Aktiengesellschaft v Commissioner Legal Services & Board Coordination (Tax Appeal E055 of 2023) [2024] KETAT 1040 (KLR) (28 June 2024) (Judgment)

Neutral citation: [2024] KETAT 1040 (KLR)

REPUBLIC OF KENYA

IN THE TAX APPEAL TRIBUNAL

TAX APPEAL E055 OF 2023

E.N WAFULA, CHAIR, E NG'ANG'A, AK KIPROTICH, EN NJERU & M MAKAU, MEMBERS

JUNE 28, 2024

BETWEEN

SIEMENS AKTIENGESELLSCHAFT ..... APPELLANT

AND

THE COMMISSIONER LEGAL SERVICES & BOARD COORDINATION ..... RESPONDENT

JUDGMENT

Background

1. The Appellant is a Permanent Establishment (PE) registered as a branch of Siemens Aktiengesellschaft ["SAG Germany"] a company incorporated in Germany, with its headquarters in Berlin and Munich. SAG Germany is a global entity engaged in the electrification value chain-from power generation, transmission and distribution to smart grid solutions and efficient application of electrical energy and other areas of medical imaging and laboratory diagnostics.

2. The Respondent is a principal officer appointed under Section 13 of the *Kenya Revenue Authority Act*, 1995. Under Section 5 (1) of the Act, the Kenya Revenue Authority is an agency of the Government for collecting and receiving all tax revenue. Further, under Section 5(2) of the Act, concerning the performance of its functions under subsection (1), the Authority is mandated to administer and enforce all provisions of the written laws as set out in Parts 1 & 2 of the First Schedule to the Act to assess, collect and account for all revenues under those laws.

3. The Respondent conducted an investigation into the Appellant tax affairs for the period 2017-2020 and issued it with a preliminary audit finding report on 22nd July 2022.

4. Vide a letter dated 26th August 2022, the Appellant made a response to the

Respondent's preliminary audit findings.

5. On 31st October 2022, the Respondent issued the Appellant with additional Corporation tax, Withholding tax and PAYE assessments amounting to Kshs. 678,593,089.00 excluding penalties and interests.

6. Of the additional assessment demanded the Appellant admitted to principal PAYE assessments of Kshs. 43,291,650.00, principal WHT assessment of Kshs. 6,103,563 and principal Corporation tax of Kshs. 42,876,906.00. The total principal taxes admitted were Kshs. 92,272,119.00.

7. On 29th November 2022, the Appellant lodged an objection against assessment raised in Corporation tax, WHT and PAYE total of 586,320,970.00 (principal taxes only)

8. The Respondent reviewed the Appellant's objection and issued an objection decision dated 27th January 2023, confirming that additional Corporation Tax, WHT and PAYE assessments objected to by the Appellant.

9. Aggrieved by the Respondent's objection decision dated 27th January 2023, the Appellant filed the Appeal herein.

The Appeal

10. The Appellant based its Appeal on the grounds in the Memorandum of Appeal dated and filed on 10th May 2023 as follows:

    a. That the Respondent erred in fact and in law by disregarding the transfer pricing policy of SAG Kenya PE indicating a Net Cost plus margin of 3% based on the functional analysis that the PE is a limited risk provider performing routine functions and relying on the interquartile margin of 6.94% which is the unadjusted benchmarking of SAG Germany's project management and engineering activities to cater for the minimal risks and functions performed by the PE contrary to the Transfer Pricing Rules, 2006 and OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration.

    b. That the Respondent erred in fact and in law by making the transfer pricing adjustment based on SAG Germany's margin of 6.94%, a margin that should be realised by a person taking all the risks and performing all functions in project management and engineering services despite the Respondent acknowledging that SAG Kenya Brach was characterized as a limited risk service provider entitled to a routine return while SAG Germany was the entrepreneur bearing such risks as associated with such a profile.

    c. That the Respondent erred in fact and in law in making the transfer pricing adjustment on the margin of 6.94% which should be realised by a person taking all the risks and performing all functions but failing to absorb the resultant total loss of the project owing to the insolvency of Isolux which would result in the PE reporting a loss of -9.26 % in 2016 jumping to - 182.07% in 2020.

    d. That the Respondent erred in fact and law in making the transfer pricing adjustment on the margin of 6.94% which was based on a benchmarking study done in 2019 for the years 2015 to 2017 after the contract had been signed as opposed to the one done in 2016 for the year 2012 to 2014, noting that the contract was signed in 2015 and its price was fixed.

e. That the Respondent erred in fact and in law by charging withholding tax on the PE's allocation of SAG Germany's general administration expenses contrary to the Kenya-Germany Double Tax Treaty ("DTA").

f. That the Respondent erred in fact and in law in failing to appreciate that there is no income by SAG Germany from SAG Kenya Branch on the allocation of general administrative expenses as the allocation is purely an allocation of approximate costs for purposes of computing profits correctly in accordance with Article 7 (2) and 7(3) of the DTA.

g. That the Respondent erred in fact and in law in failing to appreciate that Section 41 of the *Income Tax Act*("ITA") provides that the provisions of the DTA (in this case Article 7 (2) and 7(3) of the German-Kenyan DTA) overrides any inconsistent provisions of the ITA including section 18 (5) and 10 of the ITA.

h. That the Respondent erred in fact and in law in failing to hold that in 2019 no payment occurred between the PE and SAG Germany as per the definition of "paid" under the ITA for withholding tax ("WHT") to be payable under Section 10 of the ITA.

i. That the Respondent erred in fact and in failing to find that the salaries part of the invoice from Flexi is a reimbursement for salary costs and does not qualify as consideration for managerial, technical, agency, contractual, professional or consultancy service under section 2 of the ITA for WHT to be payable under the law.

j. That the Respondent erred in fact and in law in holding that the Appellant's expenses incurred wholly and exclusively for production of business income relating to Mara Gateway Hotel and Resort and Henken Catering Service and which were not attributable to the Appellant's personnel qualify as employment benefits taxable under Section 5 of the ITA.

k. That the Respondent failed to consider the evidence produced by the Appellant of the WHT payments (PRNs) showing that the Appellant had correctly paid WHT and there is no WHT payable and proceeding to confirm its WHT assessment.

Appellant's Case

11. The Appellant based its case on its;

    a. Statement of Facts dated and filed on 10th March 2023 and together with the documents annexed thereto; and

    b. Written submissions dated 19th September and filed on 20th September 2023.

12. The Appellant averred that in 2015 SAG Germany and its consortium partner, Isolux Ingeniera S.A. Spain ("Isolux"), signed a contract with Kenya Electricity Transmission Company Limited ("KETRACO") relating to the Ethiopia-Kenya electricity transmission line converter station at Suswa ("the Station").

13. That under the contract;

    a. SAG Germany and Isolux were consortium members, each member being jointly and severally liable to KETRACO for the obligations under the contract and SAG Germany being the consortium leader.

    b. The Contract price was fixed and payable in accordance with Article 2 and the payment terms listed in Appendix 1 of the Contract.

c. The Consortium was engaged to design, manufacture, test, deliver, install, complete and commission the Ethiopia-Kenya electricity transmission line converter station at Suswa ("the Station")

14. The Appellant averred that the contract was signed between SAG Germany and KETRACO, but the project delivery had three separate components, made up of one onshore and two offshore components. The three components are:

    a. The design of the Station (offshore service);

    b. The supply of equipment (offshore supply); and

    c. Civil works and installation of the equipment (onshore service).

15. That SAG Germany registered a Kenya PE registered as a branch ["the Appellant"] for purposes of discharging the onshore contractual obligations of the civil works and installation of the equipment.

16. That the offshore components were performed by SAG Germany whose functions consisted of manufacturing, engineering, project sales, research and development, market research and strategy and other functions.

17. That Appellant stated that while the onshore component was performed by the Appellant whose functions were supervision, commissioning, erection, construction and assembly works.

18. That in 2017, Isolux was declared bankrupt by the commercial courts in Madrid, Spain and was unable to complete its obligations on the project.

19. The Appellant averred that consequently, an addendum to the contract was executed on 3rd July 2017 between KETRACO and the Consortium members releasing Isolux from the contract and assigning and transferring all the obligations and accrued duties and liabilities of lsolux under the contract to SAG Germany.

