

REPUBLIC OF KENYA
IN THE TAX APPEALS TRIBUNAL
APPEAL NO. 335 OF 2022

ECP KENYA LIMITEDAPPELLANT

~VERSUS~

COMMISSIONER OF DOMESTIC TAXES.....RESPONDENT

JUDGMENT

1. The Appellant is a limited liability company incorporated in Kenya pursuant to the provisions of the Companies Act (Cap 486, the Laws of Kenya), and whose principal activity is the collection of data from portfolio companies, processing and collating the data to respond to various tasks assigned to it by its parent entity, ECP Manager LP (hereinafter referred to as “the ECP Manager”) in consideration for a fee.
2. The Respondent is a principal officer appointed under Section 13 of the Kenya Revenue Authority Act and the Kenya Revenue Authority is mandated as an agent of the Government of Kenya for the assessment, collection, receipting and accounting for all the tax revenue, and is also responsible for the administration and enforcement of the statutes set out under the Schedule to the Act.
3. In 2017, the ECP Africa Fund III PCC exited from its investment Java House Mauritius Limited through disposal of its shares to another private equity fund. ECP Africa FIII Investment LLC is one of the cells under ECP Africa Fund III PCC through which it previously owned a 90% stake in Java House Mauritius, which at the time of the disposal owned 100% stake in Nairobi Java House

Limited (Nairobi Java House), a Kenyan entity which operates the Java House brand coffee and restaurant chain in Kenya.

4. On 6th December 2017, the Respondent wrote a letter to Nairobi Java House requesting information in relation to the sale. Nairobi Java House responded to the Respondent through a letter dated 18th December 2017 stating that it was not party to the transaction and requested the Respondent to reach out directly to the Fund.
5. The Fund, through its tax agents, KPMG Kenya, responded to the Respondent in a letter dated 15th January 2018 in which it was explained that the sale was executed and concluded outside Kenya.
6. On 18th December 2020, the Respondent issued a letter of pre-assessment findings to the Appellant on the purchase and sale of Nairobi Java House Limited and management fees. The Respondent demanded a total principal tax of Kshs. 3,218,836,132.00.
7. The Respondent on 29th September 2021 issued a corporation tax assessment for Kshs. 3,210,148,174.00. The Appellant on 29th October 2021 lodged a notice of objection.
8. On 17th February 2022, the Respondent, (through a letter erroneously dated 17th February 2021), issued an objection decision in respect of the Appellant's notice of objection and demanded for corporation tax amounting to Kshs. 773,796,052.
9. Dissatisfied with the Respondent's objection decision, the Appellant lodged with the Tribunal a Notice of Appeal dated 1st April 2022 and filed on 4th April 2022.

THE APPEAL

10. The Appellant vide its Memorandum of Appeal dated 1st April 2022 and filed on 4th April 2022 set out the following grounds of Appeal;

- a) That the Respondent erred in law and fact by issuing an objection decision based on new facts and grounds in breach of Article 47 of the Constitution of Kenya;
- b) That the Respondent erred in law and fact by concluding that the income that was earned by ECP Africa Fund III PCC from the offshore disposal of its stake in Java House Mauritius Limited was business income chargeable to corporation tax in Kenya;
- c) That the Respondent erred in law and fact in concluding that ECP Manager LP and the ECP Africa Fund III PCC are related parties on the basis that ECP Manager LP has discretionary control of ECP Africa Fund III PCC;
- d) That the Respondent erred in law and fact in attributing the entire profit of ECP Africa Fund III PCC from the sale of its stake in Java House Mauritius Limited to ECP Manager LP and the Appellant;
- e) That the Respondent erred in law and fact in its Functions, Assets, and Risks analysis of the Appellant's role to ECP Manager LP and its conclusion that the Appellant carries out significant value-adding functions in Kenya for ECP Manager LP;
- f) That the Respondent erred in law and fact in applying the Transactional Profit Split Method as the basis for computing the remuneration of the functions performed by the Appellant to ECP Manager LP; and
- g) That the Respondent erred in law in applying the transactional profit split method by using the number of employees as the allocation key.

THE APPELLANT'S CASE

11. The Appellant has set out its case premised on the hereunder filed documents and proceedings before the Tribunal:

- i. The Appellant's Statement of Facts dated 1st April 2022 and filed on 4th April 2022 together with documents attached thereto.
 - ii. Appellant's Witness Statements of;
 - a) Mohamed A. Maherally admitted in evidence on oath by the Tribunal on 16th February 2022.
 - b) Daniel Beeton admitted in evidence on oath by the Tribunal on 16th February 2022.
 - iii. The Appellants written submissions dated 23rd March 2023 and filed on 24th March 2023.
12. The Appellant averred that the origin of the tax dispute relates to the disposal of ECP Africa Fund III PCC's investment in Java House Mauritius Limited (Java House Mauritius), a limited liability company incorporated in Mauritius. ECP Africa FIII Investment LLC is one of the cells under ECP Africa Fund III PCC through which it previously owned a 90% stake in Java House Mauritius, which at the time of the disposal owned 100% stake in Nairobi Java House Limited (Nairobi Java House), a Kenyan entity which operates the Java House brand coffee and restaurant chain in Kenya. (ECP Africa Fund III PCC and ECP Africa FIII Investment LLC are hereinafter referred to as "the Fund").
13. The Appellant submitted that the Fund is registered and regulated by the Mauritius Financial Services Commission and its shareholders include over two dozen institutional investors that invested between \$5 million and \$100 million each.
14. The Appellant illustrated the structure and the relationship between the Fund, ECP Manager and the Appellant pre-disposal of the 90% stake in Java House Mauritius.
15. The Appellant submitted that the Fund had identified, undertaken due diligence and signed the sale and purchase agreement for its investment in Java House Mauritius in 2012 prior to the Appellant commencing operations in

Kenya in 2013. That the Appellant is established as a private limited company in Kenya and commenced operations in 2013. By this time, the Fund had already acquired the 90% stake in Java House Mauritius.

16. That in 2017, the Fund exited from the investment by selling its shares in Java House Mauritius to another private equity fund (“the Sale”). That the sale was executed and concluded outside Kenya and the shares were sold by the Fund and acquired by the purchaser outside Kenya.
17. That in December 2017, the Respondent wrote a letter to Nairobi Java House requesting for information in relation to the sale. That the letter required, among other documents, evidence of payment of capital gains tax in respect of the Sale. That Nairobi Java House responded to the Respondent through a letter dated 18th December 2017 stating that it was not party to the transaction and requested the Respondent to reach out directly to the Fund. Nairobi Java House had in any event reached out to the Fund and requested the Fund to respond to the Respondent’s request.
18. That the Fund, through its tax agents, KPMG Kenya, responded to the Respondent in a letter dated 15th January 2018 in which it was explained that the sale was executed and concluded outside Kenya and accordingly, capital gains tax was not applicable in Kenya as the sale did not relate to transfer of shares in a Kenyan company. The Fund did not receive any response from the Respondent in relation to the letter.
19. The Appellant submitted that in 2020, nearly two years later, the Respondent issued a letter of pre-assessment findings to the Appellant and the Fund, dated 18th December 2020 (the Pre-assessment Letter) in which the Respondent reached the conclusion that Bryce Fort (Bryce) and Paul Maasdorp (Paul), as the then employees of the Appellant, had created a permanent establishment (PE) for the Fund in Kenya on the basis that they allegedly were directors in the Fund who sit in Kenya at the Appellant’s offices.

20. That the Respondent further alleged in the Pre-assessment Letter that the Fund is in the business of buying and selling of shares in African companies and therefore the income derived from the disposal of shares in offshore companies that have a nexus to Kenyan entities is subject to corporate tax in Kenya on the basis that the Fund had allegedly created a PE in Kenya. That on this basis, the Respondent demanded corporate tax of Kshs. 2,460,028,060.00 from the Appellant.
21. Further, the Appellant averred that the Respondent attributed 40% of the management fees that it believed, without evidence, was earned by ECP Manager from the Fund in respect of the management of the Fund's portfolio to the Appellant. This was on the basis that 2 of the 5 partners of ECP Manager were tax resident in Kenya.
22. However, in doing so, the Appellant stated that the Respondent did not provide any rationale for this conclusion. That on this basis the Respondent demanded additional corporate tax of Kshs. 758,808,072.00 from the Appellant.
23. That the Appellant responded to the Pre-assessment Letter through a letter dated 25th January 2021, in which it demonstrated that contrary to the Respondent's assertions, none of the employees of the Appellant (including Bryce and Paul) were, or had been, directors of the Fund, nor did they work for the Fund or act as dependent agents of the Fund. The Appellant, therefore, asserted that the Fund cannot be said to have created a PE in Kenya as alleged by Respondent.
24. The Appellant further submitted that the Respondent's assertion that the place of management and control for the Fund is in Kenya through the Appellant is unfounded. To substantiate this, the Appellant provided the Respondent with the minutes of the Fund's board of Directors demonstrating that none of the Appellant's employees participated in decision-making of the

Fund. The Appellant further provided the directors register for the Fund showing all the directors since the Fund's formation.

25. That these records clearly demonstrated that no employees from the Appellant (including Bryce and Paul) were, or had ever been, members of these decision-making bodies, and they were not involved in the decision-making of either ECP Manager or the Fund. The Appellant, therefore, asserted that the proposal to charge corporate tax in respect of management fees was erroneous, unjustified and does not have any basis in law.
26. That following the Appellant's response contained in the letter dated 25th January 2021, the Respondent did not communicate with the Appellant on any of the issues raised in the response until 29th September 2021 when the Respondent issued a corporate tax assessment for Kshs. 3,210,148,174.00 (inclusive of penalties and interest) ("**the Tax Assessment**").
27. That in the tax assessment, the Respondent dropped the pre-assessment findings relating to tax on the management fees earned by ECP Manager which it had attributed to the Appellant.
28. That in the tax assessment, the Respondent reiterated its allegation that Bryce and Paul were directors of the Fund and that they undertook the business of the Fund and made investment and disposal decisions for the Fund in Kenya. That the Respondent asserted that Bryce and Paul had therefore created a PE in Kenya for the Fund on the basis that they allegedly were directors of the Fund who sit in Kenya at the Appellant's offices.
29. The Appellant averred that it filed a notice of objection dated 29th October 2021 objecting to the tax assessment in which it reiterated its grounds that were set out in the response to the Pre-assessment Letter that:
 - i. The Appellant had not created a PE for the Fund in Kenya through its employees and, that, the Fund did not have a fixed place of business,

an office, or a place of management in the Appellant's offices in Kenya; and

- ii. Neither Bryce nor Paul nor any other employee of the Appellant are, have been or were employees, directors, or dependent agents of the Fund during the assessment period and they do not and have not in the past undertaken any activities in Kenya as employees or dependent agents of the Fund.

30. The Appellant submitted that on 17th February 2022, the Respondent, (through a letter erroneously dated 17th February 2021), issued an objection decision in respect of the Appellant's notice of objection and demanded for corporation tax amounting to Kshs. 773,796,052.00.

31. The Appellant averred that the Respondent in the objection decision departed from the basis and rationale contained in the tax assessment. The Appellant presented the table below setting out a summary of the differences between the basis/grounds of assessment under the tax assessment and the objection decision:

	Tax Liability	Grounds relied upon by the Respondent
Tax Assessment	KES 3,210,148,174	1. That the Respondent alleged that Bryce and Paul had created a PE in Kenya for the Fund on the allegation that they were directors in the Fund who sit in Kenya at the Appellant's offices. 2. That the Respondent alleged that the Fund is in the business of buying and selling of shares in companies and therefore the income derived from the disposal of shares in offshore companies that have a nexus to Kenyan entities is subject to corporate tax in Kenya on the basis that the Fund had allegedly created a PE in Kenya.

Objection Decision	KES 773,796,052	1. That the Respondent alleged that ECP Manager has discretionary control of the Fund and by implication that ECP Manager and the Fund are related parties for tax purposes. 2. That the Respondent alleged that the Appellant carries out significant functions for ECP Manager and that the operations of ECP Manager and the Appellant are highly integrated and therefore the appropriate transfer pricing method to be used to remunerate the Appellant would be the Transactional Profit Split Method using the number of employees who sit in the Appellant's offices in Kenya. 3. The Respondent alleged that the profit derived by the Fund from the sale of its stake in Java House Mauritius is attributable to ECP Manager. 4. That the Respondent alleged that the Fund is in the business of buying and selling of shares in companies and therefore the income derived from the disposal of shares in offshore companies is trading profit subject to corporation tax and further that 31.8% of the profit is attributable to the Appellant and taxable in Kenya.
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32. The Appellant being dissatisfied with the decision of the Respondent notified the Respondent of its intention to appeal to the Tribunal against the said decision vide a Notice of Appeal dated 18th March 2022 pursuant to Sections 12 and 13 (1) of the Tax Appeals Tribunal Act, 2013, and Rule 3 (1) of the Tax Appeals Tribunal (Procedure) Rules, 2015.

