce and service
British American Tobacco (BAT),	Industrial and allied
Nestle Kenya,	Commerce and service
Weetabix East Africa Limited	Industrial and allied
Bata Shoe Company	Industry and allied
Cadbury East Africa	Industrial and allied
NSN (Nokia Simens Network)	Commerce and service
Erickson	Commerce and service