20. That in 2017 and in accordance with the Transfer Pricing Rules the Appellant prepared a transfer pricing study to show the allocation of functions and risks between SAG Germany and the Branch and to determine whether the compensation for intercompany transactions were consistent with the arm's length principal.

21. That the Transfer Pricing Policy;

    a. Acknowledged that the profit and loss situation of the PE is dominated by the project under the contract (the Ethiopia-Kenya electricity transmission line converter) therefore for the sake of materiality the transfer price study concentrated on this project and the involved division of SAG Germany (Energy Management Division).

    b. Did a functional analysis concluding that SAG Germany performs the functions of manufacturing and engineering to a full extent while the PE fully performs the supervision, erection, commissioning, construction and assembly function. SAG Germany shares the functions of project procurement, project management and project logistics functions with the PE on a ration of 3:1, with SAG Germany bearing the larger portion of the functions.

    c. SAG Germany fully bears the technical, supplier and research and development risk while the quantity, deviation, price/cost deviation delay and other risks are shared between SAG Germany and the PE on a 3:1 ratio with SAG Germany bearing the larger portion of the risk. The PE does not own intangible assets.

d. Indicated that the gross margin of third party comparable of activities of the project business are not easily available and are often unreliable, an external gross margin comparison cannot be reliably applied in this case. The Transactional net margin method was therefore selected over resale price in order to test the results of the PE achieved from the project business.

e. Used the Transactional Net Margin Method of transfer pricing using a benchmarking study of 2013 to 2015 which yielded an interquartile range between 1.30% and 9.72%.

f. Set the margin of the PE at 3% which was the original calculation of the onshore part reflecting the lower risk profile of the PE. The margin falling within the interquartile range between 1.30% and 9.72%

g. Indicated that the rationale for 3% margin as;

    i. Based on the functional analysis the risks borne by the PE are very limited, they are more limited than would generally be found in a company performing similar limited risk services.

    ii. The operations performed in Kenya by the PE are limited to the onshore elements of the project with significant functions performed by SAG Germany. The associated risks are therefore fully allocated to SAG Germany and the risks attributed to the PE are much more limited than the risks generally borne by a limited risk provider.

    ii. In practice when applying TNMM a greater emphasis is generally placed on functional comparability and that the extent and complexity of differences in the level of risks borne can be difficult to identify based on the publicly available information for potentially comparable companies.

    iii. For this reason an interquartile range of arm's length net profit margins based on statically significant set of comparable companies are generally presented to mitigate to some extent the potential differences arising from these unknown factors. Where a tested party's profits are significantly increased or reduced by a factor unique to that taxpayer and that factor is not accurately able to be specifically benchmarked using publicly available information, adjustments may be required to account for such differences.

    iv. One recognised practical approach for accounting for such differences is to select a different point in the range depending on the level of functions performed, assets used and risks assumed. For example, it is possible to determine the arm's length remuneration for a service provider with relative limited functions, assets and risks by reference to a lower point in the range of results from uncontrolled service providers.

    v. The very limited risks borne by the PE cannot be specifically benchmarked or identified for potentially comparable companies based on publicly available information. The limited nature of the risk profile of the PE arises due to the inherent profile only possible due to its operations being performed by the PE vehicle. In the absence of a more reasonable and appropriate transfer pricing method, it is considered reasonable that the NCP results of the taxpayer fall towards the lower end of the benchmarked range of results, thus reflecting the lower risk profile of the tested party as compared to the comparable companies selected in the benchmark.

    vi . Concluded that the 3% margin falling within the lower interquartile range of 1.30% and 9.72% reflects the lower risk profile of the onshore part being handled by the PE.

vii. Noted that the insolvency of the consortium partner Isolux and the change of the contract in June 2017, the project will realise a negative margin, if the total loss resulting from the execution of the Isolux onshore scope was allocated to the PE the branch would have a negative margin of-176.53%

viii. Based on the function and risk analysis the loss resulting from Isolux insolvency will be shouldered by SAG Germany as the decision to take over the Isolux scope resulting in losses was taken by SAG Germany which was responsible to fulfil the contract and take most of the risk of the project while the PE is a limited risk taker performing only routine onshore functions.

22. The Transfer Pricing Study was supported by the following benchmarking studies;

a. SAG Germany's January 2016 benchmarking study for the project management services done by Deloitte & Touche GmbH. The benchmarking analysis analysed the operating margins of 13 comparable companies and yielded an inter-quartile range of 1.41% to 9.27% for the 2012 to 2014.

i. It is important to note that the benchmarking identified comparable independent companies to benchmark the project management and engineering activities of SAG, divisions in Europe. It specifically searched for companies with the function of project management and engineering of products for power generation services (e.g.turbine generators), power transmissions and power distributions (e.g. transformers,substations, switch cabinets.)

b. The 2017 roll-forward financial analysis of the comparable identified in the benchmarking analysis and the updated financial analysis of the 13 comparable companies for 2013 to 2015.The roll-forward benchmarking analysis retained 10 comparable companies and yielded an interquartile range of 1.30% to 9.72% for 2013 to 2015. This roll-forward financial analysis was the basis of the transfer pricing study provided by SAG Kenya Branch to the KRA, which captured an interquartile range of 1.30% to 9.72% for 2013 to 2015.

c. In 2019, SAG Germany engaged Deloitte GmbH to conduct a benchmarking analysis for the project management services, for 2015 to 2017, which yielded a Net Cost-Plus interquartile range of 2.71% to 13.83%

i. It is important to note that the benchmarking identified comparable independent companies to benchmark the project management and engineering activities of SAG, divisions in Europe performing project management and engineering of products for power generation services (e.g. turbine generators), power transmissions and power distributions (e.g. transformers, substations, switch cabinets, not being engaged in other functional activities such as manufacturing or distribution and not owning significant intellectual property.

23. The Appellant averred that it recognised revenue based on the stage of completion of the contract at the end of the reporting period in accordance with IFRS 15.The revenue being measured as the performance percentage against the total revenue planned for the contract. In accordance with the transfer pricing policy of the Appellant the revenue of the branch was based on the cost plus a margin of 3%.

24. The Appellant stated that Isolux was responsible for site works, site set up and execution of earth works which activities were performed in Kenya. There was no separation of the onshore costs and revenue relating to lsolux and the Appellant.

25. The Appellant submitted that in its accounting transfers from the PE to SAG Germany, costs relating to the lsolux portion necessary to make the margin on the lsolux portion zero and not a negative margin. This ensured that SAG Germany absorbed the losses on the project attributable to the lsolux portion, maintaining the 3% margin for the PE as per the transfer pricing policy and ensuring the PE does not realise a loss.

    a. In 2018 the total turnover recognised by the PE in its financials was EUR 1, 706,924.53 (KShs 198,765,216 which was inclusive of SAG share of EUR 263,713.46 and Isolux Share of EUR 1,443,211.04).

        i. The total expenses recognised is the sum of EUR 1,699,208.83 (KShs.197,867,545.10), which includes SAG branch's share of EUR 255,997.79 and Isolux's share of EUR 1,443,211.04. This was indicated in the audited financial statements for 2018 which included direct costs, administration expenses, employment expenses and establishment expenses.

        ii. A total cost of KShs 816,595,614 was reallocated to the head office to result in a profit of Kshs. 898,465.34 as per the Profit and Loss Account.

        iii. Failure to reallocate the costs would result in a loss of-815,697,148.51

    b. In 2019 the total turnover recognised by the PE in its financials was EUR 20,763,390-KShs 2,353,901,962 which was inclusive of SAG share of EUR 3,207,866.57and Isolux Share of EUR 17,555,523.79

        i. A cost of KShs. 1,196,970,491 was reallocated to the head office by making a negative expense entry labelled "other income" of the same amount.

        ii. Failure to reallocate the cost would result in a loss.

