

KENYA TAX RESIDENCY DETERMINATION UNDER MANAGEMENT AND CONTROL;

THE CASE OF NAIVAS KENYA LIMITED -VERSUS- COMMISSIONER OF DOMESTIC TAXES, TAX APPEAL NO.934 OF 2022

A. INTRODUCTION

On 4th August 2023, the Tax Appeals Tribunal in ascertaining the tax residence of companies incorporated in Mauritius relied on the judicial interpretation under English Law for the term “management and control” to conclude that in management and control, the main aspect considered are the key people managing the Company at the time.

B. FACTS OF THE CASE

In respect of the referenced case, the brief facts of the case were as follows. The Naivas Group had adopted the following structure in terms of their shareholding; -

Gakiwawa Family Investments (GFI) held 68.5% of shares in Naivas International Limited (NIL). Both GFI and NIL were incorporated in Mauritius.

On the other hand, NIL held 100% shareholding in Naivas Kenya Limited (NKL), a company duly registered in Kenya.

It was noted that GFI subsequently sold 30% of its stake in NIL to Amethis Retail at Kshs. 5.2 billion leading to the dispute the subject of the Appeal.

C. DISPUTE

The Commissioner of Domestic Taxes charged income tax on the sale proceed made by GFI, a company incorporated in Mauritius to Amethis Retail, at the rate of 30%. The demand in respect of the said amounts was however issued to NKL as and issued a as the tax representative of GFI for purposes of corporate tax assessment of **Kshs. 1,794,000,000** inclusive of penalties.

D. ISSUES FOR DETERMINATION

The main issues for determination as identified by the Tribunal were;

1. *Whether GFI was a tax resident in Kenya and if so, whether there was a nexus between the transaction subject of the assessments and NKL; and*
2. *Whether NKL meets the specific requirements of appointment as tax representative for GFI.*

E. BRIEF ANALYSIS OF ISSUES

On the first issue, the parties argued as follows;

NKL’s ARGUMENT

NKL noted that it was a limited liability company incorporated in Kenya and GFI was a company incorporated in Mauritius.

The nature of the NKL’s business was solely retail business and it did not engage in any management activities and especially the management of GFI.

That NKL’s only relationship with GFI was that GFI was an indirect shareholder in NKL. Consequently, the transaction the subject to assessment by the Commissioner was between GFI and Amethis Retail. Further, the subject matter was the shares in NIL and NKL had no role in the transaction whatsoever.

Taxwise Africa Consulting LLP is an independent firm that offers tax advisory services. This publication is provided for general information and is intended to furnish users with general guidance on the tax matters discussed only. This information is therefore not intended to address the circumstances of any particular individual or entity nor is it intended to replace or serve as substitute for any advisory, tax or other professional advice, consultation, or service. The authors and the publisher expressly disclaim all and any liability, responsibility to any person or entity in respect of any loss, damage or costs of any nature arising directly or indirectly from reliance placed on the material in this publication.

Readers should consult professional tax advisors to determine if any information contained herein remains applicable to their facts and circumstances.

COMMISSIONER'S ARGUMENT

On the other hand, the Commissioner argued that it carried out the independent tests to determine the nature of operations of GFI and NKL and discovered that the operations by GFI in Mauritius had limited or no activities nor tangible structures demonstrating its independent going concern status. Consequently, it was impossible to attribute the returns of the operations relating to an entity that did not demonstrate reasonable cause of existence.

On the second issue, the parties argued as follows;

NKL'S ARGUMENT

NKL relied on provisions of Section 15 and 15(A) of the Tax Procedures Act (TPA) which provides for a number of criteria for appointment of a person as a tax representative and noted that in both the assessment and the objection decision the Commissioner had failed to identify the specific provisions of Section 15 of the TPA upon which it relied on in appointing NKL as a tax representative.

NKL further argued that the blanket reference to Section 15 TPA by the Commissioner as the basis of the appointment as a tax representative was in bad faith and lacked tangible grounds for appointment going against the established canon of taxation of certainty.

COMMISSIONER'S ARGUMENT

On the other hand, the Commissioner argued that as per provisions of Section 15(1)(i) of the TPA, it established that the control and management of GFI was by directors and therefore NKL qualified as tax representatives. To support its argument, it noted as follows; -

1. Corporate Residency

The Commissioner's argued that the corporate tax residence was related to the central management and control of business of a company which was exercised by directors and not by the control of the company itself which was exercised by shareholders.

