REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI LAW COURTS

COMMERCIAL AND TAX DIVISION

TAX APPEAL NO. E062 OF 2021

BETWEEN

COMMISSIONER OF LEGAL SERVICES AND BOARD COORDINATION…… APPELLANT

AND

MCKINSEY AND COMPANY INC. AFRICA PROPRIETARY LIMITED …… …..RESPONDENT

(Being an appeal against the judgment of the Tax Appeals Tribunal at Nairobi dated 1st April 2021 in Tax Appeal No.199 of 2020)

JUDGMENT

Introduction and Background

1. This appeal arises from a judgment delivered by the Tax Appeals Tribunal on 1st April 2021 in **McKinsey and Company Inc Africa Proprietary Ltd v Commissioner of Legal Services and**

Board Coordination [2021] KETAT 137 (KLR) ('the Judgment"). The dispute before the Tribunal concerned whether the Respondent was required to withhold income tax when paying professional fees to its related entity in South Africa. The appeal is anchored in the Commissioner's Memorandum of Appeal dated 28th May 2021 where it cites 14 grounds faulting the Tribunal. The Commissioner states that the Tribunal erred in law and fact by failing to distinguish between the income element and expense element in any transaction, focusing on how the South African entity treats the income, rather than how the Respondent should treat the payment as an expense at the point of payment and ignoring the Respondent's statutory obligation to withhold income tax on payments for professional services under the ***Income Tax Act (Chapter 470 Laws of Kenya)*** ("the ***ITA***")

2. The Commissioner further states that the Tribunal erred in relying on the Kenya-South Africa Double Tax Agreement ("the DTA") , which the Commissioner asserts deals only with treatment of income, not treatment of expenses, finding that the DTA covers management/professional fees under Article 7 when such fees are not specifically provided for and should fall under Article 22(3).

That the Tribunal erred in holding that the Commissioner was wrong to demand withholding tax on payments to a related South African entity and failing to appreciate the relevance of Article 21(3) of the ***UN Model Convention*** and the deletion of Article 14 of the ***OECD Model Convention***. As such, the Commissioner is urging the court to allow the appeal, set aside the Judgment and uphold the Commissioner's Objection Decision dated 6th April 2020 which had demanded the principal withholding tax of Kshs. 179,956,998.00/=

3. The appeal was responded to by the Respondent through its Statement of Facts dated 25th June 2021 and the appeal was canvassed by way of written and oral submissions by the parties' respective counsel which I have considered and I will be making relevant references to the same in my analysis and determination below.

Analysis and Determination

4. As I determine this appeal, I am cognizant of the fact that this court's jurisdiction is circumscribed under **section 56(2)** of the ***Tax Procedures Act (Chapter 469B of the Laws of Kenya)*** ***(***"the ***TPA****")* which provides that *"An appeal to the High Court or*

to the Court of Appeal shall be ***on a question of law only****"*. In dealing with matters of law, the court must also pay fealty to the findings of fact by the Tribunal but only intervene if such findings are perverse (see **Bashir Haji Abdullahi v Adan Mohamed Nooru & 3 others [2014] KECA 621 (KLR)**].

5. As stated, even though the Commissioner raises 14 grounds in its appeal, it has condensed the same in its submissions to three issues for determination:

    i. *Whether the Tribunal misconstrued the term 'business profit' and or used the term 'Business profit' to mean 'income'*

    ii. *Whether the Respondent has a permanent establishment in Kenya*

    iii. *Whether the professional fees paid by the Respondent to its related entity in South Africa fits within the definition of 'Business Profits' or 'other income'*

Construction of the term 'Business Profit' and 'income'

6. The Commissioner has submitted that the Tribunal used the terms 'Business Profit' and 'income' interchangeably, which is legally wrong as 'income' refers to gross revenue streams

whereas ‘profit’ means revenue less expenses. It contends that Article 7 of the DTA explicitly allows deductions for expenses, while management fees are gross receipts and that under Article 7(7), if an item of income is dealt with separately in other articles, Article 7 does not apply and that since no article specifically covers management fees, they fall to the residual clause which is Article 22. The Commissioner submits that Professional Fees are not business profits under the DTA and that the same does not define ‘business’ to include professional services unlike the ***OECD Model***, which deleted Article 14 on independent services. That the DTA still contains Article 14 so there was no need to read professional services into Article 7 and that the services in this case were provided by a legal entity, not an independent individual, making Article 14 irrelevant.

