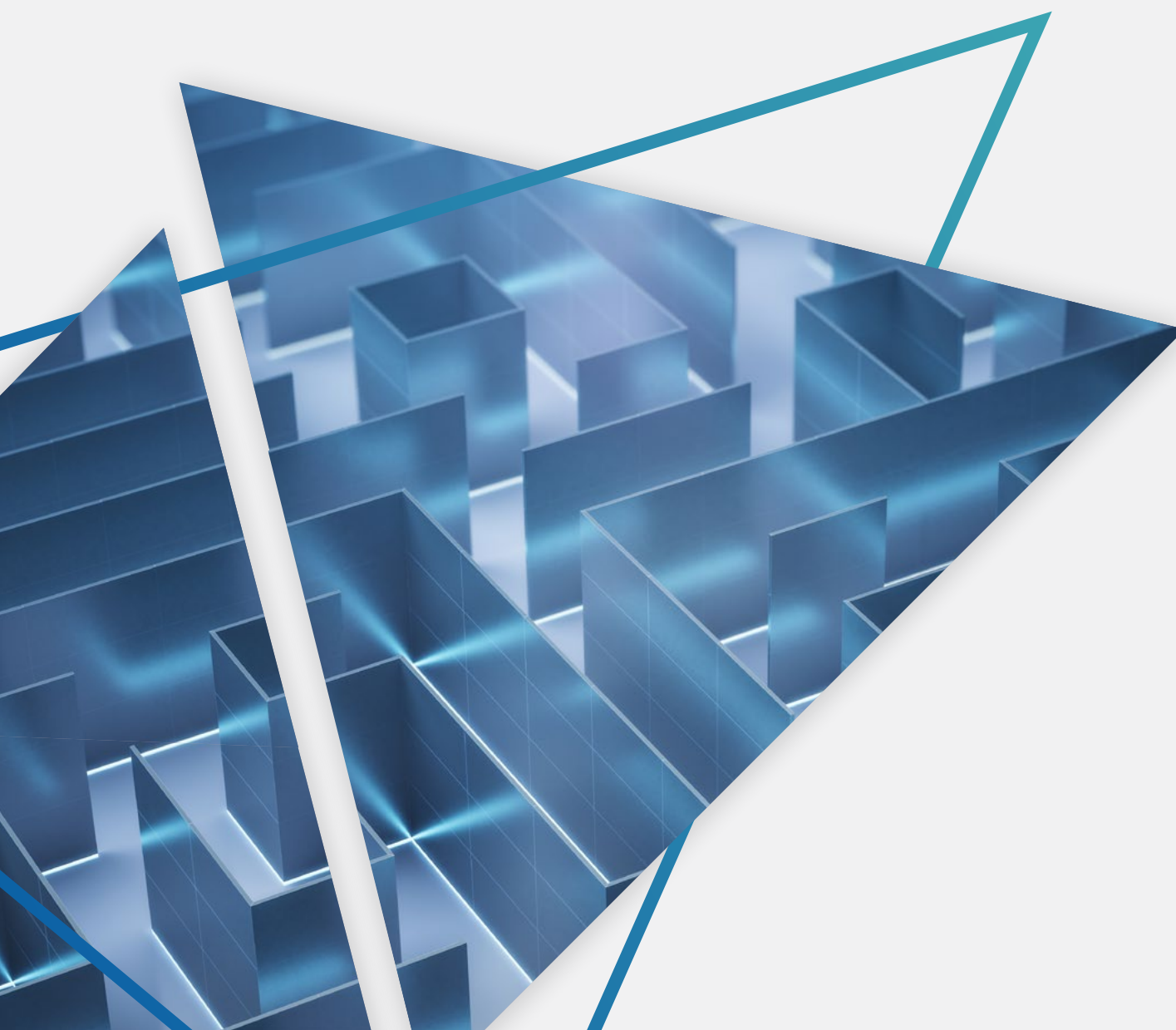


Tax & Exchange Control

ALERT | 18 July 2024



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KENYA

Only eat your share of the baguette:
An analysis of the recent High
Court decision on withholding tax
on management and professional
fees under the Kenya-France DTA



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Only eat your share of the baguette: An analysis of the recent High Court decision on withholding tax on management and professional fees under the Kenya-France DTA

On 4 July 2024, the High Court in *Commissioner of Domestic Taxes v Total Kenya Limited* (Income Tax Appeal E044 of 2021) determined that withholding tax on management and professional fees is not payable in Kenya under the Kenya-France Double Tax Agreement (DTA). This decision arises from an appeal lodged before it by the Commissioner of Domestic Taxes, following a similar finding by the Tax Appeals Tribunal (TAT) in TAT Appeal 151 of 2016 (Consolidated with Tax Appeal 16 of 2017).

