**M-Kopa LLC (c/o M-Kopa Kenya Limited) v Commissioner of Domestic Taxes (Tax Appeal 65 of 2023) [2024] KETAT 269 (KLR) (23 February 2024) (Judgment)**

Neutral citation: [2024] KETAT 269 (KLR)

**REPUBLIC OF KENYA**

**IN THE TAX APPEAL TRIBUNAL**

**TAX APPEAL 65 OF 2023**

**E.N WAFULA, CHAIR, CYNTHIA B. MAYAKA, RO OLUOCH, E NG'ANG'A, AK KIPROTICH & B GITARI, MEMBERS**

**FEBRUARY 23, 2024**

**BETWEEN**

**M-KOPA LLC (C/O M-KOPA KENYA LIMITED) ..... APPELLANT**

**AND**

**COMMISSIONER OF DOMESTIC TAXES ..... RESPONDENT**

**Model to be used in determining the tax residency of a corporate body**

*The case concerns the respondent's assessment of Kshs. 368,507,926 in taxes against the appellant, including withholding tax (WHT) on deemed interest for the 2017 financial year. The respondent invoked section 35(1) of the Income Tax Act to impose WHT obligations, while the appellant argued that the deletion of section 35(6) by the Finance Act 2016 eliminated the respondent's authority to recover unpaid WHT directly from the payer during the assessment period. The appellant contended that the recovery mechanism was only reinstated under section 39A of the Tax Procedures Act in November 2019, making the assessment unlawful.*

Reported by John Ribia

***Tax Law*** *– residency – residency of companies – place of effective management - what was the formula/model to be used in determining tax residency of a corporate body (the place where management and control of affairs of a company was for taxation purposes) - what test was used to determine the place of effective management of a corporate body – Income Tax Act (cap 470) sections 3(2), 5(5), 10, 35(1) and (6); Tax Procedures Act (cap 469B) section 39A.*

***Tax Law*** *– income tax – income chargeable to income tax – grants – stock options - whether grants were gains and profits from business, employment or rights granted for the use of property or any other form of recognized income recognised under the Income Tax Act - whether remuneration in the form of stock options constituted a taxable benefit under the Income Tax Act – Income Tax Act (cap 470) sections 3(2), 5(5), 10, 35(1) and (6); Tax Procedures Act (cap 469B) section 39A.*

***Tax Law*** *– income tax – withholding tax - where section 35(6) of the Income Tax Act, which empowered Kenya Revenue Authority (KRA) to recover unpaid withholding tax directly from a taxpayer who failed to deduct or remit the tax, was deleted by the Finance Act 2016 – effect of deletion – whether the deletion of section 35(6) of the*

*Income Tax Act by the Finance Act 2016 removed the respondent's authority to recover tax from a taxpayer who failed to withhold and remit withholding tax during the 2017 assessment period.*

**Brief facts**

The respondent conducted an audit of the appellant's operations for the 2017 financial year and assessed a tax liability of Kshs. 368,507,926, including withholding tax on deemed interest. The respondent relied on section 35(1) of the Income Tax Act to justify the withholding tax obligation. However, the appellant argued that the deletion of section 35(6) of the Income Tax Act by the Finance Act 2016 had removed the respondent's authority to recover unpaid withholding tax directly from the taxpayer for the 2017 assessment period. The appellant contended that the power was only reinstated by the Finance Act 2019 through section 39A of the Tax Procedures Act, which came into effect on November 7, 2019.

**Issues**

i. What was the formula/model to be used in determining tax residency of a corporate body (the place where management and control of affairs of a company was for taxation purposes)?
ii. What test was used to determine the place of effective management of a corporate body?
iii. Whether grants were gains and profits from business, employment or rights granted for the use of property or any other form of recognized income recognised by the Income Tax Act.
iv. Whether remuneration in the form of stock options constituted a taxable benefit under the Income Tax Act.
v. Whether the deletion of section 35(6) of the Income Tax Act by the Finance Act 2016 removed the respondent's authority to recover tax from a taxpayer who failed to withhold and remit withholding tax during the 2017 assessment period.

**Held**

1. Section 1 Income Tax Act (ITA), a resident, when applied to a body corporate, meant the place where the management and control of the affairs of the corporate entity was exercised in that particular year under consideration. The formula or model to be used in determining the place where management and control of affairs of the company was exercised was not defined in the ITA.
2. The Tax Appeals Tribunal (TAT) was cautions whereas it could use the OECD Guidelines to help it determine the residency of the appellant, it shall only apply those guidelines in cases where there were gaps in Kenyan tax statutes. Under the OECD Guidelines the place of effective management was the pivot that determined the residency of a corporate entity like the appellant.
3. The place of effective management was where the company was actually managed. It was where the key management and commercial decisions that were necessary for the conduct of the entity's business were in substance made. The definition was aligned and consistent with the ITA which had defined a resident in regard to corporate persons to mean the place where management and control of the affairs of the corporate body was exercised. The place of effective management was where the real top level of management or realistic, positive management of the taxpayer was exercised.
4. Guided by paragraph 24 of the Commentaries on the Articles of the Model Tax Convention on Income and on Capital, a company may have more than one place of management but it could only have one place of effective management at any one time. If a company's key management and commercial decisions affecting its business as a whole were made at a single location, that location was its place of effective management. However if those decisions were made at more than one location, the company's place of effective management was the location where those decisions were primarily or predominantly made.
5. Only one board of directors meeting was held in Kenya. The other meetings were held in jurisdictions outside Kenya. All decisions that were made by the board committees required the approval of the board of directors. The location where a company's board regularly convened and made decisions may often be its place of effective management, provided the board retained and exercised its authority to govern the company and substantially made the essential management and commercial decisions.

6. Members of management forwarded their recommendations to the board committees which in turn forwarded their recommendation to the full board for consideration. It was thus at the board level where key management and commercial decisions necessary for the conduct of the appellant's business were made.
7. The place of effective management location was not in Kenya because the board met in Kenya for only one meeting out of the 4 meetings that were scheduled for the year under consideration. A majority of the directors were also non-Kenyan residents who attended their meetings from locations outside Kenya. The company's board meetings were regularly held and key decisions made from a location outside Kenya.
8. The location and role of the board of directors in determining place of effective management was so vital that if one described it as a rubber stamp then it must provide concrete evidence to show for example that the directors lacked sufficient knowledge and information to perform their duties, the directors were not suitably qualified and experienced generally and in relation to the particular company, that the directors merely sat in meetings to tick the boxes while decisions were being made elsewhere or that the directors did not have reasonable time to assess the information and make the decision.
9. Key decisions were made by the directors and hence the location where they regularly met and made decisions would thus be the place of effective management of the appellant and not Kenya. The place of effective management was a legal issue that required a sequential analysis, it could never be conclusively obtained and or determined based on what one of the parties had filed or stated in their documents or filings. Its determination could only arise from a wholesome analysis of the facts and circumstances of the case. The appellant (M-kopa LLC) was not a tax resident in Kenya in the 2017 year of income.
10. Section 3(1) of the ITA applied to both residents and non-residents on the profits and gains earned from a source that was within Kenya. Section 3(2)(a) provided that grants had not been included in the exclusive list of sources of income that were chargeable to tax. Nothing was produced to show that the grant emanated from the business of the appellant to qualify it to be described as a gain, profit, interest or any other form of income recognised under the closed list of section 3(2) of the ITA. In any event it was agreed between the parties that the appellant received the said grant from a third party and it was not received in the course of business or as consideration for services offered or goods supplied. The respondent had also not proffered a reasonable cause why it opted to tax an item that had not been listed in section 3(2) of the ITA.
11. Tax statutes must be interpreted textually. Nothing ought to be construed and or intended into a tax statute. The exclusion of grants from the list of sources of income means that the respondent could not use craft or stretch the list of items listed under section 3(2) of the ITA to include grants. Anything excluded from the list was not taxable unless it was shown and proved to be a profit or a gain that was raised in the course of business by a taxpayer. The respondent was not justified in subjecting the appellant's grant income of USD 1,675,040 to taxation.
12. The Finance Act 2016 deleted section 35(6) of the ITA. The effect of the deletion was that the respondent could no longer recover tax that ought to have been withheld from a taxpayer who should have withheld it. The position remained that way until November 7, 2019 when the Finance Act 2019 re-introduced the repealed section 35(6) of the ITA under section 39A of the Tax Procedures Act (TPA). The effect of the amendment was that the respondent could not claim taxes from the appellant if it failed to withhold and remit the taxes as if the taxes were due from it. That power was taken away by the repeal of section 35(6) of the ITA. That power was only restored on November 7, 2019 which was beyond the 2017 assessment period in the instant appeal.
13. The amendment of the law in 2016 was not only applicable to resident parties and that the principle of the effect of the repeal of the law should be interpreted differently for a non-resident withholder. Tax statutes were interpreted textually. There was nothing within the provision of the repealed section

35(6) of the ITA or the reading of section 35 of the ITA which stated that the application of the repealed section 35(6) was limited to residents only. The respondent was not justified in collecting withholding tax (WHT) that ought to have been deducted by the appellant in regard to the deemed interest for the year 2017. The same ought to be recovered directly from the payee.