7. As stated by the Tribunal at Para. 70 of the Judgment, DTAs are a means by which different tax jurisdictions can cooperate and provide certainty in treatment of taxes, they remove tax barriers to cross-border trade and investment in a reciprocal manner by eliminating double taxation, providing certainty of tax treatment,

reducing tax rates, prevention of fiscal evasion, prevention of tax discrimination; and resolution of tax disputes.

8. It should also not be lost that DTA are Treaties, not legislation. They are agreements signed between independent nations and have a status similar to other international treaties. The status of a DTA as an international treaty also affects its interpretation. The general rule is that that in taxing statutes, one must look at what is clearly said, no implication or equity applies (see **Cape Brandy Syndicate V Inland Revenue Commissioners (1920) 1KB**). However, in the interpretation of treaties, domestic courts should not interpret the same solely in the light of doctrines peculiar to the domestic law but should attempt to construe it as a whole, taking into account its objects and purposes, in an endeavor to give effect to the expressed intention of its framers. I am in agreement with the Commissioner's submission that **Article 31(1)** of the ***Vienna Convention on the Law of Treaties*** sets out the general rule of interpretation thus; "***A Treaty shall be interpreted in good faith in accordance with the ordinary meaning to be***

***given to the terms of the treaty in their context and in the light of its object and purpose*."**

9. In short, courts interpret tax treaties in a broad and liberal fashion the reasons being that unlike statues, treaties are drafted by diplomats and not by parliamentary counsel, treaties could have official texts in several languages and they involve negotiations and compromises and this could lead to the use of words that make the meaning vague in order to achieve an agreement. Justice Addy, in the Canadian Tax Court in ***J. N. Gladden Estate v. The Queen*, [1985] 1 C.T.C. 163** held as follows:

> ***'The weight of authority would appear to be against the type of strict interpretation of a tax treaty which would normally be applied to****…….provision of fiscal legislation. The justification for this general rule of interpretation…lies in the* ***contractual nature of a tax treaty rather than in its formal ratification by Parliament as legislation***

10. With above principles of interpretation of DTAs in mind, it is my finding that the Commissioner's approach in the interpretation of the DTA is overly formalistic and ignores this principles of international tax law. It is not disputed that the DTA is modelled along both the ***Organisation for Economic Cooperation and Development ("OECD") Model Tax Convention*** (***OECD MTC***) and the ***United Nations Model Double Taxation Convention***. These MTCs are accompanied by ***Commentaries*** which are instructive in relation to the interpretation of the Articles of the MTCs.

11. I am in agreement with the Respondent's submission that the ***OECD & UN Commentaries*** at Para. 21 on Article 7 of the DTA explicitly state that the term "profits" in Article 7 "…*has a* ***broad meaning including all income*** *derived in carrying on an enterprise."* The distinction the Commissioner is trying to draw does not exist in treaty interpretation. **Section 3** of the ***ITA*** charges tax on "*gains or profits from a business*" and the Commissioner's own argument would create an absurdity in that a resident company's consulting fees are business profits, but a non-resident's identical fees are not. That is not how the law

works and I find that the Tribunal correctly applied the well-established, broad meaning of "profits" in Article 7. This court(Visram J.,) in **Commissioner of Domestic Taxes v Total Kenya Limited [2024] KEHC 8194 (KLR)** adopted a similar position when he stated as follows:

> *32. The definition of "business profits" is not provided under the DTA. In this regard, Article 3 (2) of the DTA states:-*
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> *"As regards the application of the convention at any time by a contracting state, any term not defined therein shall have the meaning which it has at that time under the law of that state for the purposes of the taxes to which the convention applies. The meaning of a term under the applicable tax laws of that state shall have priority over a meaning given to the term under other laws of that state."*
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> *33. Reference to Section 2 of the ITA reveals that a business is defined as "any trade, profession, or vocation, and every manufacture, adventure and concern in the nature of trade, but does not include employment".*

34. Based on my reading of the definition of a 'business' under Article 5 and my understanding of Articles 7 and 21, I am in agreement with the holding of the Tribunal, and I am persuaded that income from management fees and professional fees fall under business profits.

12. I am in further agreement with the Tribunal's position that Article 22 of the DTA is inapplicable as the said income which constitutes business profits has already been dealt with under Article 7. My reading of Article 22 is that it is a catch-all provision for income truly not contemplated by the DTA and that before taxing such an income, the Commissioner should not be asking whether there a specific Article for 'professional or management fees but rather, whether that income is from a business activity. If yes, Article 7 applies unless another specific Article applies. I note that the Commissioner cited an excerpt of a UN Technical Paper which itself provided that "…*in most situations income from technical services would be considered to be business profits… so that Article 21 [Other Income] would not apply.*" In the persuasive decision of **Bangkok Glass Industry Co. Ltd v Assistant Commissioner of**

Income Tax [2013] 215Taxman 116 (Mad) cited by the Respondent in its submissions before the Tribunal, the court held that technical fees cannot be shoved into the "Other Income" Article simply because no specific article exists. As such, I find that the Tribunal correctly applied the primary rule under Article 7 instead of the default residual rule of Article 22 and that the Commissioner's approach would make Article 7 meaningless for service businesses.