Facts

Total Kenya Limited (TKL), is a wholly owned subsidiary of Total Outre Mer (TOM), a company resident in France. In the course of its business of selling petroleum, TKL entered into a technical assistance agreement with TOM for the provision of technical and general assistance services. Following an audit of TKL's affairs between 2011 and 2015, the Commissioner of Domestic Taxes (Commissioner) found that TKL did not withhold taxes on the fees paid to TOM as consideration for the technical services received. This was followed by an assessment on the basis that the payments to TOM were subject to withholding tax as they fell within the category of "other income" under Article 21(4) of the DTA. In response to TKL's objection, the Commissioner upheld its assessment, prompting an appeal to the TAT, which determined that management and professional fees qualified as business profits within the meaning of the DTA and as TOM did not have a permanent establishment in Kenya, TKL was not obligated to withhold tax from the payments made for the technical services received.

Appeal to the High Court

Aggrieved by the finding of the TAT, the Commissioner lodged an appeal at the High Court contending that the TAT erred in law and fact in finding that the professional fees paid to TOM constituted business profits, which are provided for within Article 7 of the DTA.

The Commissioner relied on Article 7(7) of the DTA, which states that the provisions of Article 7 cannot affect other articles that permit the collection of tax on incomes which form part of a business' profits. It argued that Article 21(4) of the DTA gave Kenya the right to withholding tax on the technical fees. The Commissioner was also of the view that technical fees form part of the income rather than the profits of a business. As such, France retained taxing rights over the business profits while Kenya could impose withholding tax on the technical fees.

TKL on the other hand urged the court to dismiss the appeal on the basis that the commentary to Article 7 of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention provides that income derived from professional services is now dealt with under Article 7 of the OECD Model Tax Convention.

The court's analysis and determination

The High Court agreed with the findings of the TAT that income from management and professional fees fall under business profits, not taxable under the DTA in the absence of a permanent establishment in Kenya. It was guided by the definition of the term "business" under the Income Tax Act Cap 470, together with commentaries to the United Nations and OECD Model Tax Conventions, particularly in

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terms of the effect of the deletion of Article 14 of the OECD Model Tax Convention, which gave taxing rights in respect of management and professional fees to the source state.

On the Commissioner's argument that management and professional fees fall under Article 21, the court found this argument not to be tenable as this article was intended for "miscellaneous income" rather than management and professional fees. It highlighted the examples of such income as stated in the commentary and noted that management and professional fees could not fall within a similar category.

It is important to note that the High Court's determination herein is in tandem with the practice in other jurisdictions. For instance, in *Bangkok Glass Industry Limited v Assistant Commissioner of Income Tax* [2013] 2015 Taxman 116 (Mad), the Indian court found that technical fees could not be classified under Article 22 of the India-Thailand DTA which covered "other income". This decision also aligns with the earlier determination of the TAT in *McKinsey & Co Inc. Africa Proprietary Limited v Commissioner of Legal Services & Board Co-ordination* (TAT Appeal No. 1999 of 2020) which also assigned the treatment of management and professional fees under the Kenya-South Africa DTA as business profits taxable in South Africa, based on the absence of a permanent establishment in Kenya.

Importantly, the High Court ruled that if Kenya wished to allocate itself taxing rights under the DTA, it should have made express provisions for the same as it has in DTAs with other countries.

Commentary and conclusion

This decision is monumental as it gives guidance on tax disputes that may emanate from certain cross-border transactions. It also mirrors international best practices when it comes to the treatment of management and professional fees in a source state where there is a DTA in place.

Along with the decision by the TAT in the *McKinsey* case, it is evident that Kenya can only claim a right to withholding tax on cross-border management and professional fees where the DTA expressly states so. In the absence of such a clause, Kenya cannot lay claim to a bigger chunk of the tax revenue it is otherwise entitled to from a cross-border transaction by asserting that such income can be classified as "other income" and therefore be chargeable to withholding tax in Kenya.

Lena Onyango and Judith Jepkorir

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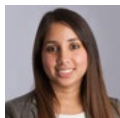
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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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