14. Under section 5(5)(a) of the ITA, benefits arising from an employee share option plan could be deemed to be income from employment. However, the value of that income shall be arrived at by determining the difference between the market value, per share, and the offer price, per share, at the date the option was granted by the employer.
15. The appellant provided an Amended and Restated Operating Agreement to prove that it issued its shares at market value thus implying that its employees did not obtain any benefit from this transaction. Section 5(5)(a) of the ITA provided a formula for determining the benefit obtained by employees in a share ownership plane which worked out as market value, per share less(minus) the offer price, per share, at the date the option was granted by the employer equalled income earned by the employee from a share option.
16. The respondent was thus behoved to show the appellant and the TAT how it arrived at its value of the benefit. Which market value did it adopt and which offer price did it apply in arriving at its conclusion on benefit? The working was not shown in the assessment dated September 26, 2022 and the objection decision dated December 6, 2022. In both cases, it merely popped up with a decided average share price of USD 38.04, where was that average share price obtained? It did not bother to address the appellant's assertion that it had adopted the market price in the share option such that no benefit was obtained by any of its employees in this transaction.
17. The respondent's action breached the dictates of section 5(5)(a) of the ITA which required it to abide by the provided formula in determining the benefit obtained by the appellant's employee who took up this share option. The respondent instead opted to come up with its own model and formula for determining the unit price of the shares and market price of the shares and predictably arrived at a nirvana destination that was contrary to section 5(5)(a) of the ITA. Its actions were thus illegal and unjustified.

*Appeal allowed.*

***Orders***

1. *The respondent's Objection Decision dated December 6, 2022 was set aside.*
2. *Each party bore its own costs.*

**Citations**

**Cases**

***Kenya***

1. *Aquavita Kenya Limited v Commissioner of Domestic Taxes* Appeal 292 of 2021 - (Explained)
2. *Commissioner of Domestic Taxes v Pevans East Africa Limited & 6 others* Tax Appeal E003 of 2019; [2022] KEHC 10392 (KLR) - (Explained)
3. *Commissioner of Domestic Taxes v Thika Road Baptist Church Ministries* Tax Appeal E024 of 2021; [2022] KEHC 644 (KLR) - (Followed)
4. *Mount Kenya Bottlers Ltd, Rify Valley Bottlers Ltd, Nairobi Bottlers Ltd & Kisii Bottlers Ltd v Attorney General, Kenya Revenue Authority, Commissioner-General of KRA & Commissioner of Customs & Excise* Civil Appeal 164 of 2013; [2019] KECA 500 (KLR) - (Mentioned)
5. *Socabelec East Africa Limited v Commissioner of Domestic Taxes* Appeal 195 of 2017 - (Explained)
6. *Unilever Kenya Ltd v Commissioner of Income Tax* Commercial Civil Case 753 of 2003; [2005] KEHC 3176 (KLR) - (Explained)

***United Kingdom***

1. *Cape Brandy Syndicate v Inland Revenue Commissioner* 12 TC 358 (1921) - (Explained)

2. *De Beers Consolidated Mines Limited v Howe* [1907] UKHL 626 - (Mentioned)
3. *HM Revenue & Customs v Smallwood & another* [2010] EWCA Civ 778 - (Followed)
4. *Trevor Smallwood Trust v Revenue and Customs* [2008] UKSPC SPC00669 - (Explained)
5. *Trevor Smallwood Trust v Revenue and Customs* [2008] UKSPC SPC00669 - (Explained)

***Australia***

1. *Bywater Investments Limited & Ors v Commissioner of Taxation* [2016] HCA 45 — Explained
2. *Malayan Shipping Company Ltd v Federal Commissioner of Taxation* [1946] 3 AITR 258 — Explained

***Israel***

1. *Shay Tzamarot Case* Civil Appeal 32172-05-13 – (Explained)
2. *Yanko Weiss* Civil Appeal 805/14 — (Explained)

**Statutes**

***Kenya***

1. Companies Act (cap 486) In general — (Cited)
2. Finance Act 2016 Act No 38 of 2016 In general - (Cited )
3. Income Tax Act (cap 470) sections 3(2); 5(5); 10; 35(1)(6) — (Explained)
4. Kenya Revenue Authority Act (cap 469) section 13 — (Interpreted)
5. Tax Procedures Act (cap 469B) section 39A) In general — ( Interpreted

**Instruments**

Organization for Economic Co-operation and Development Model Tax Convention on Income and on Capital, (OECDNTC) 2017 article 4

**Advocates**

None mentioned

## JUDGMENT

### Background

1. The appellant, M-kopa LLC is a limited liability company registered in the State of Delaware in the United States of America(USA). It is the holding company of M-kopa Kenya Ltd.

2. M-kopa Kenya is a limited liability company duly incorporated under the *Companies Act* of the laws of Kenya, and whose principal activity is the provision of digital financial services to under-banked customers.

3. The respondent is a principal officer appointed under section 13 of the *Kenya Revenue Authority Act* and the Kenya Revenue Authority is mandated with the responsibility for the assessment, collection, receipting and accounting for all tax revenue as an agent of the Government of Kenya. The respondent is also mandated with the responsibility for the administration and enforcement of the statutes set out in the Schedule to the Act.

4. The respondent undertook an audit of the appellant's operations for the year 2017 and by a letter dated September 26, 2022 communicated its tax assessment of Kshs 368,507,926.00 concerning Corporation tax, Pay as You Earn and withholding tax.

5. The appellant, aggrieved by the said assessment, lodged its notice of objection on October 26, 2022wherein it disputed the assessment in its entirety and requested the respondent to have the same set aside.

6. The respondent issued its objection decision on December 6, 2022 wherein it confirmed its assessment of Kshs 368,507,926.00.

7. The appellant aggrieved by the respondent's objection decision filed its Notice of Appeal on January 5, 2023.

**The Appeal**

8. The appellant filed its Memorandum of Appeal and Statement of Facts on January 19, 2022and raised the following grounds of appeal;

    a. The respondent erred in fact and law by deeming the appellant tax resident in Kenya.

    b. The respondent erred in fact and law by assessing the Corporation tax of Kshs. 74,016,426.00 consisting of principal tax of Kshs 46,551,212.00 penalty of Kshs 2,327,561.00 and interest of Kshs 25,137,654.00 on grant income of Kshs 155,170,705.00 received by the appellant in the year 2017.

    c. The respondent erred in fact and law by deeming the interest of Kshs 488,488,620.00 on the appellant's redeemable preference shares (the Preferred Shares) and assessing WHT of Kshs 118,702,735 compromising of principal tax of Kshs 73,273,293.00, penalty of Kshs 3,663,665.00 and interest of Kshs 41,765,777.00.

    d. The respondent erred in law by assessing the WHT of Kshs 84,848,921.00 comprising of principal tax of Kshs 52,375,877.00, a penalty of Kshs 2,618,794.00 and interest of Kshs 29,854,250.00 on the appellant's interest liabilities from third-party loans amounting to Kshs 349,172,510.00.

    e. The respondent erred in fact and law by assessing PAYE of Kshs 90,939,845.00 comprising of principal tax of Kshs 56,135,707.00, penalty of Kshs 2,806,785.00 and interest of Kshs 31,997,353.00 on the appellant's employee and senior executive's remunerations received in the form of stock options amounting to Kshs 187,119,022.00.

**The appellant's Case**

9. The appellant's case is set out on its:

    a. Statement of Facts dated and filed on the January 19, 2023,

    b. Reply to respondent's Supplementary Statement of Facts dated September 22, 2023 and filed on September 26, 2023,

    c. Written Submissions were filed on the October 19, 2023.

