

DISTINCTION BETWEEN A BRANCH AND A SUBSIDIARY OF A FOREIGN CORPORATION: LEGAL IMPLICATIONS

INTRODUCTION

Multinational corporations often grapple with the decision whether to establish branches or subsidiaries when expanding their businesses to foreign jurisdictions. This decision bears significant legal implications, particularly in how entities are taxed, their legal liabilities, and their operational freedoms. The Kenyan legal framework provides a distinctive treatment for branches and subsidiaries, affecting the choice of foreign entities wishing to establish a presence in Kenya. We discussed in our previous articles the setting up of a *branch* and a *subsidiary* of a foreign entity in Kenya.

In this article we discuss on the distinction between a branch and a subsidiary of a foreign entity in Kenya based on their legal identity and liability, and tax consideration. We also discuss the instances when the corporate veil of a subsidiary company may be lifted and the risks this pose on the parent company. Finally, we discuss on the ways to structure a holding company and subsidiary to mitigate those risks.

The table below contains the distinction between a branch and subsidiary.

BRANCH	SUBSIDIARY
Registered as a foreign company under Part XXXVII of the Companies Act, 2015	Registered as a local company under Part II of the Companies Act, 2015
Not a separate legal entity but an extension of the parent company	Separate legal entity distinct from its parent company notwithstanding that it is controlled by the parent company
Parent company is fully liable for its actions and liabilities	As a general principal a parent company is not liable for the actions and liabilities of a subsidiary.
Considered non-resident for the purpose of taxation	Considered resident for the purpose of taxation.
Pays corporation tax at the rate of 30% on all income generated from Kenya, net allowable deductions	Pays a corporation tax at the rate of 30% on its taxable profit

Pays income tax at the rate of 15% on income repatriated to its foreign parent company	Pays withholding tax at the rate of 15% on dividends paid to foreign shareholders
Decisions are centralized, with less autonomy for local management	Has its own board of directors, therefore, operates autonomously

LIFTING THE CORPORATE VEIL

A branch is an extension of the parent company; therefore, the parent company is fully liable for its actions and liabilities. On the other hand, a subsidiary is a separate legal entity distinct from its parent company. As a general principle, the parent company of a subsidiary is not liable for the actions and liabilities of the subsidiary. However, there are instances when the corporate veil may be lifted so that the parent company is held liable for the liabilities and actions of the subsidiary. These instances include: -

1. Where the Court finds improper conduct, fraud or when a company is a sham, acting as an agent of the parent company or evading tax revenues.
2. Where the subsidiary is established as an agent or mere puppet of the parent company.
3. Where the directors of the subsidiary are dictated to by the directors of the parent company.
4. Where the parent company's management has such steering interference with the subsidiary's core activities that the subsidiary can no longer be regarded to perform those activities on the authority of its own executive directors.
5. Where the parent company and the subsidiary are indistinguishably inter-linked corporate entities.

In Kanuri Limited & 33 others v Uber Kenya Limited & 2 others (Civil Case 356 of 2016) [2021] KEHC 138 (KLR) (Commercial and Tax) (7 October 2021) (Ruling), cab drivers sued Uber Kenya Limited, Uber International Holding B.V. and Uber International Limited B.V. on the basis of online agreements or contracts between the drivers and the Uber companies. Uber Kenya objected their inclusion in the proceedings claiming that it was not privy to the contracts signed by the drivers. The court was shown emails sent to the drivers by Uber Kenya Limited through their email address uber.kenya@uber.com in respect to fare adjustment. The court found that there was a relationship between Uber Kenya Limited and the B.V. companies and declined to strike out the name of Uber Kenya Limited from the proceedings.

There are also instances where a parent company is incorporated in countries considered tax havens, and the company hold subsidiary companies in Kenya. The courts may pierce the veil of incorporation to determine the management and control of such a company for the purpose of determining tax residence. Consequently, if the court determines that the company is being managed and controlled from Kenya, the same will be regarded as a tax resident and required to pay taxes attributable to tax resident companies. An example is the case of Naivas Kenya Limited v Commissioner of Domestic Taxes (Tax Appeal 934 of 2022) [2023] KETAT 499 (KLR) (4 August 2023) (Judgment).

Naivas Kenya Limited is fully owned by Naivas International Limited, a company incorporated in Mauritius. On the other hand, Naivas International Limited was fully owned by Gakiwawa Family Investments (formerly Naivas Holdings Limited) a company also incorporated in Mauritius. Gakiwawa Family Investments sold 31.5% of its stake in Naivas International Limited to Amethis Retail. The Commissioner of Domestic Taxes assessed capital gains tax on the transaction and appointed Naivas Kenya Limited as a tax representative of Gakiwawa Family Investments.

Naivas Kenya Limited challenged the decision of the Commissioner of Domestic Taxes. The court held that the common law test of residence of a company for the propose of taxation provides that a person is resident in the location of the person's management and control. Management and control refers to the decisions that drive the person's business and the person's top-level management decisions. The court found that Gakiwawa Family Investments was being

managed and controlled by Kenyan directors and the Mauritian directors did not have any power. The court therefore held that Gakiwawa Family Investments was a tax resident.

Additionally, the court found that there was a specific nexus between the transaction (sale of stake in Naivas International Limited by Gakiwawa Family Investments to Amethis Retail) and Naivas Kenya Limited. The court therefore held that the Commissioner of Domestic Taxes rightly appointed Naivas Kenya Limited as a tax representative of Gakiwawa Family Investments.

MITIGATING RISKS THROUGH STRATEGIC STRUCTURING

To mitigate against the risk of having the corporate veil lifted, multinational corporations are advised to:

a) **Ensure Operational Autonomy:** Subsidiaries, in particular, should have their board of directors, maintain separate finances, and make independent business decisions from their parent companies.
b) **Maintain Transparent Transactions:** Inter-company transactions should be conducted at arm's length, with clear documentation and adherence to all regulatory compliance.
c) **Have Separate Employees and Payroll:** The parent company and the subsidiary should have their own separate employees and payroll.
d) **Market Each Company Individually:** The holding company and the subsidiary should market their services or products separately.

CONCLUSION

The choice between establishing a branch or a subsidiary in Kenya carries profound legal implications for foreign companies. Through careful planning, legal counsel, and adherence to Kenyan law, multinational corporations can strategically structure their subsidiaries to mitigate risks and optimize their operational success within the region.

At CM Advocates, we have a distinguished team of Corporate and Commercial lawyers who can assist you set up the presence of your company in Kenya either as a branch or a subsidiary. Additionally, the team can assist in the provision of registered office services, company secretarial services, business licensing services, tax advisory as well as employment and labour law advisory among other services. We also have an outstanding team of Immigration and Global Mobility lawyers who can assist foreign directors or employees procure the relevant permits or passes as the case may be.

If you would like to consult on this article or any other legal issue pertaining to registration of branch or subsidiary of a foreign company in Kenya, or any other matter, you may contact the contributor on the emails below or the commercial team through ***commercial@cmadvocates.com***. Do also visit our website ***https://cmadvocates.com/en*** for more information about us and our services.



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