33. The Appellant appealed against the whole of the objection decision of the Respondent as set out below:

a) The Respondent erred in law and fact by issuing an Objection decision based on new facts and grounds in breach of Article 47 of the Constitution of Kenya.

34. The Appellant stated that the tax assessment issued by the Respondent was on the basis that Bryce and Paul were directors of the Fund and that they undertook the business of the Fund and made investment and disposal decisions for the Fund in Kenya.
35. That the Respondent, therefore, alleged that Bryce and Paul had created a PE for the Fund in Kenya on the basis that they were directors of the Fund who sit in Kenya at the Appellant's offices.
36. The Appellant subsequently filed the notice of objection objecting to the tax assessment in which the Appellant provided information demonstrating that the Fund had not created a PE in Kenya through the Appellant or its employees. That in particular, the Appellant demonstrated that the Fund did not have a fixed place of business, an office, or a place of management in the Appellant's offices in Kenya and that Bryce and Paul are not and were not employees, directors, or dependent agents of the Fund during the assessment period. That the Appellant further demonstrated that Bryce and Paul do not and have not in the past undertaken any activities in Kenya as employees or dependent agents of the Fund.
37. That in its objection decision, the Respondent deviated from its PE allegations which were the basis of the tax assessment, and instead, issued a new tax assessment in the objection decision on an entirely new set of facts, grounds, and legal basis. That the Respondent had deviated from its initial conclusion that the Appellant had created a PE in Kenya for the Fund and alleged that ECP Manager has discretionary control of the Fund, and on this basis, the profit derived by the Fund from the sale of its stake in Java House

Mauritius is attributable to ECP Manager and the Appellant and therefore taxable in Kenya.

38. The Appellant pointed out that the Tax Procedures Act, 2015 prescribes the procedure that is required to be followed by taxpayers and the Respondent when handling tax disputes emanating from a tax decision made by the Respondent. That Section 51 (1) of the TPA provides that a taxpayer who wishes to dispute a tax decision should first lodge an objection against the tax decision before proceeding under any other written law. The term 'tax decision' is defined under Section 2 of the TPA to include 'an assessment'.
39. That pursuant to Section 51 (2) of the TPA, a taxpayer who disputes a tax decision is required to lodge a notice of objection to the decision, in writing, with the Respondent within 30 days of being notified of the decision. That Section 51 (3) of the TPA further provides that the notice of objection should state precisely:
- a) the grounds of the objection;
 - b) the amendments required to be made to correct the decision; and
 - c) the reasons for the amendments.
40. That pursuant to section 51 (8) of the TPA, where a notice of objection has been filed by a taxpayer, the Respondent is required to consider the notice of objection and either:
- a) allow the notice of objection in whole and issue an objection decision withdrawing the tax assessment; or
 - b) allow the notice of objection in part, amend the tax assessment, and issue an objection decision with an amended tax assessment; or
 - c) disallow the notice of objection and issue an objection decision confirming the tax assessment.

41. The Appellant asserted that the Respondent did not issue the objection decision based on either of the three approaches set out above. That instead, the Respondent departed from the basis of its tax assessment, introduced new facts and grounds, and issued an objection decision not relating to the Appellant's notice of objection.
42. The Appellant averred that it would have been expected that where the facts and issues which formed the basis of the tax assessment, on which the Appellant objected to, can no longer support the basis of the tax assessment, the Respondent would have issued an objection decision withdrawing the tax assessment and thereafter issue a new tax assessment and allow the Appellant to respond pursuant to Section 51 of the TPA.
43. That by anchoring the objection decision on new facts and grounds of law, the Respondent has not accorded the Appellant reasonable and fair opportunity to be heard in respect of the new issues as prescribed in the TPA. The right to fair administrative action is not only an integral part of the Bill of Rights, but is also an essential feature of the Constitution of Kenya and the soul of a democratic society. That without fair administrative action, democracy and the rule of law cannot be maintained.
44. The Appellant asserted that its right to fair administrative action under Article 47 of the Constitution, as read together with the Fair Administrative Actions Act, 2015 (the FAAA), has been violated by the Respondent's actions.
45. The Appellant pointed out that the FAAA was legislated in 2015 to give effect to Article 47 of the Constitution and it therefore provides comprehensive provisions on fair administrative action. The FAAA applies to all state and non-state agencies, including any person exercising administrative authority, performing a judicial or quasi-judicial function under the Constitution or any written law or whose action, omission or decision affects the legal rights or interests of any person to whom such action, omission or decision relates.

46. That the Respondent, being an agency of the Government of Kenya, which is established pursuant to the provisions of the KRA Act to administer and enforce all provisions of the laws relating to imposition, assessment, and collection of taxes on behalf of the Government of Kenya, is therefore subject to the provisions of the FAAA.
47. That pursuant to Section 7(1) of the FAAA, any person who is aggrieved by an administrative action or decision may apply to a court or a tribunal for review of the administrative action or decision. That Section 7(2) of the FAAA further provides that a court or tribunal:

“(2) ...may review an administrative action or decision, if:

- a) ...*
- b) a mandatory and material procedure or condition prescribed by an empowering provision was not complied with;*
- c) the action or decision was procedurally unfair;*
- d) ...*
- e) ...*
- f) ...*
- g) ...*
- h) ...*
- i) the administrative action or decision is not rationally connected to—*
 - i. the purpose for which it was taken;*
 - ii. the purpose of the empowering provision;*
 - iii. the information before the administrator; or*
 - iv. the reasons given for it by the administrator;*
- j) there was an abuse of discretion, unreasonable delay or failure to act in discharge of a duty imposed under any written law;*

k) ...

l) ...

m) *the administrative action or decision violates the legitimate expectations of the person to whom it relates;*

n) *the administrative action or decision is unfair; or*

o) *the administrative action or decision is taken or made in abuse of power.”*

48. The Appellant asserted that the objection decision should be reviewed by the Tribunal pursuant to Section 7(2) of the FAAA for violating the provisions of the FAAA as demonstrated below:

- i. The objection decision was made in breach of mandatory and material procedure prescribed under Section 51 of the TPA: that the Respondent did not consider the notice of objection lodged by the Appellant and issue its decision as required by Section 51 (8) of the TPA. That instead, the Respondent departed from the basis of its tax assessment, introduced new facts and grounds, and issued an objection decision not relating to the Appellant’s notice of objection, in violation of Section 51 (8) of the TPA.
- ii. That the issuance of the objection decision was procedurally unfair: That by anchoring the objection decision on new facts and grounds of law, the Respondent did not accord the Appellant reasonable and fair opportunity to be heard in respect of the new issues as required by the provisions of the TPA.
- iii. That the objection decision was not rationally connected to the empowering provisions: The Respondent is empowered by Section 51 (8) of the TPA to allow, amend or reject a notice of objection upon consideration of the grounds of objection provided by the taxpayer in

respect of a tax decision. That the Respondent departed from the basis of its tax assessment and issued an objection decision not relating to the grounds of objection set out in the Appellant's notice of objection.

- iv. That the Respondent abused its power and discretion: That as highlighted above, the Respondent is empowered by Section 51 (8) of the TPA to allow, amend or reject a notice of objection upon consideration of the grounds of objection set out by the taxpayer in a notice of objection. That the Respondent exceeded its powers and discretion under Section 51 (8) of the TPA by introducing new set of facts, grounds and basis of the tax assessment instead of issuing the objection decision in respect of the notice of objection lodged by the Appellant.
- v. The Respondent violated the legitimate expectation of the Appellant: The Appellant had a legitimate expectation that the Respondent would consider the grounds of objection set out in its notice of objection and make an objection decision in relation to the notice of objection and the Tax Assessment. Instead, the Respondent did not consider the Appellant's notice of objection, departed from the basis of its Tax Assessment, introduced new facts and grounds, and issued an objection decision not relating to the Appellant's notice of objection.

49. The Appellant asserted that the Respondent breached the provisions of the FAAA in issuing the objection decision and averred that the Tribunal, therefore, had jurisdiction to review the Respondent's impugned objection decision pursuant to the provisions of the FAAA.

50. The Appellant further pointed out that procedural fairness is an integral component of the rules of natural justice. That it is now trite law that the rules and principles of natural justice are an inbuilt component of the justice delivery

system and binds all bodies that make decisions that affect the substantive rights or interests of the people. In the case of **Li Wen Jie & 2 others vs. Cabinet Secretary, Interior and Coordination of the National Government & 3 Others (Petition No 354 of 2016)**, the High Court held that the principles of natural justice operate as implied mandatory requirements when a judicial or administrative body is exercising power and non-observance of these principles invalidates the exercise of such power.

51. That further, in the case of **Jotham Mulati Welamondi vs. The Electoral Commission of Kenya Bungoma (HC Miscellaneous Application No. 81 of 2002)**, the High Court held that the Court is perfectly entitled to intervene where it is alleged that the statutory powers granted upon a person are being exercised arbitrarily, whimsically, capriciously or in flagrant disregard of the rules of natural justice. The Appellant averred that the Respondent exercised its powers to assess and collect taxes arbitrarily and in flagrant disregard of the rules of natural justice.

52. The Appellant asserted that the Respondent erred in law and fact by issuing an objection decision based on new facts and grounds in breach of Article 47 of the Constitution and the provisions of the FAAA.

b) Without prejudice to the above, the Respondent erred in law and fact by concluding that the income that was earned by the Fund from the offshore disposal of its stake in Java House Mauritius was business income chargeable to corporation tax in Kenya

53. The Appellant stated that investments by private equity funds (“the PEFs”) are long-term by nature, injecting equity capital to companies across all stages of their development. PEFs are continuously looking to expand into new markets, often across national borders. PEFs themselves do not carry out any business activity but are merely used for passive investments generating solely

passive income (dividends, interest, or capital gains). This is the case whether the PEF is formed as a listed vehicle or a limited partnership.

54. That PEFs are special-purpose vehicles that are formed by private equity investors to pool funds and directly invest in private companies. PEFs raise money from a wide range of institutional investors internationally by entering into agreements with them to commit to fund capital on demand over a defined period. That the capital is used to invest in privately-owned companies with the ultimate objective of long-term capital appreciation. That the investors in private equity funds often consist of professional and institutional investors such as pension funds, insurance companies, high-net-worth individuals, family offices, endowments, foundations, and sovereign wealth funds.
55. The Appellant argued that similar to funds that invest in publicly traded equities, PEFs identify and invest in a target company (typically called a “Portfolio Company”). PEFs hold the investments for several years and then sell the investments, seeking to make a gain on the increase in value of the shares bought in addition to passive income from the portfolio companies by way of interest or dividends, some of which may be reinvested.
56. The Appellant averred that, unlike public equity managers, PEFs tend to invest in companies that are private, i.e., not listed on a Securities Exchange. That since the shares of the portfolio companies are not listed, PEFs must devise an exit strategy to sell its investment. This often includes marketing the investment to a strategic buyer, another PEF, or possibly taking the company public. The lifecycle of PEFs is usually stated in the offering documents, but it is typically between 7 and 15 years, depending on its investment strategy.
57. The Appellant stated that a PEF calls capital commitments in stages as it identifies investment opportunities or as needed to fund operating expenses. That a PEF’s shareholders agreement will require capital contributions to be

made by its investors to the fund over a 3 to 5 year commitment period. Capital contributions are made pro rata by all investors in proportion to their capital commitments.

58. That investments in PEFs are typically illiquid, as capital is locked-up for many years, with infrequent distributions until an asset is sold thereby generating a liquidity event. Investors typically do not have an ability to withdraw their capital. That the PEF's profits are distributed to all partners based on their respective capital contributions, with a preferred return allocable to the limited partners over the life of the fund primarily for the use of their capital.
59. That the structure of a PEF may vary from one PEF to another. That however, in most instances, a PEF is legally structured as a limited partnership, or a limited company owned by its investors (shareholders). PEF will typically contract a fund manager to advise on the investment selection, management, and divestment. That ultimately, the decision on the investment selection, management and divestment is undertaken by the board of the PEF. A PEF will typically pay the fund manager an annual management fee, typically amounting to 1 to 2% of the fund's assets. Sometimes, one or more advisory companies are also contracted to provide services to the PEF, as so, also have to be remunerated.
60. That PEFs, which as an industry, manage trillions of dollars globally, make and sell investments and the gains from the disposal of investments are always treated as capital gains emanating from financial investments. That the Appellant has not come across any jurisdiction which has treated disposal of financial instruments by PEFs as business income for corporate tax purposes.
61. The Appellant averred that Paragraph 158 of the Organization for Economic Co-operation and Development ("the OECD") Model Tax Convention on Income and Capital and particularly the commentary on Article 5 which deals

with PE (the OECD Commentary) provides that gross revenues attributable to “active business activities” would clearly exclude income from passive investment activities, including, for example, receiving interest, dividends, and capital gains from investing surplus funds, which is the case with PEF.