10. The appellant stated that the summary of the taxes assessed against vide assessment notice dated September 26, 2022 was as follows:

| Description | Principal (Kshs.) | Penalty And Interest (Kshs.) | Total (Kshs.) |
|---|---|---|---|
| Income tax at the corporation tax rate | 46,551,212 | 27,45,215 | 74,016,426 |
| Withholding income tax | 125,649,170 | 77,902,485 | 203,551,655 |
| Pay as you earn | 56,135,707 | 34,804,138 | 90,939,845 |
| Total | 228,336,088 | 140,171,838 | 368,507,926 |

11. That the aforementioned assessment related to the respondent's decision to:

    a. Deem the appellant tax resident in Kenya for the 2017 year of income and subsequently subjected the appellant's income to tax in Kenya as provided for under section 3 of the *Income Tax Act* (ITA). This was on the premise that the effective management and control of the affairs of the appellant was allegedly exercised in Kenya in the 2017 year of income;

    b. Assess income tax corporation of Kshs 74,016,426.00 (which amount is inclusive of penalties and interests) on grant income of Kshs 155,170,705 received by the appellant in the year 2017. This was on the basis that the appellant was allegedly a tax resident in Kenya and therefore, its grant income was chargeable to tax under section 3(1) of the *ITA*.

    c. Deem interest of Kshs 488,488,620.00 on the appellant's redeemable preference shares (the preferred shares) and assess WHT of Kshs 118,702,735.00 (which amount is inclusive of penalties and interests) on the basis that the appellant was allegedly a tax resident in Kenya and that the preferred shares were loan instruments and hence deemed interest provisions were applicable on the preferred shares.

    d. Assess WHT of Kshs 84,848,845.00 (which amount is inclusive of penalties and interests) on the appellant's interest paid to third parties for loans advanced to it on the basis that the appellant was allegedly tax resident in Kenya and section 35(1) of the *ITA* requires a person to withhold tax at the appropriate non-resident rate upon payment to a non-resident person in respect of interest payments.

    e. Assess PAYE of Kshs 90,939,85.00 (which amount is inclusive of penalties and interests) on the appellant's employees and senior executives' remuneration received in the form of stock options on the basis that the appellant was allegedly a tax resident in Kenya and the stock options were a taxable benefit as provided for under section 5(5) of the *ITA*.

12. The appellant sets out its facts in support of its grounds of Appeal under 4 titles as follows;

**i. Tax Residence of the appellant.**

13. Under this head, the appellant averred that it was not a tax resident in Kenya in the 2017 year of income.

14. It contended that *ITA* does not define what management of an entity entails. That the absence of a definition in the *ITA* inclined it to rely on international best practices as noted in the Unilever Kenya Limited vs the Commissioner of Income Tax, Income Tax Appeal No 753 of 2003.

15. That the Organization for Economic Cooperation and Development Model Tax Convention on Income and on Capital (OECD Model Tax Convention) guides the concept of management of an enterprise and states that:

> "Where by reason of the provision of paragraph 1, a person other than an individual is a resident of both contracting states, then it shall be deemed to be a resident only of the state in which its place s place of effective management is situated.

16. In regards to the respondent's argument that 19 out of 27 meetings of the appellant were held in Kenya and therefore the control of the affairs of the appellant was exercised in Kenya, the appellant rebutted that the respondent ought to have limited its residency analysis on the meetings that were held in Kenya in 2017 because the issue under determination was the residency of the appellant for the year 2017. Its view was that this decision by the respondent was not supported by law.

17. The appellant maintained that there were 13 meetings held in the 2017 year of income. That of these, only 4 out of the 13 meetings were full board of managers meetings while the remaining 9 meetings were board committee meetings. It further submitted that only 1 out of the 4 full board of managers meetings held in 2017 was held in Kenya.

18. Going by this analysis, the appellant proffered that it would be erroneous to conclude that the appellant is a tax resident in Kenya by just one (1) board of managers meeting being held in Kenya. It stated further, that it was worth noting that the three (3) meetings which took place outside of Kenya took place in the United Kingdom at the offices of appellant's main shareholders. That this was evidence enough that control of the appellant resided at the shareholder level and all of the major shareholders who asserted control over the appellant resided outside of Kenya.

19. The appellant posited that although the concept of control has always been used to determine the tax residency of a company, however the necessary control will, in the vast majority of cases, be found at the level of the company's board of managers.

20. That its board of managers was composed of four (4) shareholder representatives each of whom was located outside of Kenya and that those four shareholders had the power to approve and remove the three independent directors on the appellant's board of managers, effectively giving control of over seven (7) of the ten (10) seats on appellant's board of managers to the four controlling shareholders, none of whom were located in Kenya.

21. In addition to controlling the composition and make-up of the appellant's board, the appellant further stated that its shareholders also controlled the company through numerous veto and consent rights including over the appellant's ability to;

    a. amend the Company's organizational documents,

    b. issue new shares of equity,

    c. increase the number of individuals on the Board of managers,

    d. Issue or create debts in excess of USD 1,000,000,

    e. grant security over the company's assets,

    f. create or holding capital stock in any subsidiary that is not wholly owned,

    g. Make any acquisition or investment or enter into any other transaction with a value in excess of USD 1,000,000,

h. Change the business of the Company or any of its subsidiaries,

i. Declare or pay dividends,

j. Approve a liquidation event or dissolution, amongst others.

22. It was its view that all approvals to undertake any of the aforementioned transactions were done by written resolutions that were executed by shareholders outside of Kenya as evidenced in its Operating Agreement for the year 2017.

23. It stated that under the OECD Guidelines, a company or a body of persons is deemed to be resident where the place of effective management is situated and that its place of effective management was in the United Kingdom where its board of directors were resident.

24. It also relied on the principle of effective management as enunciated in the House of Lords case of *De Beers Consolidated Mines Limited v Howe* [1907] UKHL 626 (30 July 1907).

25. It posited that the appellant, M-KOPA LLC's sole purpose during the period under review was that of a holding company, responsible for overseeing operations of the operating entities. That it was thus contractually prohibited from serving in a capacity other than a holding company or from undertaking operations outside of serving as a holding company. It persisted that the appellant did not engage in any operational activities in Kenya in the 2017 year of income.

26. Based on the foregoing arguments, the appellant averred that it was not tax resident in Kenya in the 2017 year of income and therefore, the income it earned in the 2017 year of income was not subject to tax in Kenya.

**ii. Grant Income**

27. Under this head, the appellant submitted that it was not a tax resident in Kenya in the 2017 year of income, and therefore, the respondent does not have any mandate within the confines of the ITA to charge income tax on grant income of the appellant which is a non-resident company.

28. Without Prejudice to its statement on non-residency, the appellant contended that grant income would not be subject to income tax since it is not expressly provided for under section 3(2) of the *Income Tax Act*, which provides for the classes of income that are subject to tax. It relied on the cases of *Mount Kenya Bottlers Ltd and 3 others v Attorney General and 3 others* [2019]eKLR and *Kenya Revenue Authority (KRA) vs Thika Road Ministry (TRM)* HCCOMMITA/E024/2021 to support the argument that section 3(1) of ITA which sets out income chargeable to tax was an exclusive and closed list

**ii. WHT**

29. The appellant divided this subheading into 2 sub-titles and submitted as follows under each one of them

**a. WHT on the Preferred shares.**

30. The appellant submitted that it had demonstrated that it was not a resident in Kenya in 2017 and therefore, the respondent does not have any mandate within the confines of the ITA to demand WHT from a non-resident company.

31. The appellant submitted on a without prejudice basis that the respondent erred in assessing WHT on the preferred shares because the *Finance Act 2016* which became effective on June 9, 2016 repealed section 35(6) of the ITA.

32. That contrary to the respondent's decision that section 35(6) of the ITA was about the imposition of penalty for failure to withhold tax, it was its view that section 35(6) of the ITA was about the collection and recovery of tax and penalty as if it were tax payable by the person.

33. The appellant maintained that the prevailing tax law was the one that allowed recovery of WHT from the withholder who failed to withhold tax, as it was due and payable by that person. That the consequence of repealing this section meant that there was no law allowing the respondent to recover WHT from persons who failed to do so, whether the WHT was due from a resident or non-resident person.

34. That in recognition of this fact, the *Finance Act 2019* introduced section 39A of the TPA effective from November 7, 2019 which allowed for the recovery of WHT from persons who failed to deduct and remit the same within the prescribed timelines.

35. The appellant thus held the view that between June 9, 2016 to November 7, 2019, there was no legal basis to support the respondent's WHT assessment for the period before November 7, 2019. it supported this argument with the decision in *Commissioner of Domestic Taxes Department v Pevans East Africa Limited and Shop and Deliver Limited and 5 others* (HCCOMMITA/E003/2019.

36. The appellant further averred that it correctly classified the preferred shares as equity in line with the provisions of International Accounting Standards (IAS) 32, which provides that a financial instrument is considered equity if it does not have a fixed maturity date and when the issuer does not have a contractual obligation to make any payment. That the preference shares are liabilities because they do not have a fixed rate of dividend or a mandatory redemption date in the future.

37. Its view therefore, was that for any form of indebtedness to qualify as a loan under this provision of the law, there had to be a fixed charge, interest, discount or premium. That the preferred shares did not have a fixed rate of dividend or interest under the operating Agreement and therefore they did not meet the definition of a loan and therefore deemed interest did not apply to it.