13. It is for the above reasons that I find that this ground by the Commissioner has no merit and the same is dismissed.

The Respondent's Permanent Establishment in Kenya

14. The Commissioner submitted that both parties admitted that the Respondent operates as a registered Branch in Kenya and that Article 5 of the DTA explicitly states that a Branch constitutes a Permanent Establishment (PE). That despite this, the Tribunal held that the Commissioner had not proved a PE in Kenya, an error that alone justifies setting aside the judgment and that if Article 7 applied, Kenya would have full taxing rights over profits attributable to that PE.

15. On its part, the Respondent submitted that it is a branch of *McKinsey & Company Inc. Africa Proprietary Limited*, the South African holding company, not a Branch of *McKinsey South Africa Pty Ltd*, the service provider. That *McKinsey South Africa Pty Ltd* is a separate legal entity and indeed has no PE in Kenya and that the Commissioner itself acknowledged this distinction in its pleadings before the Tribunal and therefore, the Tribunal's finding on no PE is therefore correct and uncontested.

16. I do not think it is in dispute that generally, the country of source of the income has the priority taxing rights and the country of residence is obliged to provide relief and that as per Article 7 of the DTA, Business Profits are only taxed in the source country where they are attributable to a PE in the source country. I am in agreement with the Respondent's submission that the Commissioner, in its Statement of Facts before the Tribunal acknowledged and accepted the Respondent's explanation of its structure and Group Entity that the Respondent *"…is a branch of McKinsey & Company Inc. Africa PTY Limited the Holding Company, a legal entity incorporated in South Africa(Holding Company) not engaged in consulting services. The [Respondent]*

received consulting services from McKinsey & Company Africa PTY Limited, a legal entity separate from the Holding Company incorporated in South Africa (engaged in consulting services)

17. In summary, the Respondent is the Kenyan branch of the holding company(McKinsey & Company Inc. Africa PTY Limited) and the Respondent paid the fees. This entity, which is a separate and distinct legal entity resident in South Africa provided the services and received the fees. The Tribunal made a factual finding that this service provider, *McKinsey South Africa*, has no PE in Kenya and I find this conclusion to be unassailable. The Commissioner's argument on this point is a fundamental misreading of the facts and is not a valid question of law for an appeal before this court. This ground by the Commissioner also fails.

Payment of fees as business profits or other income

18. I believe I have already made a finding that the based on my reading and understanding of Articles 7 and 22 of the DTA, I am in agreement with the holding of the Tribunal, and I am persuaded that income from management fees and professional fees fall under business profits. Let me also state that the

Respondent conceded to paying withholding tax for the income years 2014 and 2015 and that this dispute is only for 2016 and 2017, after the DTA came into force. In my view, this shows good faith and a clear understanding on the part of the Respondent that the DTA changed the result. As the Respondent correctly submits, Kenya knows how to reserve the right to tax management fees and that it has done so in other DTAs by including specific provisions like UN Article 12A on fees for Technical Services or a service PE provision under Article 5(3)(b) (see ***Commissioner of Domestic Taxes v Total Kenya Limited(supra)*** . The fact that these provisions are absent from the Kenya - South Africa DTA is a deliberate choice and the court cannot rewrite the Treaty to give Kenya a right it bargained away. The Commissioner's argument that in the absence of specific provisions, management fees are only taxable if a PE exists contradicts the position the Kenyan government itself took in this case.

Conclusion and Disposition

19. My finding above disposes with the appeal in the negative and I find that the Tribunal Judgment is sound in its reasoning as it was

based on the correct principles of interpretation of DTAs and treaty law and the same is hereby affirmed. On costs I find and hold that each party bears their own costs to the Appeal noting that the Appellant is a public entity which is funded from public resources. It is so ordered.

DATED SIGNED AND DELIVERED virtually at NAIROBI this 8th DAY of MAY 2026

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J.W.W. MONGARE
JUDGE

IN THE PRESENCE OF

1. Ms. Almadi for the Appellant
2. Ms. Malik for the Respondent
3. Amos- Court Assistant