62. The Appellant moreover noted that there is no trading or business activity undertaken by the fund (but only passive investment activity).
63. That the above arguments are further buttressed by the following court decisions:

- i. **Commissioner of Income Tax vs. M/S. Trishul Investments Ltd (Tax Case (Appeal) No. 1046 of 2007)**

- a) This was an appeal by the Commissioner of Income Tax (CIT) against the judgment of the Income Tax Appellate Tribunal which held that the profit / loss on purchase and sale of shares of the taxpayer / assessee should be treated as capital gain / loss and not business income. The High Court upheld the decision of the Income Tax Appellate Tribunal.

- b) The assessee was a Public Limited Company which was carrying on the business of investment in shares and securities. The relevant assessment year was 2000-2001 when the assessee filed its Return of income on 30.11.2000 declaring a capital loss of Rs. 15,62,90,890/-. The capital loss arose from a restructuring transaction involving the purchase and sale of shares in a cement manufacturing company in conjunction with the assessee's holding company. The capital loss was arrived at by taking total amount received as consideration and reducing therefrom the cost of acquisition of shares. The Assessing Officer did not accept the tax treatment under the head "capital gain"

and held that the entire shareholdings would constitute business assets of the assessee company.

c) The Court observed that the test to decide whether it was an investment or an adventure in the nature of trade, has a very thin line of demarcation. Even a single instance of transaction can be regarded as business and even multiple transaction sometimes are deemed as investments. So, the criteria for deciding whether it is investment or business is that of the intention of the assessee, i.e., whether assessee's real intention is to invest or the intention was in the nature of trade. As per the Memorandum of Association of the assessee company, it could be seen that the assessee company was incorporated to engage in the business of investment. The Court referred to the Tribunal's judgment where it held as follows:

d) "On a consideration of rival submission, we are of the view that the assessee's contention is justified in law. It is also a point for consideration that the Department never attempted to lift the corporate veil to see the real nature of the transaction. Right from the Memorandum of Association, the object of the assessee company is only to operate as an investment company. Particularly for the period ending 31.03.1996 & 31.03.1997, the company did not carry on any operations. The purchase of shares of Raasi Cements Ltd by the assessee company was only with the intention of making investment. The assessee had no intention to trade in shares. Hence it cannot be a business asset in the hands of the assessee company. The assessee company offered the same under the capital gain. Hence, by respectfully following the decisions of the Supreme Court and Calcutta High Court cited supra, we set aside the orders of the authorities below by holding that it is only an investment activity, and it cannot

be termed as a business activity. We, therefore, decide the first issue in favour of the assessee and against the Revenue."

e) The High Court upheld the decision of the Income Tax Appellate Tribunal where it held that "The finding given by the Tribunal is that the assessee had no intention to trade in shares. Hence the purchase of shares could not be business asset in the hands of the assessee. The assessee has rightly offered the same under the head "capital gain". The Tribunal also correctly arrived at a conclusion that it is only an investment activity and held that the profits derived from the sale of shares is subject to capital gain. The reasons given by the Tribunal are based on valid materials and evidence and we do not find any error or legal infirmity in the order of the Tribunal so as to warrant interference".

ii. Commissioner of Income Tax vs. H. Holck Larsen (Supreme Court of India), Civil Appeal No. 1954-55 (NT) of 1974

In this case, the taxpayer was allotted shares in a private limited company, some of which he sold. The taxpayer then purchased and sold shares in subsequent years. The Commissioner of Income Tax assessed the taxpayer for corporate tax in respect of the profits from the sale of shares. The taxpayer contended that it was an investor and not a dealer in shares and therefore not subject to corporate tax.

In determining whether the taxpayer was a dealer or an investor as a result of the income arising from the sale of shares, the Supreme Court held that:

"...In the case of sale of shares, the object or the purpose of selling the shares, in order to determine whether one was a dealer in shares or an investor in shares, should be looked at from the angle of Lord Reid in

J.P. Harrison (Watford) Ltd. v. Griffiths (Inspector of Taxes) ,40 TC 281
at pages 295-296 where it was observed that:

“The question has been asked in a number of cases: ‘If this was not trading, what was it?’ With all deference to those who have used that argument, I do not think that it is very useful in most cases. Human affairs—and business affairs—are of infinite variety. They do not fit neatly into categories or classes. In nominate contracts and transactions are of frequent occurrence, and I would not expect to find appropriate names to denote new kinds of operations devised for the sole purpose of gaining tax advantages. In the present case the question is not whether the transaction of buying and selling the shares lacks trading, but whether the later stages of the whole operation show that the first step—the purchase of the shares—was not taken as, or in the course of, a trading transaction.” (Emphasis ours)

Based on the above, the Supreme Court observed that the intention of a party at the time of the purchase of the shares is a relevant and often conclusive factor on whether the resale was in the nature of a trade or not.

- iii. In the case of **Commissioner of Income Tax (Central), Calcutta v. Associated Industrial Development Co. (P) Ltd.** [1971] 82 ITR 586, the Supreme Court observed that :

"Whether a particular holding of shares is by way of investment or forms part of the stock-in-trade is a matter which is within the knowledge of the assessee who holds the shares and it should, in normal circumstances, be in a position to produce evidence from his records as to whether it has maintained any distinction between those shares which are its stock-in-trade and those which are held by way of investment."

64. That as highlighted above, investments by PEFs are long-term by nature, providing equity capital to companies across all stages of their development. PEFs themselves do not carry out any business activity but are merely vehicles for passive investments generating solely passive income (dividends, interest, or capital gains).

65. The Appellant stated that the accounting treatment of equity investments in investee portfolio companies is as follows:

- i. The International Financial Reporting Standards ((**IFRS 9**) on Financial Instruments), require equity instruments to be measured at fair value in the statement of financial position, with value changes recognised in profit or loss, except for those equity investments for which the entity has elected to present value changes in 'other comprehensive income' (**FVTOCI**). If an equity investment is not held for trading, an entity can make an irrevocable election at initial recognition to measure it at FVTOCI with only dividend income recognised in profit or loss. Note that specifically for PEFs, IFRS 10 provides an exclusion from consolidation of the investee entity's financial statements.
- ii. Where a PEF invests in a portfolio company through a wholly owned subsidiary, the correct accounting treatment is to recognise a non-current asset in its balance sheet. IFRS 7, which deals with disclosures of financial instruments, requires assets to be segregated between assets "held for trading" and those "designated at initial recognition". IFRS has therefore provided clear guidance on the criteria that should be used to designate an asset as a "trading asset". Under IFRS, assets "held for trading" are defined as "*All derivatives (except those designated hedging instruments) and financial assets acquired or held for the purpose of*

selling in the short term or for which there is a recent pattern of short-term profit taking are held for trading”.

- iii. Since one of the key objectives of PEF’s is to achieve medium to long-term capital appreciation, investments in portfolio companies by PEF’s are recognised as long-term assets on its statement of financial position, in accordance with accounting principles.

66. The Appellant noted that the Fund prepares its financial statements in accordance with IFRS, and it, therefore, applies the principles set out above in recognizing assets. These financial statements are audited by international reputable audit firms in the United States. Considering the accounting treatment set out above and particularly, noting that investments in portfolio companies would not qualify to be recognised as “held for trading”, there would be no basis for the Respondent to reach the conclusion that the Fund undertakes trading activities as this is not supported by established and globally accepted accounting principles. This could have been the case if the accounting treatment required the Fund to recognise the investments in portfolio companies as “held for trading” assets, which is clearly not the case.

67. The Appellant asserted that the gain arising from the sale of shares in portfolio companies should be treated as capital gains for accounting and tax purposes. In this regard, the income earned by the Fund in respect of the disposal of shares in Java House Mauritius is a capital gain.

68. That it then becomes important to analyse whether the relevant provisions of the ITA impose capital gains tax on a sale of shares in an offshore entity.

69. That capital gains tax is chargeable pursuant to Section 3(2)(f) of the ITA and the Eighth Schedule to the ITA. That Paragraph 2 of the Eight Schedule provides that

“...the income in respect of which capital gains tax is chargeable, is the whole of a gain which accrues to a company or an individual on or

after 1 January 2015 on the transfer of property situated in Kenya, whether or not the property was acquired before 1 January 2015”.

That in this regard, capital gains tax would only apply to property situated in Kenya and not to non-Kenyan property.

70. That the term ‘property’ is defined in the Eighth Schedule to mean, all forms of “property” and includes property acquired or held for investment purposes, which includes shares in a company. Since the transfer of Java House Mauritius shares, was in respect of a company incorporated and based in Mauritius, capital gains tax will not apply in Kenya in respect of the sale of shares by the Fund in Java House Mauritius. In this regard, neither corporate tax nor capital gains tax will apply to the sale of shares by the Fund in Java House Mauritius.
71. The Appellant asserted that the Respondent erred in law and fact by concluding that the income that was earned by the Fund from the offshore disposal of its stake in Java House Mauritius was business income chargeable to corporate tax in Kenya and such assertion does not have any basis in law.
72. The Appellant asserted that even if it were the case that the profit would be in the nature of business income, it is gravely erroneous for the Respondent to attribute the profit to its advisor and purport to charge tax in Kenya without any evidence or legal basis for the tax imposition.

c) That, the Respondent erred in law and fact in concluding that ECP Manager and the Fund are related parties on the basis that ECP Manager has discretionary control of the Fund.

73. According to the Appellant in attributing the income that was derived by the Fund from the sale of its stake in Java House Mauritius to ECP Manager, the Respondent alleged that ECP Manager has discretionary control over all the investors’ funds and that it makes decisions concerning the investment,

evaluation, selection, negotiation, structuring, commitment, monitoring of and disposition of investments of the Fund.

74. The Appellant further alleged that ECP Manager has custody of the Fund's cash, bank accounts and securities. The Respondent, without considering the services being provided by ECP Manager to the Fund for a fee, has alleged that ECP Manager has discretionary control of the Fund, and on this basis, concluded that ECP Manager and the Fund are related parties.
75. The Appellant asserted that ECP Manager does not and has never had custody of the Fund's cash, bank accounts or securities. It averred that ECP Manager, as part of its advisory scope, provides recommendations to the Fund and the Fund's board approves or rejects these recommendations. That custody of the Fund's cash and bank accounts and wiring of payments relating to the Fund are undertaken by the Fund's administrator, which like ECP Manager, is another third-party service provider contracted by the Fund for a fee. That it is therefore grossly erroneous for the Respondent to allege that ECP Manager has discretionary control of the Fund on the basis that ECP Manager has custody of the Fund's cash, bank accounts and securities.
76. The Appellant further asserted that ECP Manager does not have discretionary control of the Fund and does not have control of the Fund. That ECP Manager provides advisory services to the Fund for a fee, and it cannot therefore be treated as a related party for tax purposes on the sole basis of providing services to the Fund.
77. The Appellant argued that the Fund is a PEF established as a protected cell company (PCC) under the laws of the Republic of Mauritius with offices at IFS Court Twenty-Eight, Cybercity Ebene, Mauritius. A PCC is a corporate structure in Mauritius, limited by shares, which consists of a core and an indefinite number of cells which operate separately and allow segregation of risks, as well

as assets and liabilities, and which are legally isolated from one another under a single PCC entity structure.

78. That the Fund is registered and regulated by the Mauritius Financial Services Commission and its shareholders include over two dozen institutional investors that have invested between \$5 million and \$100 million each.
79. That the organ of the Fund which is involved in the management and control of the Fund is the Board of Directors which is responsible for making the key strategic decisions relating to the investments, management, and operations of the Fund.
80. That ECP Manager is a limited partnership based in the US and is registered as an investment advisor with the US Securities Exchange Commission (SEC). ECP Manager serves as an investment advisor to the Fund and is regulated by the SEC. ECP Manager's business in relation to the Fund consists of three key parts: Fundraising, Advisory, and Operations:
 - a. Fundraising Activities:
 - i. ECP Manager employees in the US visit global institutional financial investors and convince them to allocate capital to the Fund. This activity is undertaken out of the US and as a condition to engaging in its activities, ECP Manager is registered with the SEC.
 - b. Advisory Activities:
 - i. Sourcing: ECP Manager US-based employees identify promising investment opportunities that meet the Fund's criteria.
 - ii. Execution: After identifying a suitable opportunity ECP Manager performs a technical analysis and due diligence and presents an investment recommendation to the Fund.

- iii. Recommending: After a technical analysis has been performed by ECP Manager, ECP Manager's executive committee recommends deals to the relevant fund's Investment Committee (which is a subcommittee of the Fund's Board of Directors).
- iv. Monitoring and Reporting: After the Fund makes a decision to invest, ECP Manager is tasked to collect a variety of performance data from the investee company (financial performance, environmental and social performance, operational performance, etc) and then present that data to the Fund's shareholders in formal periodic reports.
- v. Investee Company Advisory: In rare occasions, ECP Manager may also directly advise the companies in which the Fund invests ("Investee Company"). This work is contracted directly with the investee company and may include assistance with strategic business planning, business development, assistance with operational improvement and financial planning.

c. Operational Activities:

- i. As a SEC Registered Investment Advisor, ECP Manager must comply with many regulations of the SEC. This includes reporting, record keeping, risk management marketing and other activities in the US.
- ii. ECP Manager undertakes standard operations activities such as human resource, finance, accounting as well as general administrative support.