**b. WHT on interest**

38. The appellant re-stated that:

    a. It was not tax resident in Kenya in the 2017 year of income and was thus not bound to pay WHT on interest on non-resident third-party investor loans.

    b. There was no legal provision enabling the respondent to demand WHT from it between June 9, 2016 to November 7, 2019.

    iv. Pay as you Earn

39. The appellant averred under this head, that it was not a tax resident in Kenya in the 2017 year of income and as such the respondent did not have the mandate within the confines of the ITA to tax the remuneration of its Kenyan employees and senior executives received in the form of stock options.

40. Without prejudice to the foregoing assertion, the appellant further submitted that section 5(5)(a) of the ITA (now deleted) provided that, the value of the benefit shall be the difference between the market value per share and the offer price at the date the option is granted. That since the shares that were

issued at or in many cases were above the market price at the date of the grant, there should be no taxable benefit to the employees.

41. It reiterated that since the unit price would have been the fair market value there was no taxable benefit on the employee which would have been subject to tax in Kenya.

42. The appellant submitted as follows regarding the testimony of the respondent's witness, Mr Jackson Mwangi (RW 1) who testified in court on September 28, 2023.

43. That the witness contradicted his witness statement when he stated on cross-examination that he had only considered the 2017 meetings. That this contradiction between the respondent's Witness and the respondent's documents is an unequivocal admission by the witness that it should not have taken into account meetings outside the 2017 year of income in its decision-making process.

44. The appellant also stated that contrary to the view of the witness, board committees do not make any decisions. That the role of the board committees is to provide recommendations which are considered by the main board which has the power to make final decisions on the reports.

45. The appellant supported this assertion with the OECD Corporate Governance Working Papers which states that:

> " The board of directors of a company is primarily responsible for monitoring managerial performance and providing strategic guidance to the management. In doing so, the board typically sets up specialized committees to carry out specific tasks with a view to support and improve its work. Committees perform both monitoring and advisory functions for the board, knowing that the letter remains collective responsibility for decision-making. Their importance has grown over time due to increased legal requirements and recommendations, corporates crutiny, shareholders' and stakeholders' pressure on boards, and the more complex business environment."

46. It explained that the presence of the officers of the Kenyan entity in the meetings did not mean that they were part of the decision-making process because these officers were mere invitees to the board. That this does not make the said officers members of the committees.

47. That the assertion by RW1 that the board of managers merely rubber-stamp the decision of the officers of the appellant's Group goes against the well-known theory in corporate governance known as the agency theory. That under the agency theory, whilst managers usually have greater access to information and are more knowledgeable about the company's affairs than the shareholders, this information asymmetry makes it easier for managers to recommend decisions that are not necessarily in the best interests of shareholders.

48. That RW 1 witness statement in claiming that the appellant is a holding company with subsidiaries in Kenya, Uganda, Tanzania and the United Kingdom shows that he does not understand the business operation of the appellant.

49. The appellant referred to page 17 of the Audited Financial Statements which it stated showed that its revenue was USD 53,743,903 and other operating income which comprised of the grant income was USD 1,675,040. It asserted that the respondent's assessment was in error as it assessed the grant revenue of appellant's Group company some of which had already been taxed in Kenya and Part of which accrued outside Kenya and hence not subject to tax in Kenya.

50. That appellant's income which is the focus of the assessment, if at all, ought to have been its local grant income and not the group income.

51. On the applicability of the TRM case, the appellant submitted that the respondent's analysis of the case is wrong because the High Court's judgment is of general application and not of limited applicability as the respondent wishes to claim. That the High Court ruled that the sources of income under section 3 is a closed list. This means that income such as grant income is not subject to tax in Kenya since it is not listed in section 3 of the *Income Tax Act*.

52. It was its view that the court's holding in the Pevans case was that section 35(6) of the *Income Tax Act* was deleted and therefore, the respondent could not pursue the appellant in that matter for withholding tax. Secondly, it was its view that how section 35 (6) is drafted is that it applies to the whole of section 35 of the *Income Tax Act* which provides for withholding tax whether in respect of resident persons or non-resident persons.

53. That withholding tax in the case of non-residents is provided for under section 35(1) of the *Income Tax Act*, whereas section 35 (3) of the ITA provides for withholding tax applicable to resident persons.

54. The appellant stated that the *Income Tax Act* provides that a benefit is the difference between the market value of the shares and the offer price of the shares on the date of grant of the options. That based on the extracts from the appellant's amended and restated unit option plan it is clear that the price of the shares at the exercise date is the fair market value of the shares at the date of grant. That this means that the amount to be paid by the employees is the fair market value at the date on which the option is granted.

55. That there was therefore no taxable benefit in this Appeal since the offer price of the options is equal to the fair market value of the options at the date of the grant.

56. That the appellant referred the Tribunal to paragraph 50 of the respondent's Statement of Facts dated 20 February 2023 which is worded as follows:-

> " the exercise price of the share options is equal to the market price of the underlying shares on the date of the grant of the stock options being subject to four-year vesting, conditioned on each employee's continued employment with the appellant."

57. In its view, the above statement proved its case and left one to wonder why the respondent is assessing PAYE on the stock options yet no benefit is accrued to the employee

58. The appellant restated with regard to the respondent's Supplementary Statement that:

    a. It was a holding company which was prohibited from engaging in the operational activities of the Kenyan company in 2017.

    b. The role of making key strategic decisions lies with the board of managers and not its Committees whose role is to deal with specialised matters and present their recommendations to the board for consideration.

    c. Senior managers present their views to Committees which synthesise the issues for consideration and decision making by the board.

    d. Whereas the board can operate independently of the committees, the committee cannot operate independently of the board

**Appellant's Prayer**

59. Based on the foregoing the appellant prays that:

a. The objection decision dated December 6, 2022which set out and confirmed the income tax assessment of Kshs. 368,507,926.00 be annulled and set aside in its entirety;

b. The Appeal be allowed with costs to the appellant; and

c. Any other remedies that the Honorable Tribunal deems just and reasonable.

**respondent's Case**

60. In its response to the appellant's case, the respondent has grounded its case on:

a. Statement of Facts dated February 17, 2023 and filed on February 20, 2023,

b. Witness Statement by Jackson Mwangi dated and filed on June 23, 2023 that was admitted in evidence under oath on the September 28, 2023

c. Written Submissions dated October 11, 2023and filed on October 16, 2023.

d. Supplementary Statement of Facts dated June 23, 2023and filed on June 26, 2023

61. The respondent stated that its 2017 audit of the appellant revealed that:-

a. The appellant filed at the Securities and Exchange Commission in the United States of America (USA) in the period 2013-2017 indicating that its principal place of business is in Kenya and the addresses of all the executive directors are in Kenya;

b. The said declaration was made to a Constitutionally mandated body of a State Government, the Securities and Exchange Commission of USA without contemplation of any tax matters that might arise.

c. The executive directors listed in the appellant's financial statements were tax residents in Kenya and its accounts were signed off by Jesse Moore who is the CEO of M-Kopa Kenya Limited and lives in Kenya;

d. The chairman of the board of M-Kopa Limited is a Kenyan citizen. The other members who are non-residents are non-executive board members;

e. The appellant's Executive directors, Mr Chad Larson and Mr. Jesse Moore, who are Kenyan residents, signed all the appellant's agreements. These agreements include and are not limited to grant agreements, loan agreements and Employees Share Option Agreements (ESOPs) on behalf of M-Kopa.

62. The respondent further stated that it reviewed the minutes of the board of managers meetings and observed that:-

a. Twenty-seven (27) Board of Managers meetings were held in the period 2012-2017, however, none of the meetings was held at the registered office in Delaware in the United States of America;

b. Nineteen (19) meetings were held in Kenya;

c. Six (6) meetings were held in the United Kingdom (at the Shell Foundation, GIM and GSMA Headquarters) and not in the M-Kopa offices in the United Kingdom.

d. One (1) meeting was held in the USA (Gates Foundation offices).

e. One (1) meeting was held in Switzerland (LGT Offices).

63. The respondent stated that the meetings held by the appellant outside Kenya were not held at M-kopa LLC offices in those respective countries.

64. That based on the foregoing analysis it concluded that the appellant was a tax resident in Kenya in the period 2017 and thereby deemed the whole of its gains or profits in 2017 to have accrued in or have been derived from Kenya.

65. That its tax assessment dated September 26, 2022 demands Kshs 368,507,926.00 as principal taxes, penalties and interest for the tax heads of PAYE, Withholding and Corporation tax was based on the concept of tax residency that the appellant is a tax resident in Kenya.