Further, that its inquiry was not from where GFI was controlled from but rather as to where the business of GFI was controlled. That the majority of the directors in GFI were Kenyans and tax residents in Kenya hence control in Kenya.

2. Adventure in Trade

The Commissioner argued that GFI had no employees, premises, functions performed, and risks undertaken in Mauritius or any real economic activity in Mauritius. GFI was incorporated for the purpose of owning shares in NIL which did not produce goods or services.

Further, by looking at the period of acquisition, ownership, and disposal of the shares, the same indicated that the 30% stake that GFI held in NIL was held solely for trade and not for long term investment. Therefore, the acquisition and disposal of the shares was an adventure, and the realized gains were therefore taxable.

F. TRIBUNAL'S DETERMINATION

On the first issue, the Tribunal relied on Section 3(b) of the Income Tax Act which provides that body of persons means *that the body is a company incorporated under a law of Kenya or that the management and control of the affairs of the body was exercised in Kenya in a particular year of income under consideration or that the body has been declared by the Minister by notice in the Gazette to be resident in Kenya for any year of income.*

Taxwise Africa Consulting LLP is an independent firm that offers tax advisory services. This publication is provided for general information and is intended to furnish users with general guidance on the tax matters discussed only. This information is therefore not intended to address the circumstances of any particular individual or entity nor is it intended to replace or serve as substitute for any advisory, tax or other professional advice, consultation, or service. The authors and the publisher expressly disclaim all and any liability, responsibility to any person or entity in respect of any loss, damage or costs of any nature arising directly or indirectly from reliance placed on the material in this publication.

Readers should consult professional tax advisors to determine if any information contained herein remains applicable to their facts and circumstances.

The Tribunal observed that for management and control, the main aspect considered was the key people managing the Company, which implied that shareholding was different from management.

Since only the Kenyan directors could initiate and authorize transactions of the bank accounts in Mauritius for GFI and NIL, the same confirmed that the financial management was done from Kenya therefore GFI and NIL are managed and controlled in Kenya and therefore were tax residents in Kenya.

The tribunal also observed that the common law test provided that a person was a resident in the location of the person's management and control.

Considering that the term 'management and control' had not been defined under the Kenyan Tax Laws, the Tribunal relied on the judicial interpretation under English law which held management and control to mean '*making decisions about the strategic policy and direction of a company*'.

In the end the Tribunal held that GFI was managed and controlled from Kenya thus GFI was a tax resident of Kenya.

Further that there was a nexus between the transaction subject to assessment and NKL in so far as the sale existed. Therefore, NKL was liable to pay corporation tax as assessed by the Commissioner.

On the second issue, the Tribunal noted that GFI was incorporated in Mauritius on 21st November 2017 as a private company with liability limited by shares. Its business activity was holding investments. GFI initially held 100% shareholding in NIL. NIL on the other hand had shareholding in NKL.

To this end, the Tribunal concluded that the control and management of GFI was by the directors, qualifying them for appointment as tax representatives. The Tribunal relied on the provisions of Section 15 of the TPA and held that NKL meets the specific requirements of appointment as tax representative of GFI.

G. IMPACT OF THE ABOVE DECISION TO TAX STRUCTURING OF BUSINESSES IN KENYA

This decision impacts subsidiary companies in Kenya whose holding companies are offshore. The subsidiary companies are at risk of being appointed tax representatives and taking on tax liabilities from activities of their holding companies unless it can be shown that the holding company is an independent entity with a reasonable cause of existence in its country of residence.

Additionally, this decision will impact business structuring decisions especially in setting up offshore holding companies. Before setting up offshore companies it is now imperative to take the following into consideration:

- ✓ The origin and location of the holding company directors;
- ✓ Business activity of the holding company; and
- ✓ Management and Control of the holding company.

H. LET'S TALK.

Kindly do contact us for specific advisory on your structure based on your specific facts. It's critical for all group structures to be reviewed and ensure that tax residency and substance tests have been implemented properly to avoid inadvertent tax exposures.

Taxwise Africa Consulting LLP is an independent firm that offers tax advisory services. This publication is provided for general information and is intended to furnish users with general guidance on the tax matters discussed only. This information is therefore not intended to address the circumstances of any particular individual or entity nor is it intended to replace or serve as substitute for any advisory, tax or other professional advice, consultation, or service. The authors and the publisher expressly disclaim all and any liability, responsibility to any person or entity in respect of any loss, damage or costs of any nature arising directly or indirectly from reliance placed on the material in this publication.

Readers should consult professional tax advisors to determine if any information contained herein remains applicable to their facts and circumstances.