81. That ECP Manager provides the above advisory services to the Fund for an annual management fee of 2% of the Fund's assets and that the fee payable is

not constant throughout the life of the Fund. This is because as the Fund's assets decline upon a divestment, the fees payable also decline in the same ratio as the asset portfolio under management is also reduced.

82. That ECP Manager is headquartered in the US. That its subsidiaries are currently in France, Cote d'Ivoire, South Africa, and Kenya. The Kenyan subsidiary is ECP Kenya Limited, the Appellant therein.
83. The Appellant averred that its business involves collection of data from portfolio companies, processing and collating the data to respond to various tasks assigned to it by ECP Manager in consideration for a marked-up fee of 7%. The employees of the Appellant receive assignments from ECP Manager's Executive Committee in the US. These assignments primarily relate to analysis and review of data to provide input for reports issued to ECP Manager. That the assignments do not relate to fundraising, recommending investments, making investment decisions, or making exit decisions. And that this is evidenced by the fact that the Fund was raised, and investment made in Java House Mauritius 2012 prior to the Appellant commencing operations in Kenya in 2013.
84. The Appellant stated that the Respondent in its objection decision alleged that ECP Manager has discretionary control over all the investors' funds and that it makes decisions concerning the investigation, evaluation, selection, negotiation, structuring, commitment, monitoring of and disposition of investments. That the Respondent, without considering the services being provided by ECP Manager to the Fund for a fee, has alleged that ECP Manager has discretionary control of the Fund, and on this basis, concluded that ECP Manager and the Fund are related parties.
85. The Appellant asserted that ECP Manager does not have discretionary control of the Fund and does not participate in the management and control of the Fund. That ECP Manager provides advisory services to the Fund for a

fee, and the Fund's board makes its investment decisions upon consideration of ECP Manager's advice and recommendations. That the ECP Manager cannot therefore be treated as a related party for tax purposes on the sole basis of providing services to the Fund.

86. That the Appellant argued that Section 18(6) of the ITA provides that a person (including an enterprise) is deemed to be related to another person for transfer pricing purposes, where:

- i. either person participates directly or indirectly in the management, control, or capital of the business of the other; or
- ii. a third person participates directly or indirectly in the management, control or capital of the business of both; or
- iii. an individual, who participates in the management, control, or capital of the business of one, is associated by marriage, consanguinity or affinity to an individual who participates in the management, control, or capital of the business of the other.

87. The term 'related enterprises' is further defined in the Income Tax (Transfer Pricing) Rules, 2006 (the TP Rules) to mean, one or more enterprises whereby:

- i. one of the enterprises participates directly or indirectly in the management, control, or capital of the other: or
- ii. a third person participates directly or indirectly in the management, control, or capital of both.

88. The Appellant posited that Paragraph 11 of the OECD Transfer Pricing Guidelines for Multinationals Enterprises and Tax Administrations, July 2017 (OECD TP Guidelines) also provides that two enterprises are associated if one of the enterprises participates directly or indirectly in the management, control,

or capital of the other or if the same person participates directly or indirectly in the management, control, or capital of both enterprises.

89. The Appellant stated that for the Respondent to assert that ECP Manager and the Fund are related persons for tax purposes, it would need to demonstrate that ECP Manager participates directly or indirectly in the management, control, or capital of the Fund or a third person controls both ECP Manager and the Fund.

90. That the term ‘control’ was defined in paragraph 32 (1) of the Second Schedule to the ITA (now deleted) in relation to a body corporate to mean:

“...the power of a person to secure, by means of the holding of shares or the possession of voting power in or in relation to that or another body corporate, or by virtue of powers conferred by the articles of association or other document regulating that or another body corporate, that the affairs of the first mentioned body corporate are conducted in accordance with the wishes of that person; and in relation to a partnership, means the right to a share of more than one-half of the assets or of more than one-half of the income of the partnership;

Provided that in the case of a body corporate, unless otherwise expressly provided for by the articles of association or other documents regulating it, “control” shall mean the holding of shares or voting power of twenty-five percent or more.”

91. The Appellant noted that based on the information set out by the Respondent in its objection decision, the Respondent has alleged that ECP Manager owns 2% of the Fund. The Appellant asserted that ECP Manager does not own 2% of the Fund. That instead, some partners, former partners, and employees of ECP Manager have pooled capital in the Fund of approximately 2% of the

Fund's total assets in their individual capacities through a separate investment vehicle, and not as ECP Manager.

92. That, therefore, it follows that ECP Manager cannot be said to be owning a stake in the Fund. Even if it were the case, the Appellant asserts that 2% ownership in an entity does not meet the domestic and international thresholds of control for tax purposes which is in the range of 20% to 25% or more voting power.

93. The Appellant further notes that the term "management and control" has not been defined in the Kenyan tax laws. That this term has however been subjected to significant judicial interpretation under English law. In broad terms, the term 'management and control' has been determined by English law to mean making decisions about the strategic policy and direction of a company. These decisions can generally be distinguished from decisions of a more day to-day, operational nature, which would not meet the test.

94. The Appellant argued that in the case of **Bullock v Unit Construction Company (1959) 38 TC 712**, the court stated that the issue of management and control is

"a pure question of fact, to be determined ... upon scrutiny of the course of business and trading". Citing the case of *Union Corporation Ltd v Commissioner of Inland Revenue 34 TC 207*, the Court further stated as follows:

"The Company may be properly found to reside in a country where it "really does business" that is to say, where the controlling power and authority which according to the ordinary constitution of a limited liability company, is vested in its board of directors, and the exercise of that power and the authority, is to some substantial degree to be found".

95. The Appellant stated that it is therefore settled principle that the making of decisions about the strategic policy and direction of a company is reserved for the Board of Directors of a company and therefore exercise management and control of the company.
96. The Appellant asserted that ECP Manager does not participate in the management and control of the Fund. That the key organ for the management and control of the Fund is the Board of Directors which is responsible for making the key strategic decisions relating to investments, management, and operations of the Fund.
97. The Appellant submitted that neither the partners or directors of the Appellant or ECP Manager control the Board of Directors of the Fund. This is further evidenced by the minutes of the board of directors of the Fund on acquisition and disposal of Java House Mauritius which demonstrate that neither the Appellant nor ECP Manager participated in the key strategic decisions relating to investments, management, and operations of the Fund.
98. The Appellant submitted that ECP Manager only provides the required advisory services to the Fund, including submitting investment proposals to the Fund's Investment Committee for consideration and recommendation to the Board of Directors. Provision of these services for a fee does not and would not amount to exercising management and control of the fund for tax purposes.

d) Without prejudice to the above, the Respondent erred in law and fact in attributing the entire profit of the Fund from the sale of the Fund's stake in Java House Mauritius to ECP Manager and the Appellant.

99. The Appellant asserted that the Respondent erred in attributing the entire profit from the sale of the Fund's stake in Java House Mauritius to ECP Manager and the Appellant.

100. That the Respondent disregarded the profit due to the Fund's shareholders and investors and attributed the entire profit to ECP Manager and the Appellant as set out below.

Entity	Number of Employees	Percentage attribution
ECP Kenya Limited Personnel	7	31.82%
ECP Manager Personnel	15	68.18%
Total ECP Group Advisory Personnel	22	100.00%

Description	Amount in KES
ECP Fund III share of selling price	9,476,014,826
Less Investment Expense	3,923,662,206
Profit	<u>5,552,352,620</u>
Attributed Profit to ECP Kenya Limited @31.82%	1,766,657,652
Principal Tax @ 30%	529,997,296
Penalty @ 5%	26,499,865
Interest @41%	<u>217,298,891</u>
Total Liability	<u>773,796,052</u>

101. The Appellant averred that even if it were the case that ECP Manager were to be deemed to be related to the Fund for tax and transfer pricing purposes, only a portion of the profit of the Fund would be attributed to ECP Manager. That in any event, it would be the fees earned by ECP Manager from the Fund that would be adjusted to reflect an arm's length price (which is the rate applied by ECP Manager) and not the profit earned by the Fund.
102. That where the Commissioner is of the view that dealings between related parties are not at arm's length price, he is empowered to adjust prices to reflect an arm's-length price. The Appellant is cognisant of the fact that both ECP

Manager and the Fund are non-resident entities and therefore the Commissioner does not have the jurisdiction and authority to adjust prices between them. That in any event, the arm's length price between ECP Manager and the Fund would not be the entire profit derived by the Fund from the sale of its stake in Java House Mauritius but the arm's length price payable to ECP Manager for provision of advisory services to the Fund.

103. The Appellant further pointed out that the Respondent had assumed that the number of employees for both the Appellant and ECP Manager was constant throughout the years in review. That when the Appellant commenced operations in Kenya in 2013, it only had three employees who were advisors against a total of 33 advisory personnel in ECP Manager.
104. Further, the Appellant averred that the Respondent erred by attributing the entire profit to ECP Manager and the Appellant, and consequently the tax demanded was excessive. Without prejudice to the above, assuming that the Respondent's allegations were factual and have a basis in law, including the allegation that ECP Manager owned 2% of the capital contribution in the Fund, the correct calculation of the profit that would be attributed to the Appellant, using the Respondent's transaction profit split method would be as follows:

Shareholder	Ownership percentage
ECP Manager	2%
Other	98%

Description	Amount in KES
ECP Fund III share of selling price	9,476,014,826
Less Investment Expense	3,923,662,206
Profit	<u>5,552,352,620</u>
Attributed Profit to ECP Manager @2%	111,047,052.40

Attributed profit to ECP Kenya @31.82	35,333,153.04
Principal Tax @ 30%	10,599,945.91
Penalty @ 5%	529,997.30
Interest @41%	<u>4,345,977.82</u>
Total Liability	<u>15,475,921.02</u>

105. The Appellant averred that the Respondent erred in law and fact by attributing the entire profit earned by the Fund from the sale of its stake in Java House Mauritius to ECP Manager and the Appellant, without taking into account that the Fund's shareholders are independent third parties, majority of which were institutional investors.
106. In addition, the Appellant stated it is gravely erroneous for the Respondent to attribute profit of a PEF to its advisor and purport to charge tax in Kenya without any evidence or legal basis for the tax imposition.
- e) **The Respondent erred in law and fact in its Functions, Assets and Risks analysis of the Appellant's role to ECP Manager and its conclusion that the Appellant carries out significant value adding functions in Kenya for ECP Manager.**
107. The Appellant argued that in a further attempt to attribute the alleged income of ECP Manager to the Appellant, the Respondent carried out an erroneous Functions, Assets and Risks (FAR) analysis in respect of the Appellant's provision of services to ECP Manager and concluded that the Appellant carries out significant value adding services to ECP Manager.
108. That the Respondent further asserted that the operations of ECP Manager and the Appellant are highly integrated and therefore the appropriate transfer pricing method to be used to remunerate the Appellant would be the Transactional Profit Split Method (TPSM).

109. That on this basis, the Respondent has erroneously proceeded to use the number of employees as an allocation key for the split of the entire profit earned on the disposal of the Fund's stake in Java House Mauritius between ECP Manager and the Appellant.
110. That the Respondent disregarded the Appellant's transfer pricing documentation (the TP Policy) which sets out the functions, assets and risks carried out by the Appellant in provision of its services to ECP Manager and the appropriate remuneration for the Appellant. The Appellant asserts that contrary to the Respondent's allegations, its function is to provide administrative support to ECP Manager as illustrated by the Appellant's TP Policy.
111. That the Respondent's FAR analysis lists the following activities as being undertaken by the Appellant:
- i. sourcing for investors and sourcing for investment opportunities;
 - ii. evaluating investment opportunities;
 - iii. selection of investment opportunities;
 - iv. negotiation of investment opportunities; and
 - v. committing to investments.
112. The Appellant noted that the Fund was established in 2008 and the Appellant commenced operations in Kenya in 2013. That consequently, the Appellant could not have participated in the sourcing of investors for the Fund which by definition had to be completed before 2008. That furthermore, seven of the eight investments (including the investment in Java House) that were undertaken by the Fund were evaluated selected negotiated and committed prior to the Appellant commencing operations in 2013.

113. That furthermore, the Respondent's FAR analysis lists the following additional activities as being undertaken by the Appellant:
- i. monitoring investments;
 - ii. disposing investments;
 - iii. participate as Board Members of Investee Companies;
 - iv. develop and Support portfolio company strategies; and
 - v. provide periodic reports for portfolio companies.
114. The Appellant averred that in the interview between Bryce and the Respondent of 17th September 2020 it was unequivocally confirmed by Bryce that the Appellant does not make any sourcing or exit decisions, and specifically, that Bryce confirmed that "Sourcing is done from the head office say in London or New York, but the regional offices are usually for monitoring especially when there is a huge portfolio of investments". In the said Interview, that Bryce also confirmed that there is need to continually collect information from the portfolio companies and report back to ECP Manager and this is the role performed by the Appellant.
115. That the Appellant's primary role is to perform the administrative function of monitoring and reporting on the performance of companies that the Fund owns, consequently the functions of monitoring investments and providing periodic reports alleged by the Respondent are part of the Appellant's administrative functions.
116. The Appellant maintained that its function is to provide administrative support to ECP Manager as illustrated by the TP Policy and as confirmed to the Respondent in the Interview. The Appellant prepared its TP Policy pursuant to Section 18 (3) of the ITA and the TP Rules.