66. The respondent specifically responded to the appellant's Appeal under the following itemised heads

**i. Whether the corporation tax assessment of Kshs. 74, 0166,426 for the year 2017 is proper in law.**

67. Under this head, the respondent stated that it considered the provisions of article 4 of the *Organisation for Economic Cooperation and Development Model Tax Convention on Income and on Capital* (OECD NTC) which states that:-

> " The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined."

68. That the respondent met all the requirements under article 4 of the OECD as follows:

a. The chief executive officer and the senior executives carried out the day-to-day management of the company from Kenya. The 2 board members were also tax residents in Kenya with key strategic decisions being made in Kenya by senior managers who were permanent employees of the appellant.

b. The majority of the meetings of the appellant were held in Kenya which was also recorded as the headquarters of the appellant. That the board merely met to rubber-stamp the decision of the management which was based in Kenya. It relied on Professor Dr Klau Vogel in his commentary on the OECD Model Convention which stated that:

> " the top level management of a company is usually carried out by its board of directors unless it can be shown that the control of the company's affairs was effectively usurped and exercised by some third party and that the directors were content merely to rubberstamp the decision which were taken."

69. The respondent also invoked the concept of residence as was well laid out in the case of *De Beers Consolidated Mines Ltd v Howe* 5TC198 (De Beers Case) where it was held that:-

> " I regard that as the true rule; and the real business is carried on where the central management and control abides. It remains to be considered whether the present case falls within that rule. This is a pure question of fact, to be determined, not according to the construction of this or regulation or by-law, but upon a scrutiny of the course of business and trading"

70. It argued that *De Beers* case has held that directors, while agents of the company, cannot be ordered by the General meeting.

71. The respondent also relied on the cases of:

a. *Malayan Shipping Company Ltd v Federal Commissioner of Taxation*, (1946) 3 AITR 258 where the court held that:

> "the company was a resident of Australia because the managing director exercised from Australia complete management and control over the business operations of the company, notwithstanding that the trading operations were conducted abroad."

b. *Bywater Investments Limited & ors v Commissioner of Taxation*; Hua Wang Bank Berhad v Commissioner of Taxation [2016] HCA 45 (Bywater), where the court held that:

> "management and control is a question of fact to determine by the reality of what happens and it may even be exercised by persons without any legal authority to manage or control a company and a company carrying on business and has its management and control in Australia it will necessarily carry on business in Australia even when the only business carried on in Australia consists of that management and control, and trading operating are conducted outside this country."

72. It also relied on the case of *Yanko Weiss* (Civil Appeal 805/14 and the *Shay Tzamarot case* (Civil Appeal 32172-05-13)[4]; which led the Israel authority to issue a new supplementary circular on how to review the control and management question. In summary, the circular outlined:-

a. That it is important to determine the persons who make material decisions and where they are located. This includes day-to-day decisions that are not routine. Check on whether there are detailed BOD minutes or the board just "rubber stamps" the decisions taken elsewhere.

b. That the process of making a substantial decision (as opposed to the act of making the formal decision itself) is performed elsewhere, and it being part of why BOD meeting is convened, may establish management and control outside of that particular country.

c. That the existence of foreign directors and managers does not in itself indicate management and control outside the country, if this involves people who are not knowledgeable in company affairs, and do not wield the authority applied in making significant decisions for the company.

d. The fitness, experience and familiarity with the company business of the person purported to be its CEO, or whoever determines the way it conducts its business, should be examined.

73. From the foregoing considerations of tax law, international guidelines and case laws, it concluded that the appellant's Central Management and Control/place of effective management was in Kenya for the year 2017 as evidenced by the following;

a. Minutes of Directors and Committees.

b. The number of meetings held in Kenya.

c. Senior managers in leading positions, setting strategic goals and making decisions on M-kopa operations are permanent employees in Kenya.

d. The role of the board is limited to the approval of various decisions and strategies as proposed by management who were residents in Kenya.

74. It thus asserted that the key management, commercial and strategic decisions that were necessary for the conduct of the appellant's business were in substance initiated, developed and made in Kenya, hence the appellant was tax resident in Kenya and subject to tax laws in Kenya.

75. The respondent also invoked sections 3(1),(2) and 4 of the ITA to argue that its assessment of tax in this case was justified.

76. The respondent posited that the appellant received grants from different organizations to help it drive the business of supplying solar services for low-income earners. That it reviewed financial statements for the period 2017 and noted that the appellant reported grant income of Kshs. 173,215,886.40 while a review of the M-Kopa Kenya financial statements revealed that M-kopa Kenya reported grant income of Kshs. 18, 05,181.00. That the grant income was thus properly brought to charge according to section 3(2) of the *Income Tax Act*.

**ii. Whether the assessments for withholding tax are proper in law.**

77. The respondent stated that M-kopa LLC had issued common shares to various investors and a series of preference shares consisting of Series A, Series B, Series C, Series E and Series F.

78. That members holding series F preferred shares had a right of redemption to their shares as stipulated in the operating agreement. Specifically, paragraph 3.12 and 6.10 of the operating agreement provides for redemption of preferred shares.

79. That in determining whether redeemable preference shares were a liability or an equity instrument, the Tribunal ("TAT") in the case of *Aquavita Kenya Limited v Commissioner of Domestic Taxes*, held that:

> " A debt arises for the purpose of his provision when an amount or credit is advanced by one party to another; an amount is to be paid or repaid by that other party at some point in the future in satisfaction of the advance and this amount is fixed or determinable or will be ascertainable when payment is due."

80. That section 10(Sic) and section 35 of the ITA provide for the imposition of tax on deemed interest. Consequently, since deemed interest applies where interest would have been payable, it follows that deemed interest is applicable on loans as well as other forms of indebtedness. Therefore, the preferred units were an obligation or liability, hence the provisions of deemed interest are applicable.

81. That a similar decision was also made by the TAT in the case of *Socabelec East Africa Limited vCommissioner of Domestic* where it was stated that

> " for any form of indebtedness to qualify as a loan as defined by section 16(3) of the ITA, there must be fixed charge interest, discount or premium. However, it is our position that an interest-free loan is a loan issued at a discount and hence falls within the definition of loans under section 16(3)."

82. It stated that after the above decision, the Tribunal on April 19, 2022 in the case of Aquavita Kenya Limited v Commissioner of Domestic Taxes made a ruling that redeemable preference shares were a debt obligation and therefore subject to section 35 that applies withholding tax on deemed interest.

83. The respondent stated that section 35(6) of the ITA was with regards to the imposition of penalty for failure to withhold tax specified under section 35(1) of the ITA.

84. It distinguished the case of *Commissioner of Domestic Taxes v Pevans East Africa Limited, Shop & Deliver Limited and 5 others* as one that involved resident parties where the respondent had an alternative to collect tax from the resident withholdee. That however, in this case, the issue involved a non-resident party whose withholding tax deduction is final and the Commissioner cannot pursue the non-resident for tax payment.

85. That the audited financial statements of the appellant for the year 2017 were qualified by its independent auditors because it failed to classify the preferred units as liabilities. That this of itself confirmed that the preferred units were an obligation and therefore the provisions of deemed interest were taxable.

86. It was its view that the repealed section 35(6) of ITA was with regards to the imposition of penalty for failure to withhold tax specified under section 35(1) of ITA.

87. That section 35(1) of the ITA required a person upon payment to a non-resident person in respect of interest to withhold tax at the appropriate non-resident rate. That the interest paid to the non-resident third-party investors was thus liable to withholding tax.

**iii. Whether the PAYE assessment of Kshs. 90, 939,845 is proper in law,**

88. The respondent affirmed under this head that the appellant's consolidated financial statements indicated that its employees and subsidiaries received remuneration in the form of share-based payments, whereby employees rendered services as consideration for equity instruments (equity-settled transactions).

89. That the exercise price of the share options was equal to the market price of the underlying shares on the date of grant with the stock options being subject to four-year vesting, conditioned on each employee's continued employment with the appellant.

90. That the appellant granted 47,568 options in the period 2017 whose weighed average share price was USD 38.04, giving rise to a taxable benefit of USD 1,809,486.72 (Kshs 187,119,022) which was correctly brought to charge. That the appellant was thus correctly assessed for corporation tax and other taxes.