26. That in accordance with Article 7, Paragraph 1 and 3 of the German Kenya DTA which allows for the deduction of expenses incurred by the PE including executive and general administrative expenses in determining the profits of a permanent establishment, SAG Germany allocated administration costs to the PE as follows:

    a. SAG Germany's financial statements contain the general administrative expenses incurred at company level used for the calculation of the overhead cost factor to be applied in the allocation of administration costs to the various countries where SAG Germany has a PE including Kenya

    b. These are, as defined in SAG Germany financials, headquarter functions such as compensation of HQ personnel such as members of the supervisory board, management board, communication department, HR department, Controlling and financing department.

    c. The overhead cost factor is calculated based on the general administrative costs and net sales defined in the audited financial statements issued by SAG's Germany's Independent Public Accountants, Ernst & Young GmbH, according to German generally accepted accounting principles.

    d. The general administrative costs allocated to the PE in 2017, 2018, 2019 and 2020 was KShs.9,590,133.41, 8,467,398.22, 423,702,353.22 and 192,587,911.23 respectively.

e. In 2019, when undertaking the transfer of costs undertaken as explained in paragraph 17, the entire general administrative amount of KShs. 423,702,353.22 was included in the costs transferred to the head office.

27. The Appellant stated that it entered into a contract with Flexi Personnel Limited ('Flexi') for the provision of outsourced employment services where Flexi contracted personnel to work on the project at the site in Suswa.

a. Flexi issued the Appellant invoices for both the salary cost of the personnel and a management fee.

b. In accordance with the law, the Appellant withheld tax on the management fee portion of the invoice and remitted it to the Respondent.

c. Subsequently on 30th July 2019 the Appellant wrote to the Respondent requesting the Respondent to allocate its unutilised advanced tax payment of KShs.15,231,306 towards the WHT liability of, if any, of KShs. 15,111,808 arising from the failure to withhold the full amount (salary plus management fee) from the invoices issued by Flexi.

28. That in 2020,there was a global reorganization of the Siemens enterprise, and in Kenya the activities of the project were transferred from Siemens AG to Siemens Gas and Power GmbH & Co. KG, later renamed to Siemens Energy Global GmbH & Co.KG("Siemens Energy"). Siemens Energy registered a branch in Kenya ("Siemens Energy Kenya PE") to undertake the contract works.

29. The Appellant averred that the Respondent undertook an audit of the affairs of SAG Kenya PE and issued additional assessments for the years 2017 to 2020 and issued its preliminary findings on 22nd July 2022 indicating its intention to charge additional Corporation tax, PAYE and withholding tax.

30. In the preliminary letter of findings, the KRA;

a. Acknowledged that in accordance with the Appellant's TP policy the Appellant was characterised as a service provider bearing minimal risk and through the Transactional Net Profit Margin (TNMM) method the benchmarking yielded margins of a range between 1.30% and 9.72%.

b. Noted that SAG Germany as the entrepreneur shouldered the loss of the project caused by the insolvency of Isolux but the Branch had negative returns for the years examined, that KRA therefore requested for a detailed financial analysis to support that the appellant's remuneration was at arm's length.

c. Indicated that Appellant had claimed tax credits amounting to Kshs. 615,016,109.00 for the period 2018-2020 but noted that the credit relating to the Appellant as the PE amounted to Kshs. 103,712,367.00. KRA indicated that the excess credit of Kshs. 511,303,741.00 related to the offshore component of the project and that it intended to disallow the excess credit amounting to Kshs. 511,303,741.00.

d. Indicated that the Appellant claimed costs in relation to general administrative expenses allocated to SAG Germany which related to headquarter expenses incurred at the headquarter office level and allocated the Appellant based on the revenue generated by the PE. KRA classified these costs as management/professional fees and charged WHT at 15% as per the Germany-Kenya DTA amounting to Kshs. 63,555,352.00 in 2019 and Kshs.28,888,186.00 in 2020.

e. Charged PAYE on costs incurred by the Appellant on house rent payments, catering, utilities, hotel accommodation and payments for various supplies consumed in the site amounting to Kshs. 13,414,755.00.

f. Charged WHT on payments made by the appellant of geophysical surveys, accounting, staff contracting and consulting services claiming the payments were qualifying payments and intended to charge WHT amounting to Kshs. 19,703,107.00.

31. The Appellant responded on 26th August 2022 indicating that;

a. SAG's transfer pricing study, which indicates that SAG Kenya Branch should yield an operating margin of 3%, based on the functions performed, assets utilized, and risks assumed in the project was based on the 2016 benchmarking study (1.41% to 9.27%) and the 2017 roll-forward of the financial analysis of the comparables (1.30% to 9.72%).

b. The project calculation was performed in 2014 (before signature by KETRACO agreeing to the final total price) and the SAG Kenya Branch was calculated to yield an operating margin of 3% based on the functions performed and risks assumed by SAG Kenya Branch during this project reflecting the lower risk profile of the branch. This operating margin was in line with the benchmark study of 2016 and the roll-forward financial analysis in 2017.

i. SAG Kenya Branch, being the branch of SAG Germany, was bound by the overall project price agreed with customer as SAG Kenya Branch was only part of the overall project executing only the onshore portion of the project.

ii. Due to the insolvency of the consortium partner (Isolux) and the change of the contract in June 2017, the overall project realized a significant negative margin. SAG Kenya Branch would have had the following negative margins per year up to now, from -9.26% in 2016 jumping to -182.07% in 2020. Since the execution of the lsolux activities related to Kenya only, it would have to be attributed to SAG Kenya branch.

iii. As the customer could not have been convinced to increase the project price, the decision had been taken that SAG Germany would take over the lsolux scope resulting in losses. The reason for this was, that the decision in respect of lsolux in its total was also taken by SAG Germany, hence the main portion of the losses would be borne by SAG Germany as the SAG Germany is responsible to fulfill the contract and takes most of the risk of the project.

c. indicated that the project calculation and calculated attributable margin to SAG Kenya Branch was correct from the transfer-pricing perspective, in line with the benchmarking studies and the function and risk profile of SAG Kenya Branch.

d. The general administrative expenses allocated by head office to the SAG Kenya Branch do not qualify as management or professional fees paid by a permanent establishment that are subject to WHT under the provisions of Section 10 of the ITA ("the Act") as;

i. Article 7 of the Kenyan-German DTA requires the appellant to attribute profits to the Appellant as its permanent establishment as if it is a distinct and separate entity dealing at arm's length with its head office (SAG Germany)

ii. For the purpose of determining these profits (of the PE) Paragraph 3 of Article 7 of the DTA allows the deduction of expenses incurred for the purpose of the PE including executive and general administrative expenses.

iii. The allocation of general administrative expenses is done in this context. Thus, there is no income derived by SAG Germany from SAG Kenya Branch. I is purely an allocation of approximate costs for purposes of computing profits correctly.

iv. To say that SAG Germany made payment through SAG Kenya Branch, would be to say that SAG Germany made payment to itself.

An entity cannot make a payment to itself. This would be an absurdity.

v. Indicated that there was no "payment" in 2019 as the payment was reallocated back to SAG Germany by recognising income equivalent to these costs as other income whose effect was similar to a reversal.

e. Indicated that the WHT liability of Kshs. 13,174,988 in relation to payments made to Flexi Personnel Limited ("Flexi") was already settled as part of overpaid WHT as per the Appellant's letter dated 30th July 2019.

i. It also indicated that the payment in respect of these invoices was excessive as WHT was applied on the entire invoice amount as opposed to the management fee component of the invoice amount.

f. Indicated that the expenses of meals and entertainment/catering services and meals relating to Mara Getaway Hotel and Resort, for 2017 and 2018 related to meals at the Mara Getaway Hotel, with customer (KETRACO) team in respect of progress updates on the project carried out by SAG Kenya Branch. These expenses were incurred in the course of production of business income and are not taxable employment benefits under Section 5 of the ITA.

g. Indicated that the Appellant correctly paid WHT on civil works and on management and professional fees and provided the supporting Payment Registration Numbers ("PRNs")to the Respondent.