117. That Section 6.1.2 of the TP Policy sets out the administrative support functions carried out by the Appellant for ECP Manager. An example of the type of administrative support provided by the Appellant to ECP Manager, as set out in the TP Policy, is as follows:

“when ExCo assigns employees of ECP Kenya the task of visiting a company in South Africa to enable ECP Manager to determine whether it is suitable for an investment. The team (which would likely include employees from other ECP offices in addition to Kenya) would visit the target company, meet management, ask for data and analyse it. It would undertake a preliminary analysis and present its findings back to the ExCo for further analysis and decision making.

118. That a further example of administrative support services is as follows:

“...would be requiring the ECP Kenya employees to fill out HR review forms to giving an opinion on the performance of senior and junior professional staff. Such information would be used by ECP Manager for purposes of making appropriate decisions in relation to personnel matters.”

119. That this is further evidenced by the Interview where Bryce stated the following as his daily role:

“His main role is monitoring the investment portfolio and, in this regard, he ensures that his team collects all the information relating to the investment portfolio as required by ECP Manager. His team compiles reports in the appropriate format based on tasks assigned by ECP Manager from time to time, which he then submits to the Washington office. The Washington office will then undertake further reviews of the analysis and use the reports received from ECP Kenya to prepare more comprehensive reports which may subsequently be

circulated to the investors in the Fund. This is about 90 percent of his team's role in Kenya."

120. The Appellant further noted that the Respondent erred in relying on the template job descriptions of an ECP Managing Director, Vice President, and Associates to conclude that the Appellant's functions are significant value adding services. That the Respondent had requested for what would ordinarily be the job descriptions of key staff of ECP and it was forwarded via email template job descriptions of ECP staff at the global level. The job descriptions are merely general descriptions, but in fact, the functions performed by the Appellant's employees are materially different as was evident from the Interview highlighted above.
121. That the Respondent undertook one functional analysis interview, with Bryce. That the Appellant further pointed out that the facts set out in the minutes of the meeting in relation to the Appellant's functions had not been reflected accurately in the objection decision, as it was clarified that key roles such as sourcing, investment decisions, fund raising, and exit are all undertaken by ECP Manager and not by the Appellant.
122. That furthermore, with only one interview completed, the Respondent relied on the job descriptions, which are generic in nature and used across ECP Manager and its subsidiaries, rather than factual determination of what the roles and responsibilities of each individual employee of the Appellant on a day-to-day basis.
123. The Appellant asserted that it has never participated in the decision-making function for the Fund in respect of its investment activities in Kenya, and a good example would be the acquisition and disposal of the Fund's stake in Java House Mauritius.
124. That in relation to the Respondent's reliance on generic job descriptions, the OECD TP Guidelines in paragraph 1.46 states that where a conduct is not fully

consistent with economically significant contractual terms, further analysis is required to identify the actual transaction. That it further states:

“Where there are material differences between contractual terms and the conduct of the associated enterprises in their relations with one another, the functions they actually perform, the assets they actually use, and the risks they actually assume, considered in the context of the contractual terms, should ultimately determine the factual substance and accurately delineate the actual transaction.”

125. That the OECD TP Guidelines provides under paragraph 1.35, that:

“The accurate delineation of the actual transaction or transactions between the associated enterprises requires analysis of the economically relevant characteristics of the transaction. These economically relevant characteristics consist of the conditions of the transaction and the economically relevant circumstances in which the transaction takes place. The application of the arm’s length principle depends on determining the conditions that independent parties would have agreed in comparable transactions in comparable circumstances. Before making comparisons with uncontrolled transactions, it is therefore vital to identify the economically relevant characteristics of the commercial or financial relations as expressed in the controlled transaction.”

126. The Appellant stated that as guided by the OECD TP Guidelines, the actual transaction between the parties is established from written contracts, as well as the conduct of the parties and other economically relevant characteristics of the transaction. In the case of inconsistencies, the transaction should be delineated in accordance with the characteristics of the transaction reflected in the conduct of the parties.

127. The Appellant averred that although the general template job descriptions of the Managing Director, Vice President, and the Associate, have roles that could be interpreted to relate to sourcing, evaluation, selection, and negotiation of investment opportunities, there was in fact a material difference with what was actually being performed by the relevant employees of the Appellant, as explained during Bryce's interview.
128. That the Respondent in its finding failed to demonstrate and to identify which functional activities are exercising control or contributing relatively more value in the transaction between ECP Manager and the Appellant. The Appellant reiterated that, at no point does it hold investment funds on behalf of the Fund.
129. Regarding the advisory personnel, the Appellant asserted that the services provided by the employees are autonomous in nature, in that, the services can be performed by an independent consultant. In addition, the Appellant has not capitalised any intangible assets in its books. The personnel in question do not create unique and intangible value to the transaction at hand. The Appellant maintained the position presented in its TP Policy that, it, does not hold unique assets and has the simpler risk profile.
130. That the Respondent ought to have considered the factual evidence provided to it in determining the Appellant's functions to reach a correct conclusion in its FAR analysis. Unfortunately, the Respondent misrepresented the facts stated in the meeting minutes of the functional analysis interview and no further factual evidence of what the Appellant's employees do is presented.
131. It was the Appellant's assertion that the Respondent's allegation that the Appellant's functions are of significant value to ECP Manager, is erroneous and factually incorrect.
132. The Appellant averred that the Respondent carried out an erroneous FAR analysis in respect of the Appellant's provision of services to ECP Manager and

concluded that the Appellant carries out significant value adding services to ECP Manager. The Respondent therefore erred in attributing some of the income earned by the Fund to the Appellant.

f) **The Respondent erred in law and fact in applying the Transactional Profit Split Method as the basis for computing the remuneration of the functions performed by the Appellant to ECP Manager.**

133. The Appellant asserted that the Respondent erred in applying the TPSPM for the remuneration of the functions performed by the Appellant, for the following reasons:

134. That the Appellant prepared its TP policy in line with the ITA, the TP Rules and the OECD Guidelines and has applied the TP policy in its dealings with ECP Manager. The OECD Convention has often been applied in Kenya for transactions where the domestic law provisions are silent. That this position was laid out in the case of **Unilever Kenya Limited vs. Commissioner of Income tax [2005] eKLR**. The case related to transfer pricing adjustment as provided under Section 18(3) of the ITA. However, at the time, the TP Rules had not yet been introduced and therefore the Appellant relied on the OECD Guidelines for Multinational Enterprises to determine the appropriate method for determining the arm's length price. In determining the case, the court held that where the ITA is silent on certain matters the provisions of the OECD will apply. In particular, the court held that;

“... and especially because of the absence of any such guidelines in Kenya, we must look elsewhere. We must be prepared to innovate, and to apply creative solutions based on lessons and best practices available to us. That is indeed how our law will develop and our jurisprudence will be enhanced. And that is also how we shall encourage business to thrive in our country.”.

135. The Appellant averred that the OECD TP Guidelines provide guidance on the typical process to be followed when preparing a transfer pricing policy and determining the arm's length price of a related party transaction in paragraph 3.4 as follows:

“Step 1: Determination of years to be covered.

Step 2: Broad-based analysis of the taxpayer's circumstances.

Step 3: Understanding the controlled transaction(s) under examination, based in particular on a functional analysis, in order to choose the tested party (where needed), the most appropriate transfer pricing method to the circumstances of the case, the financial indicator that will be tested (in the case of a transactional profit method), and to identify the significant comparability factors that should be taken into account.

Step 4: Review of existing internal comparables, if any.

Step 5: Determination of available sources of information on external comparables where such external comparables are needed taking into account their relative reliability.

Step 6: Selection of the most appropriate transfer pricing method and, depending on the method, determination of the relevant financial indicator (e.g. determination of the relevant net profit indicator in case of a transactional net margin method).

Step 7: Identification of potential comparables: determining the key characteristics to be met by any uncontrolled transaction in order to be regarded as potentially comparable, based on the relevant factors identified in Step 3 and in accordance with the comparability factors set forth at Section D.1 of Chapter I.

Step 8: Determination of and making comparability adjustments where appropriate.

Step 9: Interpretation and use of data collected, determination of the arm's length remuneration"

136. The Appellant asserted that it followed the above nine-step approach in preparing its TP policy and arriving at the arm's length rate applied in the remuneration for the provision of services to ECP Manager. Accordingly, based on the functions, assets and risk analysis set out in the Appellant's TP policy, the most appropriate method was chosen i.e. the Transactional Net Margin Method (TNMM) with the Full Cost Mark-up as the Profit Level Indicator and the correct arm's length compensation for the Appellant applied.
137. The Appellant asserted that based on the transfer pricing analysis it undertook, the rationale for selecting TNMM as the transfer pricing method was explained in the TP Policy and it was also explained why TPSM would not be a suitable transfer pricing method for the routine administrative support services provided by the Appellant.
138. The Appellant further averred that The Revised Guidance on the Application of the Transaction Profit Split Method Inclusive Framework on BEPS: Action 10th July 2018 (the TPSM Guidance) states that the TPSM is most appropriate where there are:
- i. Unique and valuable contributions by each of the parties to the transaction; and
 - ii. Highly integrated business operations.
139. That the TPSM Guidance further explains as follows:

"Contributions (for instance functions performed, or assets used or contributed) will be 'unique and valuable' in cases where:

- i) they are not comparable to contributions made by uncontrolled parties in comparable circumstances; and*
- ii) they represent a key source of actual or potential economic benefit in the business operations. The two factors are often linked: comparables for such contributions are seldom found because they are key source of economic advantage.”*

140. The Appellant asserted that the TPSM Guidance is clear on the circumstances in which TPSM can be applied and the conditions which would need to be fulfilled. The Appellant further argued that the Respondent did not demonstrate how any of these conditions were met, to warrant application of TPSM.

141. That in addition, the Appellant posited that in the case of **Aztec Software and Technology vs. ACIT 2007 107 ITD 141 Bang**, the Tribunal considered both India transfer pricing legislation and the OECD TP Guidelines and gave guidance on when each of the transfer pricing methods could be applied to a transaction. The Tribunal stated the following in relation to the transactional profit split method:

“This method may be applicable in cases where transactions involve transfer of unique, intangible or any multiple interrelated international transactions, which cannot be evaluated separately for determining the ALP (Arm’s Length Price) of any one transaction.

The profit split method first identifies the profit to be split for the associated enterprise from the controlled transactions in which the associated enterprises are engaged. It then splits those profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. The combined

profit may be the total profit from the transactions, or a residual profit intended to represent the profit that cannot readily be assigned to one of the parties, such as the profit arising from high value, sometimes unique, intangibles.

The contribution of each enterprise is based upon a functional analysis and valued to the extent possible by any available reliable external market data.

The functional analysis is an analysis of the functions performed (taking into account assets used and risks assumed) by each enterprise. The external market criteria may include, for example, profit split percentages or returns observed among independent enterprises with comparable functions.”

142. The Appellant asserted that based on the TPSM Guidance and caselaw set out above, the functions performed by the Appellant, being administrative support services, are not unique and valuable contributions, noting that there are independent comparables as set out under Section 8.5.1 of the Appellant’s TP Policy, and in addition, the administration support function is not a key source of economic benefit.
143. That the Respondent further erred by alleging that the Appellant and ECP Manager functions are highly integrated. The Guidance states as follows in relation to integration of functions:

“Although most multinational groups are integrated to some extent, a particularly high degree of integration in certain business operations is an indicator for the consideration of the transactional profit split method.”

144. That the TPSM Guidance further explains a high degree of integration as follows:

“A high degree of integration means that the way in which one party to the transaction performs functions, uses assets and assumes risks is interlinked with, and cannot reliably be evaluated in isolation from, the way in which another party to the transaction performs functions, uses assets and assumes risks. In contrast, many instances of integration within a multinational result in situations in which the contribution of at least one party to the transaction can in fact be reliably evaluated by reference to comparable uncontrolled transactions.”

145. The Appellant asserted that based on the definitions above, the Appellant’s function of administrative support services would not be regarded as highly integrated, since ECP Manager’s functions, assets and risks are well defined and independent comparables for the functions provided by the Appellant are readily available and this is evidenced in Section 8.5.1 of the Appellant’s TP Policy.
146. The Appellant further asserted that based on the above, the Respondent erred in applying the TPSPM in the remuneration of the Appellant’s functions. The Appellant reiterated that it followed the required approach provided in the OECD TP Guidelines in preparing its TP policy and arriving at the right arm’s length rate applied in its remuneration for provision of services to ECP Manager. Accordingly, based on the FAR analysis done in respect of the Appellant’s policy, the most appropriate method applicable and which was chosen, is the TNMM.

g) The Respondent erred in law in applying the transactional profit split method by using the number of employees as the allocation key.