91. The respondent further stated that:-

    a. According to the year 2017 AFS, the appellant had nine directors, three of whom were described as executive directors while the remaining six were described as non-executive directors.

    b. The three executive directors were the founders of the M-Kopa group and were appointed to the board by common members with majority shares. Two of them, Messre Jesse Moore, the Group's Chief Executive Officer and Chad Larson, the Group's Chief Credit Officer were tax residents in Kenya in the year 2017.

    c. Out of the remaining six Non-Executive directors, two of them Mr. Mugo Kibati Chairman and Ms Susan Githuku, were independent directors and Kenyan citizens while the remaining four Non-Executive directors had been appointed by the preference shareholders to represent their interest in the board as follows;

        i. one director was appointed by the lead investor on behalf of Series A, B and C Preferred members;

ii. One director was appointed by the lead investor on behalf of series D preferred members;

iii. One director was appointed by the lead investor on behalf of series E Preferred members and

iv. One director was appointed by the lead investor on behalf of series F Preferred members.

d. The appellant's board of directors who are referred to as the board of managers in the operating agreement have delegated certain powers to various committees and management of the group who report to the board on various key strategic decisions being undertaken by the group during the board meetings. The following were the committees in the year 2017:-

i. Credit Committee;

ii. Strategy and Research & Development (SRD) Committee;

iii. HR & Compensation (HR&C) committee; and

iv. Audit & Risk (A&R) Committee; and

v. Audit & Risk (A&R) Committee.

a. Each committee consists of three to four boards of managers and an equivalent number of senior managers of the appellant's group would also attend the meetings by invitation of the board.

b. Senior managers were permanent employees of the appellant's group in leading positions, setting strategic goals and making decisions on the appellant's operations as indicated in the 2017 "Development Effects" report to the Loan facility provided to the appellant's subsidiary in Kenya.

c. Thirteen out of fourteen senior managers were resident in Kenya in the year 2017. The other senior manager was a resident in Uganda.

92. That the "Notice of Exempt offering of securities" in "Form D" to the Securities and Exchange Commission (SEC) in the USA for the year 2017 states the principal place of business and contact information of the appellant as Chania Avenue –Off Ring road Kilimani, Nairobi Kenya. This is the registered address of M-Kopa Kenya Limited, the appellant's subsidiary in Kenya. The notice also indicates the above address as the address of the following related persons;

| Name | Relationship |
|---|---|
| Jesse Moore | Executive Officer and Director |
| Nicholas Hughes | Executive Officer and Director |
| Chad Larson | Executive Officer and Director |
| Mugo Kibati | Director |
| Susan Githuku | Director |
| Jesse Zigmud | Executive Officer |
| Yesse Oenga | Executive Officer |
| Carl Thielk | Executive Officer |
| Pauline Vaughan | Executive Officer |
| Samuel Kariuki | Executive Officer |

93. That the appellant was thus a resident company in Kenya

94. Flowing from this analysis, the respondent argued that pursuant to commentary to article 4(3) of the 2017 OECD MTC the following factors ought to be taken into consideration in determining the place of effective management;

    a. Where the meetings of the person's board of directors or equivalent body are usually held;

    b. Where the chief executive officer and other senior executives usually carry on their activities;

    c. Where the senior day-to-day management of the person is carried on; and

    d. Where the person's headquarters are located.

95. The respondent argued that based on these parameters, it was its view that key management, commercial and strategic decisions that were necessary for the conduct of the appellant's business were in substance initiated, developed and made in Kenya, hence the appellant was tax resident in Kenya and subject to tax laws in Kenya. That while the board of managers and committees held meetings at various locations including Kenya in the year 2017, their role was limited to approving the various decisions and strategies proposed by management who were residents in Kenya.

96. That having established that the appellant was a tax resident in Kenya, grant income was taxable under section 3(2) of the ITA because it accrued in or was derived from Kenya. That this interpretation is in sync with the judgment by the Court of Appeal in the case of Mount Kenya Bottlers Ltd & 3 other v Attorney General and 3 others(2010 eKLR).

97. It concluded by asserting that it had established that the appellant was a tax resident in Kenya, it therefore followed, that withholding tax was payable on interest on loans provided by shareholders and third parties in accordance with sections 10 and 35 of the ITA.

**respondent's Prayers**

98. The respondent prayed for orders that:

    a. The Appeal be dismissed with costs.

    b. Its objection decision dated December 6, 2022 be confirmed.

**Issues for Determination**

99. The Tribunal has considered the pleadings, testimony and submissions made by the parties and is of the considered view that the Appeal distils into the following issues for determination: -

    i. Whether the appellant (M-kopa LLC) was a tax resident in Kenya in the 2017 year of income.

    ii. Whether the respondent was justified in issuing its Objection Decision dated December 6, 2022 in regard to corporation tax, withholding tax and PAYE.

**Analysis and Determination**

**i. Whether the appellant (M-kopa LLC) was a tax resident in Kenya in the 2017 year of income**

100. The appellant's position was that it was a non-resident company because only one of its 4 annual board meetings were held in Kenya and its headquarters was in the United Kingdom. That its board of managers was composed of four (4) shareholder representatives each of whom was located outside of Kenya and that those four shareholders had the power to approve and remove the three independent directors on it board of managers, effectively giving control of over seven (7) of the ten (10) seats on it's board of managers to the four controlling shareholders, none of whom were located in Kenya.

101. It posited that its sole purpose during the period under review was that of a holding company, responsible for overseeing operations of the operating entities. That it did not engage in any operational activities in Kenya in 2017 year of income. It also stated that under the OECD Guidelines, a company or a body of persons is deemed to be resident where the place of effective management is situated, and that its place of effective management (POEM) was in the United Kingdom where its board of directors were resident.

102. In response to the appellant's position, the respondent argued that MKOPA-LLC was a tax resident in Kenya, because it made a declaration to the Securities and Exchange Commissions Filings in the United States of America that its principal place of business was in Kenya and the addresses of all the executive directors were in Kenya.

103. It was also its case that the company held 19 out of 27 meetings in Kenya and that all meetings held outside Kenya were held at non M-kopa offices in those respective countries. That the persons who were making executive decisions were also based in Kenya hence its decision to arrive at the conclusion that the appellant was a resident of Kenya.

104. The *Income Tax Act* has defined 'resident' under section 1 of the ITA as follows:

> " resident", when applied in relation—
>
> "(b) to a body of persons, means -
>
> (i) that the body is a company incorporated under a law of Kenya; or

(ii) that the management and control of the affairs of the body was exercised in Kenya in a particular year of income under consideration; ..."

105. It is clear from this definition that a resident when applied to a body corporate means the place where the management and control of the affairs of the corporate entity was exercised in that particular year under consideration.

106. The formula or model to be used in determining the place where management and control of affairs of the company was exercised has not been defined in the ITA. The Tribunal is then left to rely on case laws and international legal instruments to guide it in identifying the appellant's place of effective management (PEM). This position was affirmed by Visram (J)( as he then was) in *Unilever Kenya Limited vs The Commissioner of Income Tax* (Income Tax Appeal No. 753 of 2003) [2005] eKLR when he said that:-

> "I have no doubt in my mind that the OECD principles on income and on capital and the relevant guidelines such as "Transfer Pricing" principles, the CUP method adopted for calculations of what ought to be the income, the Cost Plus Return method as well as Resale Minus Method adopted for looking into compliance with arm's length principles are not just there for relaxed reading. These have evolved in other jurisdictions after considerable debates and taking into account appropriate factors to arrive at results that are equitable to all parties. The ways of doing modern business have changed very substantially in the last 20 years or so and it would be fool-hardy for any court to disregard internationally accepted principles of business as long as these do not conflict with our own laws. To do otherwise would be highly short-sighted."

107. The Tribunal is cautious that whereas it can use the OECD Guidelines to help it determine the residency of the appellant, it shall only apply those guidelines in cases where there are gaps in Kenyan tax statutes.

108. Article 4, paragraph 3 of the articlesof the Model Convention with respect to Taxes on Income and on Capital [as they read on November 21, 2017] states as follows concerning the definition of a resident:

> "Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors.

109. From this description, it is clear under the OECD Guidelines that the place of effective management is the pivot that determines the residency of a corporate entity like the appellant.

110. Paragraph 24 OECD Commentaries on the articles of The Model Tax Convention has defined Poemas follows;

> "The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the

place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

111. The POEM is thus where the company is actually managed. Put another way, it is where the key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. This definition is aligned and consistent with the ITA which has defined a resident in regard to corporate persons to mean the place where management and control of the affairs of the corporate body was exercised.

112. The Courts have given guidance on how to interpret and determine the POEM in the UK case of *Trevor Smallwood Trust v Revenue and Customs*, [2008] UKSPC SPC00669 where it was held that:

> " The POEM was where the key management and commercial decisions that were necessary for the conduct of the entity's business were in substance made, which would normally be where the most senior persons, such as the board of directors, made their decisions. The directors could not be regarded as a rubber-stamp or puppet if they applied their minds to the decision-making process."

113. The Appeal Court affirmed this position in the subsequent Appeal in *Her Majesty's Revenue & Customs v Smallwood & another* [2010] EWCA Civ 778 at 48.

114. It is apparent from Smallwood's case that the POEM is where the real top level of management or realistic, positive management of the taxpayer was exercised.