32. The Respondent issued its assessment on 31st October 2022 and in the assessment KRA;

a. Adjusted the return NCP margin in accordance with the benchmarking median of 6.94% and made transfer pricing adjustments amounts to KShs. 35,669,386.00 in 2017, KShs.12,830,349.00 in 2018, KShs. 251,413,927.00 in 2019 and KShs. 318,107,394.00 in 2020, claiming that;

i. It noted that the comparative analysis and benchmarking for comparable companies involved in similar activities as SAG Kenya (project management and engineering) gave an NCP average of an interquartile range of 2.71% and 13.83% with a median of 6.94%

ii. the review of the financial position of SAG Kenya revealed that the NCP of the branch was-6.26% in 2017, 0.46% in 2018, -0.13% in 2019 and-34.54% in 2020 and concluded that the company results did not fall in the arm's length range as per the benchmarking done.

iii. The profits (loss) of SAG Kenya depended on its operation and not necessarily on that of the Company as a whole since under Article 7 2. of the Kenyan-German Double Tax Treaty 'there shall be in each contracting state be attributed to that permanent establishment the profits it might be expected to make if it were distinct and separate enterprise engage in the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.'

iv. From the functional analysis SAG was characterised as a limited risk service provider entitled to a routine return while SAG Germany was the entrepreneur bearing the risk associated with the profile. The decision to fulfil the work obligations related to Isolux and the resultant losses should not be borne by any part by SAG Kenya as a limited risk provider.

v. Siemens Energy-Kenya Branch is a separate entity from SAG Kenya which was not under audit, the Respondent reviewed the return filed by SAG Kenya in 2020 which the branch had negative returns.

b. Maintained its position that the credit attributable to SAG Kenya should be that which relates to the portion of the contract that was declared in Kenya and maintained that it will disallow credits amounting to Kshs. 511,303,741.00, to effect this the Respondent added back income corresponding to the disallowed credits.

c. Assessed WHT on management and professional fees paid to SAG Germany claiming that;

i. Section 18 (5) of the ITA dictates that the gains and profits of a PE should be determined without any deduction in respect of management fees paid by the PE to the Non-Resident person and section 10 (1) (ii) of the ITA excludes management or professional fees paid or purported to be paid by a permanent establishment to its head office from being considered as income accrued or derived from Kenya except for deductions provided under the Double Tax Agreement.

ii. By the above Sections the ITA does not envision situations where management fees can be deemed to arise between a PE and its head office. Kenya and Germany have a shared taxing right for management fees none of the provisions under the Articles limits Kenya from taxing the income.

iii. There was no detailed breakdown of the headquarter costs to establish the specific nature of the same. The Respondent concluded that the nature of these costs mainly included expenses relating to management of the enterprise including the P.E. That there is no reversal in the ITA return filed with the KRA for the 2019. The Respondent assessed WHT amounting to KShs. 63,555,352 in 2019 and KShs. 28,888,186 in 2020.

d. Indicated that there were no explanations for the meals and services that were provided at site by Mara Getaway Hotel and Resort Henken Catering services and assessed additional PAYE on untaxed benefits amounting to Kshs. 285,264.00 in 2018, KShs.342,420.00 and KShs.9,000.00 in 2020.

e. Assessed WHT on Civil Works amounting to Kshs. 1,966,151.00, other management and professional fees on payments amounting to Kshs. 16,432,481.00 to resident companies and non-residents amounting to Kshs. 883,439.00.

f. Assessed the WHT relating to Flexi Personnel claiming that:-

i. The WHT should have been paid on the entire cost paid to Flexi on account of the definition of management or professional fees which indicates that it is payment as consideration for managerial or consultancy services however calculated.

ii. The payment made and requested to be allocated to WHT for Flexi, was not effected on iTax and no declaration was made in relation to Flexi on iTax. The payment also relates to PAYE which is a different tax head from WHT.

33. The Appellant objected on 29th November 2022, in the objection the Appellant;

a. Reiterated its position that the net cost plus margin (NCP) of 3% instead of 6.94% is in accordance with the Appellant's Transfer pricing policy, benchmarking studies and the functions performed and the low risk profile of the PE in comparison to the comparables.

b. Indicated that the 3% was to ensure that the branch assumed very limited risks based on the functions performed and risks assumed by the branch in the project. This is evidenced by the fact that when the consortium partner become insolvent, SAG Kenya PE did not shoulder any loss and reported the margin of 3%, despite the project realising an overall negative margin. If the loss on the execution of the lsolux work was allocated to SAG Kenya branch, it would realise a margin of-176.53%.

c. Indicated that the margin of 6.94% and not 3% is akin to saying that SAG Kenya PE is not a limited risk service provider. If the Respondent claims so, it should be prepared to accept that the project would realise a negative margin because SAG Kenya PE would shoulder part or all of the loss resulting from the lsolux portion of the project.

d. Requested that the costs of Kshs 1,196,970,491.00, transferred to the head office in 2019, be excluded from the cost base used to determine additional income due from SAG Kenya PE for 2019. The Appellant indicated that the costs were transferred by recognising income equivalent to these costs.

i. The costs appear in the general ledger and profit and loss account of SAG Kenya PE as expenses but are neutralised by an income entry. The entry being clearly described in Note 5 of the audited financial statements provided to the KRA as "PE reallocation of costs to HQ".

ii. These costs should be excluded from the base on which the 3% operating income margin is applied.

e. Indicated that due to the 2020 global reorganization of the Siemens enterprise in Kenya the activities of the project were transferred from SAG to Siemens Gas and Power GmbH & Co. KG, later renamed to Siemens Energy Global GmbH & Co.KG.

i. The Siemens and Isolux portions of the project work were split with the lsolux portion being reported by SAG PE Kenya while the Siemens portion was reported by Siemens Energy Kenya PE. Thus, the 3% margin can only be accounted for in Siemens Energy Kenya PE.

ii. Siemens Energy and SAG Germany are bound by the overall project price agreed between SAG Germany and the customer. The margin of 3% is on the project and irrespective of how many entities may be involved, it cannot change. Therefore, a margin cannot be declared in both SAG Kenya PE and Siemens Energy Kenya PE for the Siemens portion of the same contract. For 2020 and subsequent years, any corporation tax assessment can only be made on Siemens Energy Kenya PE.

ii. The Appellant recalculated the corporation tax payable by the Appellant as indicated:

2017 (KES)	2018 (KES)	2019(KES)	Total (KES)
Declared Taxable			
(16,988,265)	898,466	(5,538,080)	
Income as per SAR			
Add:Transfer Pricing			
25,126,721	5,034,486	73,848,053	
Adjustment			
Revised Taxable income	8,138,456	5,932,952	68,309,973
Add:Disallowable			
2,856,583	2,230,212	28,911,516	
Deductions			
Less:Allowable			
1,008,184	1,033,093		
Deductions			
Adjusted Taxable Income	10,995,039	7,154,980	96,188,396

Tax on Total Income

4,123,140

2,683,117

36,070,648

Tax credits for onshore			
6,246,841	33,550,418		
services			
Tax Due/ (refundable)	4,123,140	(3,563,724)	2,520,231

Penalty (5%)

206,157

-

126,012

332,169

Interest @1% (KES)

2,391,421

-

856,878

3,248,299

Total Tax Due

6,720,718

-

3,503,120 10,223,838

f. Maintained its position that the general administrative expenses allocated by head office to the SAG Kenya Branch do not qualify as management or professional fees paid by a permanent establishment that are subject to WHT under the provisions of Section 10 of the ITA.

   i. Indicated that there was no "payment" in 2019 as the payment was reallocated back to SAG Germany by recognising income equivalent to these costs as other income whose effect was similar to a reversal.

g. Objected to WHT on the salary costs paid to Flexi Personnel Limited as they are reimbursement for costs and not consideration for any service indicating that the management fee is the consideration for the labour brokerage services provided and is the only element that should be subject to WHT.

h. Objected to the levying of PAYE on expenses relating to Mara Gateway Hotel and Resort and Henken Catering Service as the expenses are not attributable to staff but are expenses incurred wholly and exclusively for production of business income and,thus, an allowable deduction under the law.

   i. Indicated that the KRA WHT assessment on civil works and other management and professional fees was made without consideration of the WHT payments and provided

the corresponding WHT certificates and a detailed worksheet indicating the PRNs for each WHT.

ii. Made payment of the PAYE, WHT and Corporation tax assessment not in dispute amounting to Kshs. 10,223,838.00 taking into account the Appellant's withholding tax credits in 2018 and 2019.