147. The Appellant averred that the Respondent erred in its application of the TPSPM by using the number of employees of the Appellant as an allocation key and alleging that the most important element in the investment advisory

industry is the personnel who ultimately determine whether the investors will realise a profit. The Respondent assumed that the number of employees at the Appellant's company was consistent across the years covered by the assessment period. While this is a key aspect which was utilised by the Appellant in arriving at the demand, the Respondent did not corroborate this assertion, and yet this has a significant impact on the quantum of the Demand.

148. That the TPSM Guidance states that in the transactional profit split method, the relevant profits are to be split between the parties to the transaction on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. The Guidance further states that;

“In general, the determination of the relevant profits to be split and of the profit splitting factors should:

- a. Be consistent with the functional analysis of the controlled transaction under review, and in particular reflect the assumption of the economically significant risks by the parties, and*
- b. Be capable of being measured in a reliable manner.”*

149. The Appellant therefore asserted that not only did the Respondent err in the application of the TPSM, but it also erroneously applied the number of employees as the profit allocation key and also further erred on the number of ECP Manager employees who were utilised in arriving at the demand. These personnel do not reflect the assumption of the economically significant risks that each party (between ECP Manager and the Appellant) undertakes in the investment decisions, and consequently, the allocation key chosen by the Respondent was erroneous as it cannot be measured in a reliable manner in relation to the risks undertaken by each of the personnel.

150. Further, the TPMS Guidance states that the headcount as an allocation key can be used as a profit splitting factor in circumstances where the employee group has similar skills and responsibilities and there is a strong and relatively consistent correlation between this, and the creation of value represented by the relevant profits.
151. That the Respondent erred in using the headcount of the Appellant's personnel as an allocation key because the personnel that the Respondent had referred to (the Managing Director, Vice President and three Associates) are not of similar skills neither do they have similar responsibilities in the Appellant's company. Further, the Respondent failed to demonstrate the correlation between the contribution of the mentioned employees and the relevant profits to be split.

Appellant's Prayers

152. Pursuant to the aforementioned the Appellant made the following prayers to the Tribunal;
- a) That the objection decision of the Respondent contained in the letter dated 17th February 2022 demanding payment for corporate tax amounting to Kshs. 773,796,052.00 be set aside.
 - b) The Appeal be allowed with costs to the Appellant.
 - c) Any other orders that the Tribunal may deem fit.

THE RESPONDENT'S CASE

153. The Respondent has set out its case premised on the following documents and proceedings before the Tribunal;
- i. The Statement of Facts dated 28th April 2022 and filed on the same date together with documents attached thereto;
 - ii. The Respondent's witness statement of Timothy Nthuku admitted on oath by the Tribunal on 16th February 2022.

- iii. The Written Submissions dated 2nd March 2023 and filed on 10th March 2023.

154. The Respondent replied to the Appeal as follows:-

a) The Respondent erred in law and fact by issuing objection decision based on new facts and grounds in breach of Article 47 of the Constitution of Kenya.;

155. The Respondent averred that it did not issue an objection based on new facts as alleged by the Appellant. That contrary to the Appellant's allegations, the Respondent averred that it did not shift/alter its basis of assessment, but simply went further in the objection decision to demonstrate how over and above the Appellant having a Permanent Establishment (PE), there was direct link and control between the Appellant, the Manager and the Fund.

156. The Respondent averred that having a permanent establishment is just but one limb as the basis for the assessment but to support its position, the Respondent elaborated and demonstrated how the Appellant had both direct and indirect control on the transactions of the Fund.

157. The Respondent maintained that no new facts were raised or introduced in the objection decision but was within its legal mandate to review all the documents and information in respect to the assessment in dispute.

158. The Respondent averred that it is in the interest of justice, protection of taxes and executing its Constitutional mandate to provide all the crucial information to justify the assessment.

b) The Respondent erred in law and fact in concluding that ECP manager LP and the ECP Africa Fund III PCC are related parties on the basis that ECP manager LP has discretionary control of ECP Africa Fund III PCC.

159. The Respondent averred and maintained that there is overwhelming evidence that the Appellant had both direct and indirect control in the fund which led to the conclusion that the Appellant was also a beneficiary of the income earned from the disposal of the offshore stake in JHML and the same were subject to corporation tax in Kenya.

160. That the Respondent demonstrated the direct and indirect control as follows:

a) Section 18. Ascertainment of gains of profits of business in relation to certain non-resident persons

(3) Where a non-resident person carries on business with a related resident person and the course of such business is so arranged that it produces to the resident person either 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 such resident person from such business shall be deemed to be of such an amount as might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length.

(6) For the purposes of subsection (3), a person is related to another if—

(a) Either person participates directly or indirectly in the management,

Control or capital of the business of the other;

(b) A third person participates directly or indirectly in the management, control or capital of the business of both; or

(c) an individual, who participates in the management, control or capital

of the business of one, is associated by marriage, consanguinity or

affinity to an individual who participates in the management, control or capital of the business of the other.

161. That from the information obtained from **Securities Exchange Commission**

Form ADV for ECP Manager III LP (The Manager), the following were noted;

- i. The filing entity is ECP Manager III LP but the primary entity of conducting business is Emerging Capital Partners (ECP)
- ii. The address of ECP is:

1909 K Street, STE 340,

Washington, District of Columbia,

United States of America.

- iii. There are four other offices for ECP which are:

Corner of 5th & Maude St. Sandton,

8th Floor, the Forum Building,

Johannesburg, South Africa.

Immeuble, 4th Floor Aisle C,

Avenue Botreau Roussel,

Abidjan, Cote de Ivoire.

14 Avenue Franklin Delano Roosevelt,

3rd Floor,

Paris, France.

9 West 9th Floor,

Ring Road Parklands,

Nairobi, Kenya.

- iv. ECP Manager III LP is a large advisory firm that either has regulatory assets under management of \$100 million or more, or has regulatory assets under management of \$90 million dollars or more at the time of filing its most recent annual updating amendment as is registered with the SEC.
- v. ECP Manager III LP has 22 employees (out of 27) who perform investment advisory functions.
- vi. ECP Manager III LP advises 4 pooled investment vehicles with an Asset size of \$568,332,961. (*See page 11 of the annexed and marked KRA 4 of Securities Exchange Commission Form ADV for ECP Manager III LP SEC*)
- vii. All 4 pooled investments are discretionary.
- viii. ECP Manager III LP manages several private funds: ECP Africa FIII Investment LLC, ECP Africa Fund III Partnership SA, ECP Africa Fund III PCC
- ix. ECP Africa Fund III PCC is domiciled in Mauritius. The directors of the Fund are **Arunagirinatha Runghien, Carolyn Campbell and Rubina Toorawa.**
- x. ECP Africa Fund IIIA LLC is a private equity fund domiciled in Mauritius. Its directors are **Arunagirinatha Runghien, Carolyn Campbell and Rubina Toorawa.**
- xi. ECP Africa Fund IIIA LLC is a feeder fund for ECP Africa Fund III PCC. ECP Africa Fund IIIA LLC has 2 beneficial owners.

- xii. ECP Manager III LP and its related entities own 2% of ECP Africa Fund IIIA LLC.
- xiii. ECP Manager III LP sends all account statements to the investors of ECP Africa Fund IIIA LLC.
- xiv. ECP Manager III LP *has **discretionary authority** to determine the securities to be bought or sold for a client's account, amount of securities to be bought or sold for a client's account, broker or dealer to be used for the purchase or sale of securities for a client's account, commission rates to be paid to a broker or dealer for a client's securities transactions. (See page 41 of Securities Exchange Commission Form ADV for ECP Manager III LP)*
- xv. ECP Manager III LP has custody of the clients' cash and bank accounts and securities.
- xvi. The ownership of ECP Manager III LP is as follows:

Legal Name	Type of Entity	Title	Ownership
Carolyn Campbell	Individual	CLO	10% <= 25%
Hurley Doddy	Individual	CO-CEO	10% <= 25%
Vincent Le Guennou	Individual	CO-CEO	10% <= 25%
Emerging Capital Partners III LLC	Domestic Entity	LLC	10% <= 25%

- xvii. The ownership of Emerging Capital Partners III LLC is as follows:

Legal Name	Type of Entity	Status
Carolyn Campbell	Individual	Partner

Hurley Doddy	Individual	Partner
Vincent Le Guennou	Individual	Partner
Bryce Fort	Individual	Partner

162. The Respondent averred that from the information above which was obtained from information filed by ECP Manager (the Manager) who is the parent Company of the Appellant, it was crystal clear that the Manager has control of the Fund and the ownership of the Fund, the Manager and the Appellant is the same across board in all the related Companies.
163. That the ECP Manager (The Manager) has discretionary authority to determine the securities to be bought or sold for a client's account, amount of securities to be bought or sold for a client's account, broker or dealer to be used for the purchase or sale of securities for a client's account, commission rates to be paid to a broker or dealer for a client's securities transactions.
164. The Respondent averred that the Appellant has Directors or proxies in the Companies they have invested in. That for instance, in the merger notification submitted by NJHL, the person that undertook the filing of the notice was Paul Maasdorp. Paul Maasdorp, as highlighted by the Emerging Capital Partners website, is an employee of Emerging Capital Partners. He sits in the Nairobi office of Emerging Capital Partners. At the time of filing the merger notification, Paul Maasdorp was filing as a director of NJHL and his address was as follows

21533-00505 Java Executive Offices

2nd Floor ABC Place

Nairobi Kenya

165. The Respondent stated that on page 5 in paragraph 5 of the notification that JHML is a company incorporated in Mauritius and holds 100% of the legal and beneficial interest in NJHL. Further, JHML has the same address as ECP Africa Fund III Investments LLC (ECP) that was stated in the merger notification in year 2012.

166. The Respondent averred that it is apparent from the 2017 merger notification that the address of ECP FUND was the same to that of ECP Manager III LP (ECP GP) The address is shown below;

1909 K Street, NW, Suite 340

Washington, DC 20006

167. The Respondent averred that over and above the direct and indirect control by the Appellant and the manager, during the meeting with one of the Directors of the Appellant Mr. Bryce the following was noted from the interview;

- i. From 2005 to 2013 Bryce was based in Washington but since 2013, he has been based in Nairobi
- ii. Bryce monitors the investment portfolio and ensures his team collects all the information relating to the investment portfolio, with reference to Key Performance Indicators.
- iii. Bryce's team compiles reports in the appropriate format based on tasks assigned by ECP Manager.
- iv. Bryce confirmed that he is a partner in ECP Manager.

168. The Respondent averred that from the meeting it was clear that the Director Mr. Bryce came to Kenya around the same time when NJHL was established to monitor the way the investment was performing and grow the business.

169. The Respondent averred that from the interview held between Bryce Fort (Appellant's Director) and the Respondent on 17th September 2020, it was clear that Bryce Fort is a partner in ECP and indeed a founding partner of the entity(ies). Being so he is a vital actor in the functions carried out by ECP Manager. He is also a Managing Director of the Appellant. Gains and losses of a partnership are allocated to its partners. Bryce Fort and Paul Maasdorp are tax resident in Kenya. Further, that, Bryce Fort has been a director of Wananchi Group Limited, NJHL, Cellcom Telecommunications Limited and Maarifa Education. This shows that indeed Bryce manages and controls the risk of ECP and its funds, including ECP Africa Fund III PCC.
170. The Respondent averred that it is apparent from the Functions, Assets and Risks (FAR) Analysis that the Appellant oversees Fund management activities, identifies new business opportunities, monitor investments for all the funds under management by ECP, oversees structuring and negotiating transactions, prepare investment proposals for each stage of a project, conducts due diligence and drive structuring and negotiations in transactions, participate as members of board of directors for portfolio companies, develop and support portfolio companies strategies and manage exits, among other vital functions. In this sense, ECP Kenya Limited manages and controls the investment risk ensuring that ECP has direct control of portfolio companies, their strategy and is continually monitored to meet the set-out objectives laid out for the investment.
171. The Respondent averred that Arunagirinatha Runghien, Anuj Maheshwari, Sateeta Jeewoolall Jessoo are employees of Sanne Group and simply offer administrative services to ECP Funds. As highlighted in the brochure for ECP Manager submitted to the Securities Exchange Commission, they are proxies appointed by ECP to serve the interests of the advisory clients. The decision makers of ECP funds are therefore the partners of ECP.

172. The Respondent averred that the Appellant had 22 employees who offer actual advisory services. Of the 22 employees, 7 are in Nairobi, 3 in Johannesburg, 5 in Abidjan, 3 in France and 4 in the US. The 7 employees in Kenya include 3 Managing directors, one of whom is a partner in ECP (Bryce Fort), 1 vice president and 3 Associates.
173. The Respondent noted that the Appellant does not have any employees in Mauritius to mean there are no transactions in Mauritius, but just an office for purpose of incorporation and physical presence.
174. That in concluding the relationship test, the Respondent reviewed the risks assumed by the Appellant which are:
- a) Risks relating to the African continent. These include political risks, legal risks, crime and corruption, environmental risks and restrictions on trade.
 - b) Financial risks. These include uncertainties in registration, settlement, clearing and custodial systems; foreign currency, exchange rate and market risks, restrictions on repatriation of capital and profits; accounting standards, limited availability of information, due diligence; tax risks; long term investments and illiquid securities
 - c) Risks related to the advisory client and other risks. These include the speculative nature of investments; project financings; restrictions on transfer and withdrawals; risks arising from managerial assistance; liabilities upon disposition; competition; dependence on key personnel
 - c) The Respondent erred in law and fact by concluding that the income that was earned by ECP Africa Fund III PCC from the offshore disposal of its stake in Java House Mauritius Limited was business income chargeable to corporation tax in Kenya.