115. As guided by paragraph24 of the Commentaries on the articlesof the Model Tax Convention on Income and on Capital, Condensed version, dated July 15, 2014, the Tribunal concurs that a company may have more than one place of management but it can only have one place of effective management at any one time. If a company's key management and commercial decisions affecting its business as a whole are made at a single location, that location will be its place of effective management. However if those decisions are made at more than one location, the company's place of effective management will be the location where those decisions are primarily or predominantly made.

116. In this appeal it was a common fact between the parties that only one board of directors meeting was held in Kenya. The other meetings were held in jurisdictions outside Kenya. It was also apparent that all decisions that were made by the board committees required the approval of the board of directors.

117. As was stated in the Trevor Smallwood case, the location where a company's board regularly convenes and makes decisions may often be its Poem, provided the board retains and exercises its authority to govern the company and substantially makes the essential management and commercial decisions.

118. In this appeal, members of management forwarded their recommendations to the board committees which in turn forwarded their recommendation to the full board for consideration. It was thus at the board level where key management and commercial decisions necessary for the conduct of the appellant's business were made.

119. The appellant's Operating Agreement has also confirmed that it is the board of directors who have been bestowed with the power and authority to manage and make decisions on behalf of the appellant. The said Operating Agreement provides as follows in article 8.1 :

> " Except for those actions requiring by this agreement to be approved by the Preferred Approving Group, the Series E Preferred Approving Group,the Enhanced Series F-2 Proffered Approving Group and/or the common members, the business, properties and

affairs of the company shall be managed and all powers of the Company shall be exercised by a Board of Managers (the Board of Managers)."(emphasis ours).

120. Meaning that the place Poem in this case was where the appellant's board met and made decisions. In this case that location would not be in Kenya because the board met in Kenya for only one meeting out of the 4 meetings that were scheduled for the year under consideration. A majority of the directors were also non-Kenyan residents who attended their meetings from locations outside Kenya. This in essence meant that the company's board meetings were regularly held and key decisions made from a location outside Kenya.

121. This view that the location of majority directors is also vital in determination of a company's Poem was affirmed in *Trevor Smallwood Trust v Revenue and Customs*, [2008] UKSPC SPC00669 as follows:-

> " The question cannot depend on what the company chooses to call its head office. One must look at facts and not mere terms. I find in the present case that a clear majority of the directors reside in the United Kingdom, and all questions of policy appear to be dealt with by them in London. All important contracts by the company would appear to be sealed in London. So far as our information goes, the seal of the company would appear to be kept in London and to be there affixed to documents requiring to be sealed by the order of the directors."

122. The same view was reiterated in *De Beers Consolidated Mines Ltd v Howe* [1906] AC, 455, where the court stated that:

> " ...company resides for purposes of income tax where its real business is carried on.... I regard that as the true rule and the real business is carried on where the central management and control actually abides."

123. The location and role of the board of directors in determining Poem is so vital that if one describes it as a rubber stamp then it must provide concrete evidence to show for example that the directors lacked sufficient knowledge and information to perform their duties, the directors were not suitably qualified and experienced generally and in relation to the particular company, that the directors merely sat in meetings to tick the boxes while decisions were being made elsewhere or that the directors did not have reasonable time to assess the information and make the decision.

124. This view aligned with the UK case of *Trevor Smallwood Trust v Revenue and Customs*, [2008] UKSPC SPC00669 where it was held that:

> " The directors could not be regarded as a rubberstamp or puppet if they applied their minds to the decision-making process.

125. In this Appeal it is clear that key decisions were made by the directors and hence the location where it regularly meets and makes decisions would thus be the POEM of the appellant and not Kenya.

126. It needs to be noted that the POEM is a legal issue that requires a sequential analysis , it can never be conclusively obtained and or determined based on what one of the parties has filed or stated in their documents or filings. Its determination can only arise from a wholesome analysis of the facts and circumstances of the case.

127. Based on the above analysis the Tribunal hereby finds and holds that the appellant(M-kopa LLC) was not a tax resident in Kenya in the 2017 year of income.

**ii. Whether the respondent was justified in issuing its Objection Decision dated 6th December 2022 in regard to corporation tax, withholding tax and PAYE.**

128. The respondent issued various assessments under this issue. The Tribunal shall analyse and decide on the justification of the assessed tax heads as hereunder:

a. Whether grant income received by the appellant was chargeable to tax in Kenya for the year 2017

129. section 3(1) of the ITA applies to both residents and non-residents on the profits and gains earned from a source that was within the Republic. The said section 3(1) of the ITA provides as thus:-

> "3. (1) Subject to, and in accordance with, this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya."

130. The appellant argued that the grant income that it earned in the period under review was not expressly provided for under section 3(2) of the ITA which provides for classes of income that are subject to tax.

131. Its alternative argument was that its grant revenue was USD 53,743,903 and other operating income which comprised grant income amounting to USD 1,675,743,040. That the respondent thus erred to assess on this entire amount and yet some of it had already been taxed and the other part accrued from a source outside Kenya.

132. The respondent retorted that the appellant reported a grant income of Kshs 173,215,886.40 and M-kopa Kenya reported a grant income of Kshs 18,045,181.00. That this grant income was categorised as other operating income in the appellant's 2017 profit and loss accounts. It argued that it is the appellant's categorisation of the grant as an operating income that led it to bring it to charge under section 3(1) of ITA.

133. section 3(2) of the ITA provides as follows regarding income that is chargeable to tax:

> "(2) Subject to this Act, income upon which tax is chargeable under this Act is income in respect of -
>
> (a) gains or profits from –
>
> (i) a business, for whatever period carried on;
>
> (ii) employment or services rendered
>
> (iii) a right granted to another person for use or occupation of property;
>
> (b) dividends or interest;
>
> (c)
>
> (i) a pension, charge or annuity; and
>
> (ii) any withdrawal from, or payments out of, a registered pension f u n d or a registered provident fund or a registered individual retirement fund; and

(iii) any withdrawals from a registered home ownership savings plan.

(ca) income accruing from a business carried out over the internet or an electronic network including through a digital marketplace;

(d) Deleted by Act No 14 of 1982, s.17

(e) an amount deemed to be the income of a person under this Act or by rules made under this Act;

(f) gains accruing in the circumstances prescribed in, and computed in accordance with, the Eighth Schedule.

(g) subject to section 15(5A), the net gain derived on the disposal of an interest in a person, if the interest derives twenty per cent or more of its value, directly or indirectly, from immovable property in Kenya; and

(h) a natural resource income;"

134. The textual reading of section 3(2)(a) of the ITA makes it clear that grants have not been included in this exclusive list of sources of income that are chargeable to tax. Therefore, the issue that is pending determination is whether grants were gains and profits from business, employment or rights granted for the use of property or any other form of recognized income caught by the ITA.

135. Nothing was produced before the Tribunal to show that the grant emanated from the business of the appellant to qualify it to be described as a gain, profit, interest or any other form of income recognised under the closed list of section 3(2) of the ITA. In any event it was agreed between the parties that the appellant received the said grant from a third party and it was not received in the course of business or as consideration for services offered or goods supplied.

136. The respondent has also not proffered a reasonable cause why it opted to tax an item that had not been listed in section 3(2) of the ITA contrary to the dicta in *Commissioner of Domestic Taxes v Thika Road Baptist Church Ministries* (Tax Appeal E024 of 2021) [2022] KEHC 644 (KLR) (Commercial and Tax) (31 May 2022) (Judgment)where the High Court stated as follows:

> " Tithes, freewill donations and offerings to the churches and other religious organizations did not fall within the scope of income which was chargeable as per section 3(2) of the ITA. The Commissioner had not demonstrated that tithes, donations and offering were gains and profits from business, employment or rights granted for use of property or any other form of recognized income caught by the ITA".

137. The Tribunal thus finds and holds that tax statutes must be interpreted textually. Nothing ought to be construed and or intended into a tax statute as was stated in the celebrated case of *Cape Brandy Syndicate v Inland Revenue Commissioner* (1921) where the court held that;

> " ...in a taxing act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in. Nothing is to be implied. One can only look fairly at the language used."

138. The exclusion of grants from the list of sources of income means that the respondent cannot use craft or stretch the list of items listed under section 3(2) of the ITA to include grants. The reality is that

anything excluded from this list is not taxable unless it is shown and proved to be a profit or a gain that was raised in the course of business by a taxpayer. The Tribunal is guided in its finding by the decision of the courts in *Commissioner of Domestic Taxes v Thika Road Baptist Church Ministries* (Tax Appeal E024 of 2021) [2022] KEHC 644 (KLR) (Commercial and Tax) (31 May 2022) (Judgment) where the Court held as thus:-

> " The list of sources of income set out in section 3(2) of the ITA was an exclusive and closed list bearing in mind that section 2 of the ITA stated that tax meant the income tax charged under that Act. That was buttressed by the use of the word "means" which when used in legislation implied that the indicative list was closed."