34. The Respondent issued its Objection decision on 27th January 2023;

a. Confirming the Transfer pricing adjustment and Corporation tax assessment

b. Claiming that the Appellant did not add back the credits amounting to Kshs. 511,303,741.00 relating to the offshore component of the project that was billed by SAG Germany and confirmed the Corporate tax assessment on this issue where it added back income corresponding to the disallowed credits to effect the disallowance

c. Confirmed the PAYE assessment on meals and catering services provided at site by Mara Getaway Hotel and Resort and Henken Catering Service claiming that without proper/further support these costs were correctly disallowed.

d. Confirmed the withholding tax assessment on management fees payable to the head office stating that no breakdown of headquarter costs, Article 12 of Kenya-Germany DTA does not limit Kenya from taxing management and professional fees paid to Germany

e. Confirmed the WHT on Flexi Personnel Limited on account of the definition of management and professional fees under Section 2 of the ITA.

35. With regard to Transfer pricing the Appellant stated that the Respondent disregarded the transfer pricing policy of SAG Kenya PE indicating a Net Cost plus margin of 3% based on the routine functions performed and minimal risks assumed by the PE and relied on the interquartile margin of 6.94% which is the unadjusted benchmarking of SAG Germany's project management and engineering activities to cater for the minimal risks and functions performed by the PE contrary to the Transfer Pricing Rules, 2006 and OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration

36. That the Respondent made the transfer pricing adjustment based on SAG Germany's margin of 6.94%, a margin that should be realised by a person taking all the risks and performing all functions in project management and engineering services despite the Respondent acknowledging that SAG Kenya Brach was characterized as a limited risk service provider entitled to a routine return while SAG Germany was the entrepreneur bearing such risks as associated with such a profile.

37. That the Respondent made the transfer pricing adjustment on the margin of 6.94% which should be realised by a person taking all the risks and performing all functions but failed to absorb the resultant total loss of the project owing to the insolvency of Isolux which would result in the PE reporting a loss of -9.26% in 2016 jumping to -182.07% in 2020.

38. With regard to WHT on the Appellant's allocation of SAG Germany's general administrative expenses the Appellant stated there is no income derived by SAG Germany from SAG Kenya Branch and the allocation of general administrative expenses is in adherence is purely an allocation of approximate costs for purposes of computing profits correctly in accordance with Article 7 (2) and 7(3)of the DTA

39. That Article 7(2) of the Germany-Kenya DTA provides that for the purposes of determining the profits that should be recognized by the Appellant, the head office and its permanent establishment should be treated as if they were distinct and separate parties dealing with each other in open market conditions.

40. That Paragraph 3 of Article 7 of the DTA provides that in determining the profits of a permanent establishment, there shall be allowed expenses incurred for the purpose of the permanent establishment including executive and general administrative expenses.

41. That the Respondent failed to appreciate that Section 41 of the ITA provides that the provisions of the DTA (in this case Article 7 (2) and 7 (3) of the German-Kenyan DTA) overrides any inconsistent provisions of the ITA including section 18 (5) and 10 of the ITA.

42. That domestic legislation may depart from what is recognized internationally and may even legislate fictions. For instance, the deemed interest is a legal fiction deeming the existence of income where there is none. The recognition of payments made by a PE to its head office as income of the head office is another fiction. Such fictions are perfectly legal in domestic law.

43. The Appellant stated that in the UK case of Fowler v HMRC [2020] UKSC 22, the UK Supreme Court determined that a statutory fiction created by a deeming provision of UK tax law did not affect how the terms of a bilateral tax treaty should be applied. In this case, a UK deeming provision applied to treat an employed taxpayer as if they were carrying on a trade. The Supreme Court ruled that the statutory provision did not change the fact that, for the purposes of the DTA, the taxpayer derived "income from an employment" and hence that the employment income article of the DTA was the applicable article.

44. That the “distinct and separate enterprise" concept under Article 7 is a fictional separation of legal entities that would otherwise be regarded as a single legal entities. This is intended to ensure that profits are appropriately or correctly allocated between a resident in one contracting state and a permanent establishment in the other state, for purposes of taxation of profits.

44. The Appellant stated that the legal fiction of "distinct and separate enterprise" is not a general rule applicable throughout the DTAs in which it is adopted, including the Germany-Kenya DTA. It is restricted to Article 7 where it is contained with regards to the allocation of profits between a permanent establishment and its head office. There is nothing in Article 7 or any other article in the DTA indicating that it is intended to be of general application. lf there was any intention that the fiction be extended to all articles of the DTA, it would have clearly provided for in the other Articles of the DTA.

44. That without prejudice to the above, In 2019 there was no payment/no payment occurred as per the definition of 'paid' under the ITA for WHT to be payable under Section 10 of the ITA. Section 2 of the ITA defines "paid"(from which the word "payment" is derived) as follows: ""paid" includes distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person."

WHT on Flexi Personnel

46. That the Appellant averred that WHT is not payable on the salaries part of the invoice from Flexi as it does not qualify as management and professional fees as defined in section 2 of the ITA which excludes 'payment made to an employee by his employer' and defines professional fees as 'a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services however calculated;'

47. The Appellant stated that he Tax Appeals Tribunal ruled in the case of Two Lakes Packaging Services Limited v.Commissioner of Domestic Tax (2021) held "Looking at the definition of management of management and professional fees as stated in the Act, it is logical to conclude that services related to employee costs can indeed fall under the definition of professional services. However, the reimbursement for costs themselves cannot be deemed to be payments or consideration for any services

rendered. By their nature, payroll costs, NSSF, NHIF and such costs were not payments to the contractor and therefore could not have been subject to withholding tax."

PAYE

48. The Appellant averred that the expenses relating to Mara Gateway Hotel and Resort and Henken Catering Service are not personnel expenses and do not qualify as employment benefits taxable under Section 5 of the ITA. The expenses were incurred wholly and exclusively for production of business income and are an allowable deduction in line with the provisions of section 15(1) of the *Income Tax Act*.

49. That the Respondent failed to consider the evidence produced by the Appellant of the WHT payments(PRNs) showing that the Appellant had correctly paid WHT and there is no WHT Payable.

50. That pursuant to the Respondent's objection decision the Appellant filed a Notice of Appeal on 24th February 2023.

Appellant's Prayer

51. The Appellant's prayed to this Tribunal for the following orders:

    a. That the Respondent's objection decision dated 27th January 2023, additional tax assessment dated 31st October 2022 and preliminary audit findings dated 22nd July 2022 be struck out entirely;

    b. The Respondent, its employees, agents, or other person purporting to act on its behalf be barred and/or estopped from demanding or taking any further steps towards enforcement or recovery of principal tax, penalties and interest on the Respondent's demand as stipulated above;

    c. The costs of this Appeal; and

    d. Any other remedies that the Honourable Tribunal deems just and reasonable.

Respondent's Case

52. The Respondent opposed this Appeal while relying on its:

    a. Statement of Facts dated and filed on 6th April 2023.

    b. Submissions dated 3rd November 2023 and filed on the 15th November 2023.

53. The Respondent averred that in 2015, Siemens (SAG Germany) and its consortium partner, Isolux Ingeniera S.A Spain (Isolux) signed a contract with Kenya Electricity Transmission Company Limited (" KETRACO) relating to the Ethiopia-Kenya electricity transmission line converter station at Suswa ("the station"). In order to execute the local portion of the contract SAG Germany set up a branch in Kenya (SAG Kenya).

54. The Respondent averred that the onshore part of the erection/ construction and project implemented by the Appellant herein consisted of supervision, commissioning, erection/ construction and project works. The offshore part of the project was performed by SAG Germany and it consisted of manufacturing, engineering, project sales, research and development, market research and strategy and other related functions.

55. The Respondent averred that based on the review of the transfer pricing policy, the Appellant was characterized as a service provider bearing minimal risks while SAG Germany was characterized as the entrepreneur bearing the associated entrepreneur risks. Further, that the Transactional Net Profit Margin (TNMM) transfer pricing method with a profit level indicator (PLI) of the Net Cost Plus Margin (NCP) was applied.

56. The Respondent averred that the comparability analysis and benchmarking done yielded a set of comparable companies that are involved in similar activities as the Appellant (project management and engineering). The 3-year average PLI interquartile range derived from the final set of 13 comparable companies as per the search updated in 2019 was as below;

Minimum	Lower Quartile	Median	Upper Quartile	Maximum
0.5%	2. 71%	6. 94%	13. 83%	16. 92%

The NCP for the Appellant was:

2017	2018	2019	2020
-6.26%	0.46%	-0.13%	-34.59%

57. The Respondent observed that the results of Appellant were not within the arm's length as per the benchmarking done.

58. The Respondent averred that for purposes of attribution of profit under the provisions of Articles 7(2) of the Kenya-Germany Double Tax Treaty (DTA), "there shall in each contracting state be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment." This meant that the profits/losses of Appellant were dependent on its operation and not necessarily that of the company as a whole.