175. The Respondent posited that as per **Section 2 of the Income Tax Act**

“business includes any trade, profession or vocation, and every manufacture, adventure and concern in the nature of trade, but does not include employment.”

176. The Respondent averred that in an online journal, *“How we made it in Africa”* in an article titled *“The journey so far: Carolyn Campbell, partner, Emerging Capital Partners”* published on 20th December 2018, Carolyn Campbell is interviewed by Justin Probyn. In the interview Carolyn Campbell was asked to elaborate on one of the toughest situations she had found herself in as a business owner. Carolyn, who is a founding partner of ECP, answers by saying that:

“Since founding ECP 18 years ago, we raised more than US\$ 3 billion for investment, invested in more than 60 African companies and fully exited 43 of them.” She adds, *“The way ECP was designed from the start helped us overcome ... challenges. Rather than time the market, we spread our investments over several years which allows us to be patient and exit at the right time.”*

That in the same interview, Carolyn is asked which achievement she is most proud of. She answers by saying,

“I am proud of the lasting and important companies we have built. When I land in a key African airport, I am pleased to see a café or bank that we grew from often a smaller concept into a national brand.”

That ECP has exited several investments over the years.

177. The Respondent averred that since the fund is in the business of buying and selling shares in companies, it therefore follows that the income derived there from should be subjected to income tax in Kenya.

178. The Respondent stated that Section 3 (1) of the ITA provides as follows,

“Subject to and in accordance with this Act, a tax known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.”

179. That according to Section 3 (2) (a) (i) of the ITA,

“Subject to this Act, income upon which tax is chargeable under this Act is income in respect of gains or profits from a business, for whatever period carried on.”

180. The Respondent averred that in the merger notification at page 6 paragraph 8 it was stated that when ECP invested in NJHL through JHML, it only had 17 stores across 2 brands (**Java House and Planet Yoghurt**). However, as per the date of filing, an additional brand had been added - **"360 Degrees Artisan Pizza."** As at 31st May 2017, the target (JHML) operated 41 establishments under the name Java House, 7 establishments under the name Planet Yoghurt and 2 establishments under the name 360 Degrees Artisan Pizza.

181. At the time of the merger notification (year 2017), NJHL had a **gross annual** turnover of Kshs. 3,159,027,797.00 for the twelve months ending 30th June 2016.

182. That the Respondent demonstrated that ECP had grown the sales of NJHL by a factor of x2.57 from the time ECP invested to the point of this merger notification. Further, NJHL assets in Kenya as of 31st June 2016 stood at Kshs. 1,947,976,998. The monetary value of the consideration offered for JHML was USD 101,400,000. The consideration was for 100% acquisition of shares held by JHML.

The break-down was as follows:

- i. USD 82,589 to ECP for expenses relating to expenses incurred by ECP in respect of this Agreement and Transactions
- ii. USD 91,185,670 to ECP fund and
- iii. USD 10,131,741 to Kevin Ashley

183. The Respondent averred that from the information obtained, the Fund through JHML had 100% shares in NJHL. That further, the Respondent noted that the value of the entire JHML (USD 101,400,000) was equal to the value of NJHL (Kshs. 1,947,976,998) to mean that JHML is a shell which only exists on paper with no economic value. That the value attached to JHML is in the real sense the value of NJHL.
184. The Respondent averred that it is very unlikely for a company like the Fund who are in the business of investing for Capital appreciation then exits when it's ripe to invest in hollow project with no revenue generation.
185. That the Appellant wants to make the Tribunal believe that the offshore sale was a sale of shares in JHML which is outside Kenya and therefore the income was derived outside Kenya and no business income accrued to the Appellant or its related companies.
186. The Respondent asserted that the Appellant's allegation is far from the truth and misleading to the Tribunal.
187. The Respondent averred that the total assets owned by JHML are exactly the same assets of JHNL and the two cannot be separated.
188. The Respondent averred that if the fund disposed off JHML and JHML owned 100% shares in NJHL, then it goes without saying that what was disposed was NJHL. That the question one would be left asking is, if NJHL is part of the assets of JHML and JHML has been sold to Star Foods Holding meaning anything that comprise JHML including NJHL has been disposed. Isolating NJHL would mean JHML was not disposed at 100 % and there is a percentage

that was left out, this being the percentage that owned NJHL which the Appellant has not demonstrated. That if at all the Appellant is not misleading the Tribunal, they should have distinguished the value of NJHL and JHML.

189. The Respondent averred that if Appellant separates the two, it will be crystal clear that JHML is not in existence and they are simply using the same to avoid paying taxes in Kenya since there is no tax implication in Mauritius which is a tax haven.
190. The Respondent averred that having established that the actual sale was not sale of shares in JHML but the sale was for the shares in NJHL it was justified to assess taxes on the Appellant using the profit Split method.
191. The Respondent averred that whichever way the Appellant tilts the issue of whether the income was derived in Kenya or not, by virtue of being in management of the fund the profits earned by the fund are directly attributable to their input from Kenya and any income earned is business income for the related company subject to tax.

d) The Respondent erred in law and fact in its Functions, Assets and Risk Analysis of the Appellant's role to ECP manager LP and its conclusions that the Appellant carries out significant value adding functions in Kenya for ECP Manager LP.

192. The Respondent averred that from the information filed on SEC by ECP Manager and the job description of the Directors and the employees, it is apparent that the Appellant oversees Fund management activities, identifies new business opportunities, monitor investments for all the funds under management by ECP, oversees structuring and negotiating transactions, prepare investment proposals for each stage of a project, conducts due diligence and drive structuring and negotiations in transactions, participate as members of

board of directors for portfolio companies, develop and support portfolio companies strategies and manage exits, among other vital functions.

193. That in this sense, the Appellant manages and controls the investment risk ensuring that ECP has direct control of portfolio companies, their strategy and is continually monitored to meet the set-out objectives laid out for the investment.
194. That the returns and other information provided by Appellant formed the basis for the Functions, Assets and Risks (FAR) Analysis:
 - a) **The Respondent erred in law and fact in attributing the entire profit of ECP Africa Fund III PCC from sale of its stake in Java House Mauritius Limited to ECP manager LP and the Appellant.**
 - b) **The Respondent erred in law and fact in applying the Transactional Profits Split Method as the basis for computing the remuneration of the functions performed by the Appellant to ECP Manager LP.**
195. The Respondent addressed ground 4 together with ground 6 in the Appellant's Memorandum of Appeal as hereunder.
196. The Respondent averred that the Appellant's transfer pricing policy, had been benchmarked as a company that provides routine management consulting services, business consulting and accounting, auditing and book keeping services. That however, based on the evidence in the Respondent's possession, the Appellant offers value adding activities that are integral to the performance of the fund as an investment advisory firm.
197. The Respondent averred that the Appellant stated that it is currently remunerated on a Full Cost Mark-up plus 8% which is a routine return for services rendered by the Appellant.
198. That further, the services that contribute to the core business of the MNE group, that is creating profit earning activities, are not subject to a routine return. That if the intra-group service leads to the creation of a valuable and

unique intangible property and involves the assumption or control of significant risk by the service provider, then a method that takes into account all these factors must be applied to ensure the service provider is adequately remunerated for its service(s).

199. The Respondent averred that as per the law the Appellant ought to earn an arms-length return for the functions it performs, risks it assumes, manages or controls, and assets it utilizes. This should also be done in line with the arms-length principle. That the FAR analysis carried out showed that indeed the Appellant should not be the subject of a routine return.
200. The Respondent averred that based on the facts of the case already stated above, profits should be attributed in such a way as to ensure that Appellant is well remunerated for the value adding services it provides to the Fund as a whole.
201. The Respondent asserted that in its assessment, the most appropriate transfer pricing method to be used was the Transactional Profit Split Method.
202. That as per the OECD Transfer Pricing Guidelines 2017 Chapter II paragraph 2.115 states:

“The main strength of the transactional profit split method is that it can offer a solution for highly integrated operations for which a one-sided method would not be appropriate.... A transactional profit split method may also be found to be the most appropriate method in cases where both parties to a transaction make unique and valuable contributions to the transaction, because in such a case independent parties might wish to share the profits of the transaction in proportion to their respective contributions and a two-sided method might be more appropriate in these circumstances than a one-sided method”

203. The Respondent averred that both the ECP Manager (the Manager) and Appellant offer very significant value adding services that are paramount in the generating of profits for investors. That the most important element in the investment advisory industry is the personnel who ultimately determine whether the investors will realise a profit for the amount of funds committed by them. That since ECP manager has full discretionary authority for all funds that it manages, it is the personnel of ECP manager ultimately who will ensure that the investors' funds are aptly invested to make a profit.
204. The Respondent maintained that the allocation key for the profit split is therefore the number of advisory personnel in Kenya. That their mere presence does not suffice to use them as the allocation key. That however, it is important to note that in Kenya there is a Partner (Bryce Fort who is a participating partner of ECP and Managing Director of the Appellant), Paul Maasdorp (an employee but not a participating partner of ECP of the Appellant), Kameel Virjee (Managing Director of the Appellant), Johannes Ferreira (Vice President of the Appellant) and three associates. The three (3) Managing Directors and Vice President serve as directors of portfolio companies amongst other functions as highlighted in the FAR analysis. Therefore, the number of advisory personnel in Kenya is an appropriate allocation key for the Profit Split Method.
205. That Para 7.35 and 7.36 of the 2017 Organisation for Economic Co-operation and Development (OECD) Transfer Pricing guidelines ("the guidelines") provides that;

"... in an arm's length transaction, an independent enterprise normally would seek to charge for services in such a way as to generate profit, rather than providing the services merely at cost...."

...In determining whether the intra-group services represent the same value for money as could be obtained from an independent enterprise,

a comparison of functions and expected benefits would be relevant to assessing comparability of the transactions...”

206. That further, Para 1.51 of the Guidelines further provides that;

“...in transactions between two independent enterprises, compensation usually will reflect the functions, that each enterprise performs, taking into account the assets used and risks assumed.”

207. The Respondent averred that going by the above provisions from the OECD Guideline, it was well within the law to attribute the income to both the Appellant and the ECP manager.

208. That Section 18 (3) of the ITA further states that;

“Where a non-resident person carries on business with a related resident person or through its permanent establishment and the course of that business is such that it produces to the resident person or through its permanent establishment either 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 or through its permanent establishment or 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.

(6) For the purposes of subsection (3), a person is related to another if –

(a) either person participates directly or indirectly in the management, control or capital of the business of the other;”

209. The Respondent maintained that in the instant case, gains arising from the disposal of shares is income which is subject to Income Tax in Kenya if they

arise from activities that would be regarded as the carrying on of a trade or business in Kenya. That however, in this case it is not only the Appellant that was an actor in this transaction, but also other entities were involved in the same. That for this reason, only the income attributable to the activities carried on in Kenya or the input of personnel from related companies should be brought to charge in Kenya.

210. The Respondent averred that the allegations of the Appellant as laid out in its Memorandum of Appeal and Statement of Facts unless where in agreement by the Respondent are unfounded in law and not supported by evidence.

Respondent's Prayers

211. The Respondent made the following prayers to the Tribunal:-

- a) The Appeal be dismissed with costs,
- b) The income tax assessment of Kshs 773,796,052.00 raised by the Respondent be confirmed and the principal taxes, interests and penalties be found due and payable as per the objection decision rendered by the Respondent.

ISSUES FOR DETERMINATION

212. The Tribunal having carefully reviewed the pleadings made by the parties as well as their submissions and upon hearing the witnesses for the respective parties, is of the considered view that the Appeal herein distils into three issues for determination being:-

- i. Whether the objection decision was validly issued.*
- ii. Whether the Respondent erred in law and fact by concluding that the income that was earned by ECP Africa Fund III PCC from the offshore*

disposal of its stake in Java House Mauritius Limited was business income chargeable to corporation tax in Kenya.

ANALYSIS AND DETERMINATION

213. Having established the issues for determination, the Tribunal proceeds to analyse them as hereunder:

i. Whether the objection decision was validly issued.

214. The Appellant averred that the Respondent erred in law and fact by issuing an objection decision based on new facts and grounds in breach of Article 47 of the Constitution of Kenya, 2010 and the provisions of the FAAA. On its part the Respondent averred that it did not issue an objection decision based on new facts as alleged by the Appellant. That contrary to the Appellant's allegations, the Respondent averred that it did not shift/alter the basis of the assessment, but simply went further in the objection decision to demonstrate how over and above the Appellant having a Permanent Establishment (PE), there was direct link and control between the Appellant, the Manager and the Fund.