139. Flowing from the above analysis, the Tribunal hereby finds and holds that the respondent was not justified in subjecting the appellant's grant income of USD 1,675,040 to taxation.

**b) Whether WHT was due on the appellant's Redeemable Preference.**

140. The appellant's contention under this head is that the respondent erred in assessing WHT on preferred shares because section 35(6) of the ITA which was repealed vide Finance Act of 2016, which became effective on June 9, 2016, related to collection and recovery of WHT and penalty from the withholder who had failed to withhold tax. That the consequence of repealing this law in 2016 was that there was no law allowing the respondent to recover WHT from persons who failed to do so.

141. It was its view that it is the *Finance Act of 2019* which re-introduced section 39A of the TPA effective from November 9, 2019 which gave the respondent the power to deduct tax from persons who failed to deduct or remit it within the prescribed timelines.

142. The respondent held the view that the preferred units were liabilities/loan instruments. That deemed interest was thus applicable on loans and therefore sections 10 and 35 of the ITA allowed it to impose a tax on deemed interest

143. The appellant did not dispute whether this income was a deemed interest. Its contention was that the law, as it was in 2017, did not impose on it an obligation to deduct and submit this withheld amount to the respondent.

144. section 35 provides as follows in regard deduction of interest and deemed interest:

> " (1) A person shall, upon payment of an amount to a non-resident person not having a permanent establishment in Kenya in respect of -
>
> .....
>
> (e) interest and deemed interest, including interest and deemed interest arising from a discount upon final redemption of a bond, loan, claim, obligation or other evidence of indebtedness measured as the original issue discount;
>
> ... deduct there-from tax at the appropriate non-resident rate."

145. It is commonplace that the Finance Act 2016 deleted section 35(6) of the ITA, which previously read as follows;

> " (6) Where a person who is required under this section and in accordance with the rules made under section 130, to deduct tax— (a) fails to make the deduction

or fails to deduct the whole amount of the tax which he should have deducted; or

(b) fails to remit the amount of a deduction to the Commissioner on or before the twentieth day following the month in which the deduction was made or ought to have been made,the Commissioner may impose such penalty as may, from time to time, be prescribed under the rules, and the provisions of this Act relating to the collection and recovery of tax and the payment of interest thereon, shall apply to the collection and recovery of that amount of tax and penalty as if they were tax due and payable by that person and the due date for the payment of which was the date on which the amount of tax should have been remitted to the Commissioner."

146. The effect of this deletion was that the respondent could no longer recover tax that ought to have been withheld from the payer who should have withheld it. This position remained like that until November 7, 2019 when the Finance Act 2019 re-introduced the repealed section 35(6) of the ITA, this time under section 39A of the *TPA*.

147. The effect of this amendment was that the respondent could not claim taxes from the appellant if it failed to withhold and remit the taxes as if the taxes were due from it. This power was taken away by the repeal of section 35(6) of the ITA. This power was only restored on November 7, 2019 which is beyond the 2017 assessment period in this Appeal.

148. The holding of the Tribunal aligns with the holding of the court in *Commissioner of Domestic Taxes v Pevans East Africa Limited & 6 others* (Tax Appeal E003 of 2019) [2022] KEHC 10392 (KLR) (Commercial and Tax) (13 May 2022) (Judgment) where the court stated as thus;

> "I am in agreement with the Tribunal that prior to 2016, section 35(6) of the ITA provided that the commissioner could claim taxes from a payer who fails to make a deduction as though the taxes were due from them. However, the amendment introduced by the Finance Act, 2016 deleted the said section 35(6) of the ITA meaning that the Commissioner could no longer demand taxes not withheld from the person who should have withheld the same and that this position remained until the enactment of the Finance Act, 2019 came into force on November 7, 2019 when the previously deleted provisions of section 35(6) of the ITA were now reintroduced and reproduced as a new section 39A under the TPA."

149. The Tribunal does not agree with the respondent's assertion that this amendment of the law in 2016 was only applicable to resident parties and that the principle of the effect of this repeal of the law should be interpreted differently for a non-resident withholder

150. It has often been stated, and now settled, that tax statutes are interpreted textually. There is nothing within the provision of the repealed section 35(6) of the ITA or the reading of section 35 of the ITA which states that the application of the repealed section 35(6) was limited to residents only.

151. Consequently, the Tribunal finds and holds that the respondent was not justified in collecting WHT that ought to have been deducted by the appellant in regard to the deemed interest for the year 2017. The same ought to be recovered directly from the payee.

**c. Whether WHT was due on interests on non-resident third-party investor loans to the appellant's**

152. Under this issue, the respondent sought to recover tax due from the payer as envisaged in the repealed section 35(6) of the ITA which was later re-introduced vide section 39A of the *TPA*.

153. This issue has been dealt with under issue No. 2(B) above and there would thus be no need to rehash the same analysis herein. The Tribunal, therefore, restates and holds that section 35(6) of the ITA which gave the respondent the power to recover WHT due from the payer was repealed and thus not available for use by the respondent in the 2017 financial period.

154. Consequently, the respondent was not justified in demanding WHT that ought to have been deducted by the appellant regarding the interests on non-resident third-party investor loan disbursements directly from the appellant. The same ought to be recovered from the payer as was stated in the Pevans East Africa case(supra)

**d. Whether employee remuneration received in the form of stock options by the appellant employee is chargeable to tax in Kenya**

155. The appellant argued under this head that it issued its shares in many cases above the market price as at the date of grant and hence no taxable benefit accrued to the employees.

156. The respondent replied thereto that the appellant granted 47,568 options whose weighted average share price was USD 38.04, giving rise to a taxable benefit of USD 1,8809,486 which was correctly brought to charge.

157. section 5(5)(a) of the ITA provides as follows regarding benefits by employees:

> "(5) Notwithstanding any other provision of this Act, the value of the benefit (excluding the value of premises as determined under subsection (3) and the value of benefit determined under subsection(2B)) for the purposes of this section, shall be the higher of the cost to the employer or the fair market value of the benefit:
>
> Provided that-
>
> a. in the case of an employee share ownership plan, the value of the benefit shall be the difference between the market value, per share, and the offer price, per share, at the date the option is granted by the employer;"

158. The Tribunal holds that textual reading of section 5(5)(a) of the ITA leads it to the conclusion that benefits arising from an employee share option plan can be deemed to be income from employment. However, the value of that income shall be arrived at by determining the difference between the market value, per share, and the offer price, per share, at the date the option is granted by the employer.

159. The appellant provided an Amended and Restated Operating Agreement to prove that it issued its shares at market value thus implying that its employees did not obtain any benefit from this transaction.

160. section 5(5) (a) of the ITA has provided a formula for determining the benefit obtained by employees in a share ownership plane which works out as thus:

> " Market value, per share less(minus) the offer price, per share, at the date the option is granted by the employer equals income earned by the employee from a share option."

161. The respondent was thus behoved to show the appellant and indeed the Tribunal how it arrived at its value of the benefit. Which market value did it adopt and which offer price did it apply in arriving at its conclusion on benefit?

162. This working was not shown on the assessment dated September 26, 2022 and the objection decision dated December 6, 2022. In both cases, it merely pops up with a decided average share price of USD 38.04. where was this average share price obtained.

163. Secondly, it did not bother to address the appellant's assertion that it had adopted the market price in this share option such that no benefit was obtained by any of its employees in this transaction.

164. Arising from the foregoing, the Tribunal finds and holds that the respondent's action regarding this issue breached the dictates of section 5(5)(a) of the ITA which required it to abide by the provided formula in determining the benefit obtained by the appellant's employee who took up this share option.

165. The respondent instead opted to come up with its own model and formula for determining the unit price of the shares and market price of the shares and predictably arrived at a nirvana destination that was contrary to section 5(5)(a) of the ITA. Its actions were thus illegal and unjustified.

**Final Decision**

166. The upshot of the foregoing is that the Appeal is merited and the Tribunal accordingly proceeds to make the following Orders:-

A. The Appeal be and is hereby allowed.

B. The respondent's Objection Decision Dated December 6, 2022 be and is hereby set aside.

C. Each party is to bear its own costs.

167. It is so ordered.

**DATED AND DELIVERED AT NAIROBI THIS 23RD DAY OF FEBRUARY, 2024.**

**ERIC NYONGESA WAFULA - CHAIRMAN**

**CYNTHIA B. MAYAKA - MEMBER**

**DR. RODNEY O. OLUOCH - MEMBER**

**EUNICE NG'ANG'A - MEMBER**

**ABRAHAM K. KIPROTICH - MEMBER**

**BERNADETTE GITARI - MEMBER**