59. The Respondent averred that from the functional analysis, the Appellant was characterized as a limited risk service provider entitled to a routine return while SAG Germany was the entrepreneur bearing such risks as associated with such a profile. The decision to fulfil the work obligation related to Isolux and the resultant losses should not be borne by the Appellant as a limited risk provider.

60. The Respondent did not disregard the Transfer Pricing Policy of the Appellant but rather used the results obtained from its own benchmarking. Though the Appellant had indicated that it should have earned a Net Cost plus Margin (NCP)of 3%, it in fact had a negative NCP for all the years under audit. This necessitated the transfer pricing adjustment done by the Respondent to align the NCP of the Appellant with their own benchmarking results.

61. That though the Appellant had indicated that a margin of 3% reflected the risk profile of the Permanent Establishment, there was no evidence/analysis provided to support the selection of this point in the range of the results obtained. Though the Appellant claimed that the functional/risk profile of the PE was different from the comparable companies, an analysis to this effect was not provided.

62. That the Respondent therefore picked the mid-point(median) in the range, which is an acceptable practice as per Paragraph 3.62 of the OECD Transfer Pricing guidelines which acknowledges that there

might be circumstances the measures of central tendency i.e median may be selected in order to enhance comparability.

63. The Respondent averred that the Appellant claimed costs in relation to general administrative expenses allocated from SAG Germany. These costs relate to headquarter expenses incurred at the Head Office level and allocated to the Appellant based on revenue generated by it in Kenya. The costs amounted to Kshs. 9,590,133 in 2017, Kshs. 458,455 in 2018, Kshs. 423,702,353 in 2019 and Kshs. 192,587,911 in 2020.

64. The Respondent averred that since taxes are imposed by the domestic law, it is crucial to first examine this issue in light of the provisions of the *Income Tax Act* (ITA). That Section 18(5) of the *Income Tax Act* provides that "when a non-resident person carries on a business in Kenya through a permanent establishment in Kenya the gains or profits of the permanent establishment shall be ascertained without any deduction in respect of interest, royalties or management or professional fees paid or purported to be paid by the permanent establishment to the non -resident person.."

65. That further, Section 10(1) (ii) of the *Income Tax Act* which was introduced in 2019 excludes management or professional fees paid or purported to be paid by a permanent establishment to its head office from being considered as income accrued or derived from Kenya except for deductions provided for under Double Tax agreements. That this implies that deductions which are allowable under a Double Tax Treaty on payments made by the PE in Kenya of a non-resident person to that non-resident person are now deemed to be income which is accrued or derived from Kenya; and thus chargeable to WHT.

66. The Respondent averred that the *Income Tax Act* envisions situations where management fees can be deemed to arise between a permanent establishment and its Head office. The Respondent averred that with regards to the applicability of Article 12 of the Kenya-Germany DTA, it is clear that Kenya and Germany have a shared taxing right for management fees, and none of the provisions under the Article limits Kenya from taxing this income.

67. The Respondent averred that during the audit review process, it requested the Appellant to provide it with a detailed breakdown of the headquarter costs to establish the specific nature of the same. However, the Appellant stated that it could not provide the same owing to the complexity and huge volume of the information.

68. The Respondent therefore concluded that the nature of these costs would mainly include expenses relating to management of the enterprise including the Appellant which amounts to provision of services by the head office to the Appellant and such costs are considered as management/professional fees as per section 2 of the *Income Tax Act*.

69. Regarding the allegation that no payments occurred in the year 2019 between the Appellant and SAG Germany as per the definition of the word "paid" under the *Income Tax Act* it is the Respondent's case that examination of tax returns filed by the Appellant did not show evidence of reversals done in respect of general administrative expenses incurred in the year 2019.

70. The Respondent averred that the Appellant had contracted Flexi Personnel Limited (Flexi) to provide labour and the total cost was inclusive of a direct cost element and management fee. The Appellant argued that payment in respect of invoices relating to Flexi was excessive as WHT was applied on the entire invoice amount as opposed to the management fee component of the invoice amount.

71. The Respondent averred that Section 2 of the *Income Tax Act* defines management or professional fee as "a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency, contractual, professional or consultancy services

however calculated". This means that WHT ought to have been calculated on the entire cost paid to Flexi.

72. The Respondent averred that the total amounts contained in the invoices were given in consideration for services offered/rendered. WHT is thus applicable on the value of the service which constitutes the direct cost element and management fee. Further, the Respondent's decision to subject the gross amounts to WHT is in line with the Third Schedule of the *Income Tax Act* which paragraph 5 (f) (i) in Head B states that, "The resident withholding tax rates shall be - in respect of management or professional fee or training fee, other than contractual fee; the aggregate value of which is twenty-four thousand shillings in a month or more, five per cent of the gross amount payable".

73. The Respondent averred that it also raised a PAYE assessment against the Appellant in relation to meals and catering services that were provided at the site by Mara Getaway Hotel and Resort and Henken Catering Services. The Respondent averred that in the absence of evidence that amount in relations to meals and catering services that were provided at the site were an allowable expense incurred wholly and exclusively for production of its business income it treated the same as a benefit to the employees which is chargeable to PAYE under the *Income Tax Act*.

74. The Respondent averred that the Appellant made payments to various local suppliers in respect of services, which are in the nature of management and professional fees and for which WHT ought to have been withheld/paid. TheVRespondent noted that the Appellant did not withhold/pay WHT while making some payments to the suppliers.

75. The Appellant argued that it had paid WHT while making payments to other service providers and provided PRN's as evidence of proof of payment. The Respondent averred that upon review of the Appellant's documents, it adjusted the WHT workings where it was evident that WHT had been paid. However, it did not admit some of the PRN's provided by the Appellant as they related to different time periods.

76. The Respondent averred that where a particular service provider was still providing services in the subsequent period, and WHT variances still exist in one or both periods, the PRNs were not admitted as proof of payment for that particular period, as they had already been utilized in a different period. Thus not all issues were extinguished by the information provided.

77. That the Appellant argued that some of the payments charged WHT were cash payments and thus WHT was not applicable. The Respondent averred that WHT was applicable to all payments made regardless of the mode of payment as per Section 35 (3)(f) viz;""a person shall, upon payment of an amount to a person resident in Kenya in respect of management or professional fee or training fees the aggregate value of which is twenty-four thousand shillings or more in a month." That further Section 2 of the ITA defines "paid" to include "distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person".

78. The Respondent submitted that in law, there is a world of a difference between assertion and proof. That whatever a party states in its case is an assertion the party needs to adduce evidence to support his assertion, with a view to proving his case.

Respondent's Prayer

79. The Respondent prayed for orders that:

    a. This Appeal be dismissed with costs

b. The additional Corporation tax, WHT and PAYE assessments amounting to Kshs. 586,320,970.00 be confirmed.

Issues For Determination

80. The Tribunal having carefully considered the pleadings filed and the evidence tendered is of the view that there is one issue that calls for its determination, namely:

> Whether the Respondent's assessment WHT on Management fees, PAYE and Corporation Tax was justified

Analysis And Findings

81. The Tribunal having determined the issue falling for its determination proceeds to analyse it as hereunder.

82. It is the Appellant's case that in 2015 SAG Germany and its consortium partner, Isolux Ingeniera S.A. Spain ("Isolux"), signed a contract with Kenya Electricity Transmission Company Limited ("KETRACO") relating to the Ethiopia-Kenya electricity transmission line converter station at Suswa ("the Station"). That under the Contract SAG Germany and Isolux were consortium members, each member being jointly and severally liable to KETRACO for the obligations under the contract and SAG Germany being the consortium leader.

