



Tax & Exchange Control

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Kenya

- Permanent establishments risk in Kenya: The dependent agent dimension in the *Travelport services case*



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Permanent establishments risk in Kenya: The dependent agent dimension in the *Travelport services case*

When it comes to permanent establishments, substance trumps form. Businesses with cross-border operations cannot rely on the contractual labelling of functions alone, therefore, if a contract describes local functions as auxiliary, those functions must genuinely be auxiliary in practice. Where the Kenya Revenue Authority (KRA) examines the true nature of those functions and finds them to be core to the business, a permanent establishment (PE) determination will follow, giving rise to tax obligations. In the recent decision in *Travelport Services (Kenya) Limited v Commissioner of Legal Services & Board Coordination* the Tax Appeals Tribunal (Tribunal) outlined functions that give rise to a PE, particularly, a dependent agent PE. This alert discusses what the decision means for businesses with Kenyan operations.

Case overview

Travelport Services (Kenya) Limited (TSKL) appealed against an additional tax assessment of KES 2,472,002,836 covering corporate tax, value-added tax (VAT) and withholding tax for the period 2019 to 2023. The assessment arose from the KRA's determination that TSKL constituted a PE of Travelport International Operations Limited (TIOL), a UK entity operating the Travel Commerce Platform (TCP). The KRA's position was that TSKL was a dependent agent of TIOL, given that its functions were core to TIOL's business and went well beyond preparatory and auxiliary activities. The activities included negotiating and concluding subscriber contracts, distributing the TCP and providing after-sales support.

In assessing whether TSKL had PE status in Kenya, the Tribunal examined its marketing recharge agreement and transfer pricing documentation, which expressly described TSKL's sales function as including attracting customers, negotiating prices with clients and delivering products, and its customer support function as constituting planning, installation, training and maintenance. The Tribunal found that these were core functions essential to TIOL's Kenyan operations, not auxiliary services, and therefore held that TSKL satisfied the dependent agent PE test under section 2 of the Income Tax Act and Article 5(5) of the Organisation for Economic Co-operation and Development (OECD) Model Convention.



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Circumstances giving rise to a dependent agent PE

The following circumstances give rise to a dependent agent PE under section 2 of the Income Tax Act and Article 5(5) of the OECD Model Convention:

- Where the dependent agent habitually concludes contracts in the name of, or on behalf of, the enterprise, particularly contracts for the transfer of ownership or the granting of rights to use property owned by the enterprise, or for the provision of services.
- Where the dependent agent performs functions exclusively on behalf of the principal entity.

- Where the principal entity exercises significant control over the dependent agent's functions.

In this case, TSKL argued that the mere presence of a subsidiary in a jurisdiction does not, in itself, give rise to a permanent establishment, as a subsidiary is recognised as a separate legal entity under paragraph 115 of the OECD Model Commentary. However, this legal separation is not conclusive. Where the substance of the relationship indicates that the subsidiary is acting on behalf of the parent in a manner consistent with a dependent agent, a permanent establishment may arise. In this regard, paragraph 84 of the OECD Model Commentary outlines circumstances in which an ostensibly independent subsidiary may be treated as a dependent agent, including where:

- The subsidiary acts on behalf of the parent enterprise.

- The subsidiary in acting on behalf of the parent entity habitually concludes contracts or habitually plays a principal role in the conclusion of contracts that are routinely concluded without material modification by the parent enterprise.
- The contracts that the subsidiary enters into are either in the name of the parent enterprise or are for the transfer of property ownership, the granting of property use rights and for the provision of services by the parent enterprise.

The KRA considered TSKL as a permanent establishment based on the following factors:

- The profit aspect. The KRA considered whether TSKL's activities were critical to the generation of TIOL's profits and concluded that TSKL's activities were directly connected to the realisation of TIOL's profits and were not remote.
- The functional similarity. The KRA considered whether TSKL's activities were similar to those of TIOL and found that TSKL's activities were similar in purpose to those of TIOL, showing that TSKL was performing a distinct rather than a supportive role.

- The resource intensity. The KRA considered whether TSKL used a significant level of resources to carry out its activities. The KRA noted that TSKL used a significant portion of staff and assets in conducting its activities.
- Exclusivity. The KRA considered whether TSKL's activities were carried out purely on behalf of TIOL. The KRA found that TSKL operated solely for TIOL's benefit.
- Core business integration. The KRA considered whether TSKL's activities went beyond marketing to constitute a core part of TIOL's business. The KRA found that TSKL's role extended beyond marketing and its after-sales services and involvement in negotiating key terms of sales contracts were found to be essential components of the business. On this basis, the KRA concluded that TSKL had a permanent establishment within Kenya.

Significance of the case in relation to dependent agent PE

The *Travelport* case is significant for two key reasons. First, the Tribunal affirmed that a dependent agent PE arises where the agent performs functions so critical to the principal enterprise's operations that the parent company cannot successfully carry out its operations in the territory of the contracting state in the absence of the dependent agent. Second, and more notably, the Tribunal expanded the circumstances under which a dependent agent PE is established by holding that where a dependent agent performs core functions crucial to the principal enterprise's operations, a PE will arise, regardless of how those functions are labelled in contractual or transfer pricing documentation.

On the distinction between core and auxiliary functions, the Tribunal made clear that the determinative test is not the characterisation or labelling of functions in agreements or documentation, but their substantive character as revealed by the totality of the evidence. Functions qualify as preparatory or auxiliary only where they are incidental to the principal entity's business, as further affirmed by Article 5(4) of the OECD Model Convention. Where, however, a dependent agent attracts customers, negotiates prices, concludes contracts and delivers and supports the principal's products, those functions are core and will create a PE.

Implications for branches and subsidiaries

The *Travelport* case has significant practical implications for enterprises operating in Kenya through branches or subsidiaries.

Branches that are found to constitute a PE will be treated as non-resident entities and subjected to corporate income tax at a rate of 30% on their profits, as well as a repatriation tax of 15% on profits remitted to the head office. Subsidiary companies, on the other hand, if found to constitute permanent establishments will be treated as resident entities and are subject to corporate income tax at a rate of 30%.

Beyond the tax on profits, the decision signals that the KRA will look beyond contractual labels and documentation to assess the true nature of an entity's functions. Therefore, enterprises cannot solely rely on the characterisation or labelling of functions in their transfer pricing documentation or intercompany agreements to demonstrate that those functions are of an auxiliary nature. Enterprises must therefore ensure that the substance of the functions is auxiliary.

Alex Kanyi, Denis Maina and Lauren Mukami

Disclaimer: Either party may appeal against the decision of the Tax Appeals Tribunal and our analysis may change depending on the decision of the High Court, if any.

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