215. The Tribunal has observed that the notice of objection was based on an assessment amount of Kshs. 3,210,148,174.00. To arrive at this figure the Respondent in its decision averred that ECP Africa Fund III PCC carried in Kenya through a PE existence in Kenya in the form of fixed place of business.

216. Conversely, the objection decision introduced a profit split and attributed profit to ECP Kenya Limited. This new approach by the Respondent led to a variation in the objection decision eventually demanding from the Appellant a total amount of Kshs. 773,796, 052.00.

217. Sub-sections 51 (8) and (9) of the Tax Procedures Act provide that: -

“(8) Where a notice of objection has been validly lodged within time, the Commissioner shall consider the objection and decide either to allow the objection in whole or in part, or disallow it, and Commissioner's decision shall be referred to as an "objection decision".

(9) The Commissioner shall notify in writing the taxpayer of the objection decision and shall take all necessary steps to give effect to the decision, including, in the case of an objection to an assessment, making an amended assessment.”

218. The Tribunal is of the considered view that the purpose of a Commissioner's review of an objection is to consider the merits of the objection, which can involve requests to a taxpayer for information on the grounds of objection and the amendments to assessment outlined by a taxpayer, all to enable the Commissioner to arrive at an objection decision.

219. Based on the Appellant's and Respondent's Statements of Facts and submissions, it is apparent that the Appellant provided the Respondent with additional information during the Respondent's review of the objection.

220. It is on this basis that the Tribunal finds that the Respondent fairly administered its mandate by considering the additional information that the Appellant provided, and issued an objection decision which allowed the objection in part and made an amended assessment.

221. In this regard, the Tribunal finds that the objection decision was validly issued.

ii. Whether the Respondent erred in law and fact by concluding that the income that was earned by ECP Africa Fund III PCC from the offshore disposal of its stake in Java House Mauritius Limited was business income chargeable to corporation tax in Kenya.

222. At the heart of the dispute is whether or not tax from the sale of the shares in JHML is due in Kenya. Section 3 of the Income Tax Act in setting out what is taxable in Kenya states as thus:

“(1) Subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.”

223. Based on the above Section, for the income to be taxable in Kenya there must be income that was sourced in and accrued in Kenya. The person accruing the income may be resident or non-resident.

224. For the income to be deemed to have been derived in Kenya, then a person must have carried out the business in Kenya. In this case the question is if the Appellant carried on a business in Kenya that resulted in the gains made from the sale. The Respondent on its part avers that the Appellant carried on business in Kenya that can be linked to the gains made from the sale while the Appellant denies this.

225. The Tribunal must therefore address itself to the question of whether the Appellant carried on business in Kenya that could result in the attribution of those gains to the Appellant.

226. The question of whether the Appellant is a subsidiary of EPC Manager is not in dispute. This is a fact that has been accepted by both parties. However, what is in dispute is the extent of the services or work performed by the Appellant for/on behalf of the Fund in Mauritius. The Respondent argued that the Appellant was managing the Fund while the Appellant argued the contrary. The Tribunal must therefore address its mind on whether the activities of the Appellant with regard to the Fund could be deemed to mean that it was in fact managing the fund for tax purposes. The question of whether such

management resulted in the establishment of a taxable presence in Kenya with taxable income must be dealt with.

227. As at the time of sale in dispute, the Income Tax Act defined a permanent establishment (PE) as:

“permanent establishment” in relation to a person, means a fixed place of business and includes a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, a building site, or a construction or installation project which has existed for six months or more where that person wholly or partly carries on business:

Provided that -

(a) the permanent establishment of the person shall be deemed to include the permanent establishment of the person’s dependent agent;

(b) in paragraph (a), the expression “dependent agent” means an agent of the person who acts on the person’s behalf and who has, and habitually exercises, authority to conclude contracts in the name of that person;”

228. Thus, for a PE to be formed one of the above criteria must have been met. Meaning that it has a fixed place of business or a place of management or branch, office or a dependent agency is created among others.

229. In discussing the definition of a PE as a fixed place of business the OECD commentaries provide that the essential characteristics are:

a) the existence of a “place of business”, i.e. a facility such as premises or, in certain instances, machinery or equipment;

b) this place of business must be “fixed”, i.e. it must be established at a distinct place with a certain degree of permanence;

c) the carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or

another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.

230. The determination of whether the above elements have been met is one that is factual and that can only be decided on a case by case basis.
231. The first two elements are not in dispute. With regard to whether there is a fixed place, the Appellant's premises for the use of the work averred to be management of the Fund. The offices are permanent in nature. The last element deals with whether the business of the Fund was carried out through the Appellant. This, in our understanding is where the dispute arises.
232. A review of the evidence adduced before the Tribunal indicates that ECP Manager plays a key role in the management and control of the Fund. According to the information adduced by the Respondent as filed at the SEC, the Manager manages several funds including the Fund in Mauritius. The Manager, according to its own declaration in Form ADV filed at the SEC, has discretionary control over the Fund. The same was reproduced by the Respondent as below:
- "Your firm has discretionary authority to determine the securities to be bought or sold for a client's account, amount of securities to be bought or sold for a client's account, broker or dealer to be used for the purchase or sale of securities for a client's account, commission rates to be paid to a broker or dealer for a client's securities transactions."*
233. Despite vehemently denying ECP's discretionary control, the Appellant did not adduce sufficient proof to dispute this claim. This is especially so in light of the fact that the filings are done by the ECP itself. This is despite the burden of proof being placed upon the Appellant.
234. The information adduced before the Tribunal seems to indicate that this discretionary control was exercised through the Appellant in Kenya. In one of

the pleadings filed before the Tribunal, the Respondent cites the information on the job descriptions of the ECP Kenya employees. It sets out their roles as follows:

- a) Identifying new business opportunities for the Funds to invest in;*
- b) Carrying out due diligence on prospective investee companies. The due diligence involves analyzing investment opportunities in terms of business, industry, financials and valuations. Additionally, it requires working with financial advisors, investment banks, consultants, industry experts, financial institutions, and lawyers. Due diligence is a very critical function since it highlights whether indeed a company should be invested in; any misstep at this level could lead to a wrong decision being made, that is, the Fund invests in a company that will eventually lead to the Fund making a loss;*
- c) Structuring and negotiating transactions that require the preparation of all documents to complete the transaction. This is a significant and highly specialized value-adding function in investment advisory.*
- d) Developing and executing exit strategies. The timing to exit an investment has to be properly planned for and executed. There exists a real possibility of making a loss if an exit from an investment is not executed at the optimal time.*
- e) Structuring and negotiating financing in connection with investee companies. This is a value-adding function as it ensures that the credit terms negotiated are the most favorable they can be for the investee companies. This includes but is not limited to the interest cost and terms of payment.*
- f) Monitor investee companies. This entails making financial models that are used to determine the performance of the investee companies with regard to Key Performance Indicators (KPIs). Continuous monitoring*

ensures that corrective action is taken early to keep the performance of investee companies optimal.

g) Developing and supporting portfolio company strategy. According to Item 8; Methods and Analysis, Investment Strategies and Risk of Loss of the Emerging Capital Partners Brochure (See Appendix 14) “ECP targets growth equity investments in companies located or has substantial operations on the continent of Africa. ECP will generally seek control positions or influential minority positions with significant contractual rights and board representation.

235. The Appellant averred that the job descriptions were templates and should not be relied upon. This, the Tribunal found curious since it was the Appellant itself through its tax agent that provided the same.

236. Based on the above job descriptions and the fact that the Appellant had been contracted to carry out the above functions by ECP Manager, it is apparent that the Appellant was in fact carrying out the business of the Fund from its premises. It was in the Tribunal’s understanding of the facts, involved in the management of the Fund. It, through its employees, was tasked with identifying new opportunities, negotiating and structuring transactions as well as monitoring and executing the exit strategy. The Appellant was unable to prove that this was not the case. Its averments that the Appellant was carrying out routine functions were not well supported. This is especially so since the Fund in Mauritius did not have staff needed to carry out the core functions of the Fund.

237. In arriving at this, the Tribunal is guided by the OECD commentaries which state as thus:

“The function of managing an enterprise, even if it only covers a certain area of the operations of the concern, constitutes an essential part of the business operations of the enterprise and therefore can in no way be

regarded as an activity which has a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4

238. The discretion with which the Appellant could carry out its functions as captured in the job descriptions of the Appellant's employees is enough to convince the Tribunal that the management of the company was being exercised by the Appellant in Kenya and thus a PE was established.
239. Thus, the Tribunal is inclined to find that since management was being exercised from Kenya by the Appellant, the Appellant formed a PE of the Fund in Kenya.
240. The question then that the Tribunal must address is whether the income that was earned from the sale of shares in Mauritius could be attributed to and be taxable on the Appellant.
241. Ordinarily, income earned from the sale of shares is treated as a capital gain and taxed according to the provisions of the Eighth Schedule. However, in this case, the Respondent averred that the income earned is business income and thus attributable, at least in part, to the Appellant.
242. Whether the income is taxable as business income is a question of fact that is answered by the various badges of trade that have been developed over the years by the various courts. The badges of trade include but are not limited to:
- a) profit seeking motive*
 - b) the number of transactions*
 - c) the nature of the asset*
 - d) existence of similar trading transactions or interests*
 - e) changes to the asset*
 - f) the way the sale was carried out*
 - g) the source of finance*
 - h) interval of time between purchase and sale*
 - i) method of acquisition.*

243. In attempting to show that the Fund was in fact trading, the Respondent adduced evidence of the Appellant's intentions to trade as evidenced through the brochures and interviews. This, it argued, indicated that its intention was to make a profit from the sale of shares of various entities. The Appellant did not provide evidence to rebut this.
244. The Appellant averred that the income from such sale should not be taxable on the Appellant for various reasons. That this includes the doctrine of separation as espoused by **Salomon vs Salomon** case. However, in this case, the veil has not been pierced and as such the doctrine would not be applicable. The question of the chargeability of the income only arises as a result of the formation of a PE.
245. The Appellant further averred that it is accepted worldwide the income of private equity funds is not deemed as trading income but as investment income. The Appellant cited various cases from different jurisdictions to substantiate this point. Whereas this may be the treatment of such private equity fund income as investment income is accepted in different countries, note must be taken that tax law is country specific and in the words of the Majanja J: in **Republic vs. Commissioner of Domestic Taxes Large Taxpayer's Office Ex-Parte Barclays Bank of Kenya LTD [2012] eKLR**

"The approach to this case is that stated in the oft cited case of Cape Brandy Syndicate v Inland Revenue Commissioners [1920] 1 KB 64 as applied in T.M. Bell v Commissioner of Income Tax [1960] EALR 224 where Roland J. stated, "...in a taxing Act, one has to look at what is clearly said. There is no room for intendment as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used... If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the

subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.”

246. Thus, if Parliament intended to exempt private equity funds from taxation, nothing would have been easier than to state so. As stated in **Association of Gaming Operators-Kenya & 41 others v Attorney General & 4 others [2014] eKLR:**

I also reiterate what I stated in Kenya Union of Domestic, Hotels, Education, Institutions and Hospital Allied Workers (KUDHEIHA) Union v Kenya Revenue Authority and Others Nairobi Petition No. 544 of 2013[2014] eKLR “ Before I deal with the constitutionality of the impugned provisions, I think it is important to establish the legislative authority of the legislature to impose taxes. Article 209 of the Constitution empowers the national government to impose taxes and charges. Such taxes include income tax, value-added tax, customs duties and other duties on import and export goods and excise tax. The manner in which the tax is defined, administered and collected is a matter for Parliament to define and it is not for the court to interfere merely because the legislature would have adopted a better or different definition of the tax or provided an alternative method of administration or collection. Under Article 209 of the Constitution, the legislature retains wide authority to define the scope of the tax.

247. In this case, since Parliament has remained silent on the matter, then the law as is applies and private equity firms remain subject to tax on their gains.

248. Having established that the Appellant formed a PE in Kenya and that the income earned was business income, the Tribunal finds that the Respondent was justified in apportioning a percentage of the income derived from the sale to the Appellant in Kenya.

249. The Tribunal in the circumstances finds that the Respondent did not err in subjecting the gains made from the sale of shares in JHML to Corporation tax in Kenya.

FINAL DECISION

250. The upshot of the foregoing analysis is that the Appeal lacks merit and the Tribunal accordingly proceeds to make the following Orders: -

- a) The Appeal be and is hereby dismissed.
- b) The Respondent's Objection decision dated 17th February 2021 be and is hereby upheld.
- c) Each party to bear its own costs.

251. Orders accordingly.

DATED and DELIVERED at NAIROBI this 6th day of October, 2023

**ERIC NYONGESA WAFULA
CHAIRMAN**

**CYNTHIA B. MAYAKA
MEMBER**

**GRACE MUKUHA
MEMBER**

**JEPHTHAH NJAGI
MEMBER**

**ABRAHAM K. KIPROTICH
MEMBER**