The basic law governing transfer pricing in Kenya is contained in section 18(3) of the Income Tax CAP, 470. It is based on the arms length principle. This section is expressed in general terms and therefore difficulty to apply. To remedy the defect, the Income tax (Transfer Pricing) rules of 2006 were issued. The rules set out methods to be employed in arriving at arm’s length price or margin for transactions between a Kenyan party and a related party in another tax jurisdiction.

The rules borrow heavily from the OECD Transfer Pricing guidelines of 1955. These guidelines are comprehensive and are widely used by both OECD and non OECD members. Specifically; Kenya applies the guidelines as soft law to augment its transfer pricing rules. The OECD Transfer Pricing guidelines were crafted for developed economies experiencing a different set of circumstances from those of Kenya. As a taxation tool, the guidelines have been applied with a lot of challenges, sometimes resulting to unwarranted loss of revenue.

It is against this backdrop that it was found necessary to examine the extent to which OECD Transfer Pricing guidelines are applicable in the Kenya’s tax legal regime. To achieve this, this study identifies parts of the Guidelines that are difficult to apply, and the useful parts not yet incorporated in the Kenya’s tax legislation. Appropriate recommendations are then made to the relevant authorities for a possible legislation change. The methodology applied in the study included the use of secondary data gathering and to a lesser extent structured oral interviews.

The findings of the study are that although the OECD Transfer Pricing guidelines are globally accepted for transfer pricing, certain aspects of it cannot be applied in Kenya due to its economy’s unique circumstances.