83. The contract price was fixed and payable in accordance with the payment terms listed in the Contract. The Consortium was engaged to design, manufacture, test, deliver, install, complete and commission the Ethiopia-Kenya electricity transmission line converter station at Suswa. The contract was signed between SAG Germany and KETRACO, but the project delivery had three separate components, made up of one onshore and two offshore components. The three components were the design of the Station (offshore service), the supply of equipment (offshore supply); and civil works and installation of the equipment (onshore service).

84. It was further the Appellant's case that it established a Permanent Establishment in Kenya, Siemens AG Kenya in order to execute the onshore component of its contractual obligations of carrying out civil works and installation of the equipment.

85. On the other hand, it's the Respondent's case that based on the review of the Transfer Pricing Policy, the Appellant was characterized as a service provider bearing minimal risk while SAG Germany was characterized as the entrepreneur bearing the associated entrepreneur risks.

86. It was the Respondent's case that based on the review of the Transfer Pricing Policy, the comparability analysis and benchmarking done yielded a set of comparable companies that were involved in similar activities as the Appellant (project management and engineering). The 3-year average PLI interquartile range derived from the final list set 13 comparable companies and that this results were not at arm's length as per the benchmarking done.

87. The Tribunal notes that Article 7(2) of the Kenya-Germany Double Tax Treaty (DTA), provides that "there shall in each contracting state be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment."

88. The Tribunal is of the considered view that the interpretation of Article 7(2) of the Kenya-Germany DTA is to the effect that the profits/losses of the Appellant were dependent on its operation and that

from the functional analysis, the Appellant was characterized as a limited risk service provider entitled to a routine return while SAG Germany was the entrepreneur bearing such risks associated with such a profile and as such, the decision to fulfil the work obligation related to Isolux and the resultant losses should not have been borne by the Appellant as a limited risk provider.

89. The Respondent further submitted that it did not disregard the Transfer Pricing Policy of the Appellant but rather used the results obtained from its own benchmarking and that though the Appellant had indicated that it should have earned a Net Cost plus Margin (NCP) of 3%, that it in fact had a negative NCP for all the years under audit which necessitated the transfer pricing adjustment done by the Respondent to align the NCP of the Appellant with its own benchmarking results.

90. The Tribunal notes that though the Appellant had indicated that a margin of 3% reflected the risk profile of the Permanent Establishment, there was no evidence/analysis provided to support the selection of this point in the range of the results obtained. Though the Appellant claimed that the functional/risk profile of the PE was different from the comparable companies, an analysis to this effect was not provided.

91. The Tribunal further notes that the Appellant wanted the Respondent to rely on the 3% margin but there was no justification for the same. The Tribunal relies on the Court of Appeal case of Mbuthia Macharia v Annah Mutua Ndwiga &another [2017] eKLR where the Court stated;

> " ....The Judge alluded to the provisions of section 107 of the *Evidence Act*, which deals with the burden of proof in any case and aptly stated that it lies with the party who desires any court to give judgment as to any legal right or liability, is for that party to show that the facts which he alleges his case depends upon exist. This is known as the legal burden and we need not repeat, save to emphasize the same principle of law is amplified by the learned authors of the leading Text Book;- The Halsbury's Laws of England, 4th Edition, Volume 17, at paras 13 and 14: describes it thus:
>
> "The legal burden is the burden of proof which remains constant throughout a trial; it is the burden of establishing the facts and contentions which will support a party's case. If at the conclusion of the trial he has failed to establish these to the appropriate standard, he will lose.
>
> > The legal burden of proof normally rests upon the party desiring the court to take action must satisfy the court or action; thus a claimant must satisfy the tribunal that the conditions which entitle him to award have been satisfied. In respect of a particular allegation, the burden lies upon the party for whom substantiation of that particular allegation is an essential of his case. There may therefore be separate burdens in a case with separate issues."

92. The Tribunal is also guided by the Paragraph 16 of the foregoing Judgment where the learned Judges of the Court of Appeal went ahead to state an important principle of law in the following words:

> " The legal burden is discharged by way of evidence, with the opposing party having a corresponding duty of adducing evidence in rebuttal. This constitutes evidential burden. Therefore, while both the legal and evidential burdens initially rested upon the appellant, the evidential burden may shift in the course of trial, depending on the evidence adduced. As the weight of evidence given by either side during the trial varies, so will the evidential burden shift to the party who would fail without further evidence"

93. In this case, the incidence of both the legal and evidential burden was with the Appellant. The Tribunal notes that the onus of proof is on the Appellant concerning its assertions that a margin of 3% reflected the risk profile of the Permanent Establishment.

94. Section 31(1) of the Tax Procedure Act provides that;

> " Subject to this section, the Commissioner may amend an assessment (referred to in this section as the "original assessment") by making alterations or additions, from the available information and to the best of the Commissioner's judgement, to the original assessment of a taxpayer for a reporting period to ensure that:-
>
> a. in the case of a deficit carried forward under the *Income Tax Act* (Cap 470), the taxpayer is assessed in respect of the correct amount of the deficit carried forward for the reporting period;
>
> b. in the case of an excess amount of input tax under the *Value Added Tax Act*, 2013 (No.35 of 2013), the taxpayer is assessed in respect of the correct amount of the excess input tax carried forward for the reporting period; or
>
> c. in any other case, the taxpayer is liable for the correct amount of tax payable in respect of the reporting period to which the original assessment relates"

95. In the absence of any evidence to the contrary, the Tribunal finds that the Respondent was justified to pick the mid-point(median) in the range, which is an acceptable practice as per Paragraph 3.62 of the OECD Transfer Pricing Guidelines which acknowledges that there might be circumstances the measures of central tendency i.e. median may be selected in order to enhance comparability.

96. The Tribunal is guided by the case of Oliver Merrick Fowler & another Vs. Kenya Revenue Authority [2022] eKLR quoted with authority in the case of Saima Khalid vs The Commissioner for Her Majesty's Revenue and Customs- Appeal No.TC/2017/02292 which stated;

> " ...The very use of the word 'judgement makes it clear that the commissioners are required to exercise their power in such a way that they make a value judgement on the material which is before them...What the words 'best of their judgement' envisage, in my view is that the commissioners will fairly consider all material placed before them, and on that material come to decision which is one which is reasonable and not arbitrary as to the amount of tax which is due."

97. The Tribunal observes that the Respondent is mandated to use the available information and its best judgment to issue an additional assessment where income has been underdeclared to ensure that the correct amount of tax has been paid. In the instant case, the Respondent in exercise of its legal mandate used the available information and its best judgment to pick the mid -point(median) in the range of 6.94% as opposed to the Appellant's proposed Net Cost plus Margin of 3%.

98. On whether the Respondent erred in disallowing tax credits of Kshs.511,303,741.00 relating to offshore components of the project. During the audit process, the Respondent noted that the Appellant claimed a tax credits amounting to Kshs.615,016,109.00 for the period 2018-2020. The Respondent however noted that the credits relating to the Appellant amounted to Kshs. 103,712,367.00. The excess credit claimed amounting to Kshs. 511,303,741 related to offshore components of the project which was billed by SAG Germany and as such therefore the same were disallowed.

99. The Tribunal notes that the credits attributable to the Appellant should be that which relates to the portion of the contract that was declared in Kenya only.

100. On whether the Respondent erred in demanding Withholding tax from the management and professional fees paid to SAG Germany. The Respondent submitted that the Appellant claimed costs in relation to general administrative expenses allocated from SAG Germany. That these costs related to headquarter expenses incurred at the Head Office level and allocated to Appellant based on revenue generated by it in Kenya. The costs amounted to Kshs 9,590,133 in 2017, Kshs 458,455 in 2018, Kshs 423,702,353 in 2019 and Kshs 192,587,911 in 2020.

101. The Tribunal notes that Section 18(5) of the *Income Tax Act* provides that "when a non-resident person carries on a business in Kenya through a permanent establishment in Kenya the gains or profits of the permanent establishment shall be ascertained without any deduction in respect of interest, royalties or management or professional fees paid or purported to be paid by the permanent establishment to the non -resident person..”

102. Further, Section 10(1) (ii) of the ITA which was introduced in 2019 excludes management or professional fees paid or purported to be paid by a permanent establishment to its head office from being considered as income accrued or derived from Kenya except for deductions provided for under Double Tax agreements. This implied that deductions which are allowable under a Double Tax Treaty on payments made by the PE in Kenya of a non-resident person to that non-resident person are now deemed to be income which is accrued in or derived from Kenya and therefore chargeable to withholding tax.

103. The Tribunal notes that the *Income Tax Act* envisioned situations where management fees can be deemed to arise between a permanent establishment and its head office. With regard to the applicability of Article 12 of the Kenya-Germany DTA, it was clear that Kenya and Germany have a shared taxing right for management fees, and none of the provisions under the Article limited Kenya from taxing this income.

104. The Tribunal notes that the Respondent during the audit review process requested the Appellant to provide it with a detailed breakdown of the headquarter costs to establish the specific nature of the same. However, the Appellant stated that it could not provide the same owing to the complexity and huge volume of the information.

105. The Respondent therefore concluded that the nature of these costs would mainly include expenses relating to management of the enterprise including the Appellant which amounts to provision of services by the head office to the Appellant and such costs were considered as management/professional fees as per Section 2 of the *Income Tax Act*.

106. With regard to the allegation that no payments occurred in the year 2019 between the Appellant and SAG Germany as per the definition of the word "paid" under the *Income Tax Act* it is the Tribunal’s view that examination of tax returns filed by the Appellant did not show evidence of reversals done in respect of general administrative expenses incurred in the year 2019.

107. On whether the Respondent erred in demanding withholding tax on gross amount paid to Flexi Personnel Limited (Flexi) for the labour subcontracting. The Tribunal notes that the Appellant had contracted Flexi Personnel Limited (Flexi) to provide labour and the total cost was inclusive of a direct cost element and management fee.

108. The Tribunal observes that the relationship between the Appellant and the Flexi Personnel was that of a consultancy nature and the entire amount payable by the Appellant to the consultant was subject to Withholding tax.

109. Section 2 of the *Income Tax Act* defines management or professional fee as;

> " a payment made to a person, other than a payment made to an employee by his employer, as consideration for managerial, technical, agency contractual, professional or consultancy services however calculated."

This therefore follows that Withholding tax ought to have been calculated on the entire cost paid to Flexi.

110. The Tribunal notes that the total amounts contained in the invoices were given in consideration for services offered/rendered withholding tax is therefore applicable on the value of the service which constitutes the direct cost element and management fee. Further subjecting the gross amounts to withholding tax was in line with the Third Schedule of the *Income Tax Act* under Paragraph 5 (f)(i) in Head B states that

> " The resident withholding tax rates shall be - in respect of management or professional fee or training fee, other than contractual fee; the aggregate value of which is twenty-four thousand shillings in a month or more, five per cent of the gross amount payable"

111. Further Section 35 (3) (f) of the *Income Tax Act* provides that;

> " Subject to subsection (3A), a person shall, upon payment of an amount to a person resident or having a permanent establishment in Kenya in respect of – Management or professional fee or training fee, the aggregate value of which is twenty-four thousand shillings or more in month:"

112. In the case of Cape Brandy Syndicate V Inland Revenu Commissioners (1990) IKB 64 as applied in TM Bell V Commissioner o income tax (1960) EALR 224 stated as follows;

> " 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 who ought 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."

113. It is the Tribunal's view that from the strict interpretation of the law, for any amount paid as management and/or professional fees irrespective of how the amount is stated, broken down and/or paid, a Withholding tax shall be deducted on the amount paid or payable.

114. The Tribunal notes that the Contract between the Appellant and Flexi Personnel Limited is for management services and the management fees paid are taxable in accordance with Section 35(3) (f) of the *Income tax Act* and therefore the services offered under the contract fall within the definition of "management or professional fee" as defined under Section 2 of the *Income Tax Act*. The Withholding tax rate applicable is 5% as per Paragraph 5 (f) (ii) of the Third Schedule to the *Income Tax Act* and from

the invoices availed by the Appellant, the Respondent noted that the Appellant failed to withhold on the entire amount.

115. On whether the Respondent erred in demanding PAYE on meals and catering services provided by Mara Gateway Hotel and Resort and Henken Services to the Appellant's employees at the Appellant's site. The Tribunal is of the view that provision of meals by an employer to an employee is a taxable benefit chargeable on the employee as per the *Income Tax Act*.

116. Section 5(4) (f) of the ITA provides that:

> " notwithstanding anything to the contrary in subsection (2)"gains or profits" do not include (f) the value of meals served to employees in a canteen or cafeteria operated or established by the employer or provided by a third party who is a registered taxpayer (whether the meals are supplied in the premises of the employer or the premises of the third party)where the value of the meal does not exceed the sum of forty-eight thousand shillings per year per employee subject to such conditions as the Commissioner may specify;

117. From the above provision of the law, it is clear that once an employer provides meals to its employees either directly or through a third party where the value of the meal exceeds the sum of forty-eight thousand shillings per year per employee then the said benefit shall be chargeable to tax on the employee.

118. In the instant case, the Respondent noted that among the Appellant's costs incurred was the costs incurred in paying third parties (Mara Getaway Hotel and Resort and Henken Catering Services) in relation to meals and catering services that were provided at the Appellant's site to its employees.

119. The Tribunal notes that in the absence of evidence that amounts in relations to meals and catering services that were provided, the same were not allowable expenses. incurred wholly and exclusively for production of its business income that was treated the same as a benefit to the employees which is chargeable to PAYE under the *Income Tax Act*.

120. On whether the Appellant discharged the burden of proof in relation to payment of Withholding tax on local management and professional fees. The Tribunal notes that the Appellant made payments to various local suppliers in respect of services, which were in the nature of management and professional fees and for which withholding tax ought to have been withheld/paid.

121. The Tribunal notes that the Appellant argued that some of the payments charged Withholding tax were cash payments and therefore withholding tax was not applicable. It is the Tribunal's view that withholding tax is applicable to all payments made regardless of the mode of payment as per Section 35 (3)(f) which provides as thus:-

> " a person shall, upon payment of an amount to a person resident in Kenya in respect of management or professional fee or training fees the aggregate value of which is twenty-four thousand shillings or more in a month."

122. Further Section 2 of the ITA defines "paid" to include "distributed, credited, dealt with or deemed to have been paid in the interest or on behalf of a person"

123. On whether the Appellant discharged the burden of proof, the Tribunal relied on Section 56 (1) of the Tax Procedure Act which provides that in any proceedings that relate to tax decisions, objections and Appeals, the burden shall be on the taxpayer to prove that a tax decision is incorrect.

124. Section 30 the *Tax Appeals Tribunal Act* provides that;

> " In a proceeding before the Tribunal, the appellant has the burden of proving –
>
> a. where an appeal relates to an assessment, that the assessment is excessive; or
>
> b. in any other case, that the tax decision should not have been made or should have been made differently."

125. In the Court of Appeal in the case of Commissioner of Income Tax v Lerematesho Ltd [1976] eKLR stated that;

> " The fact of assessment itself places on a taxpayer the burden of proving that it was excessive. Indeed, if on the evidence the taxpayer can only show that the conflicting views are equally balanced, then the taxpayer would have failed to discharge that onus."

127. The Tribunal is guided by the High Court in the case of Ushindi Limited v Commissioner of Investigation and Enforcement Kenya Revenue Authority [2020] eKLR where it has stated that:-

> " The burden of proof was on the Appellant to raise the specific items and/or aspects of the tax assessment that were manifest errors, wrongfully imposed or not liable to be paid as tax."

128. It is the Tribunal's view therefore that the Appellant did not sufficiently proof that the assessment made by the Respondent was wrong therefore it failed to discharge its burden of proof.

129. In the upshot of the foregoing, Tribunal is persuaded that the Respondent's entire assessment was justified.

Final Decision

130. In view of the foregoing, the Tribunal finds that the Appeal is unmerited and accordingly makes the following Orders:-

a. That the Appeal be is hereby dismissed.

b. That the Objection decision dated 27th January 2023 be and is hereby upheld.

c. Each Party to bear its own costs.

d) It is so ordered.

DATED AND DELIVERED AT NAIROBI THIS 28TH DAY OF JUNE, 2024

ERIC NYONGESA WAFULA - CHAIRMAN

EUNICE NG'ANG'A - MEMBER

ABRAHAM K. KIPROTICH - MEMBER

ELISHAH N. NJERU - MEMBER

MUTISO MAKAU - MEMBER