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PERMANENT ESTABLISHMENT TAX EXPOSURE FOR MULTINATIONAL ENTERPRISES (MNES) OPERATING THROUGH KENYAN SUBSIDIARIES

Introduction

The Tax Appeals Tribunal (“TAT” or “Tribunal”) has delivered an important decision in *Travelport Services (Kenya) Limited v Commissioner of Legal Services & Board Coordination (TAT Appeal No. E445 of 2025)* which significantly clarifies the circumstances under which a Kenyan subsidiary may be deemed to constitute a Permanent Establishment (PE) of a foreign enterprise for Kenyan tax purposes.

The Tribunal upheld the Kenya Revenue Authority’s (KRA) objection decision confirming additional tax assessments amounting to KShs. 2,472,002,836, covering corporate tax, VAT, and withholding tax.

This decision is particularly relevant to multinational enterprises (MNEs), transfer pricing practitioners, international tax advisors, foreign investors, and businesses in the travel, aviation, hospitality, and tourism sectors operating through Kenyan subsidiaries or marketing entities.

The ruling underscores the increasing scrutiny by tax authorities globally, including KRA, on business models involving marketing, distribution, and support entities that may effectively perform core business functions of foreign enterprises.

Background of the Dispute

Travelport Services (Kenya) Limited (TKE) is a Kenyan company engaged in marketing and training travel agents on the Travel Commerce Platform (TCP) operated by its foreign related entity, Travelport International Operations Limited (TIOL) in the United Kingdom.

The TCP is a global travel distribution platform that connects airlines, hotels, car rental companies, and other travel service providers with travel agencies and booking platforms worldwide.

Following a tax compliance review covering the period 2019–2023, the Kenya Revenue Authority issued additional tax assessments totaling KShs. 2.6 billion, alleging that:

- TKE constituted a Permanent Establishment of TIOL in Kenya
- income generated from Kenyan airlines using the Travelport platform was taxable in Kenya
- transfer pricing documentation mischaracterised TKE’s functions as preparatory or auxiliary



- Following the issuance of an objection decision confirming taxes of KShs. 2,472,002,836, the taxpayer appealed to the TAT.

Key Issues Before the Tribunal

The Tribunal identified two principal issues for determination:

1. Whether TKE constituted a Permanent Establishment of TIOL in Kenya.
2. Whether the additional tax assessments issued by KRA were justified.

The determination of these issues required the Tribunal to examine the commercial structure, contractual arrangements, transfer pricing policies, and actual functions performed by the Kenyan subsidiary.

Tribunal's Findings

Kenyan Subsidiary Deemed a Permanent Establishment

The Tribunal held that the Kenyan entity performed core commercial functions for the foreign enterprise and therefore created a Permanent Establishment under Kenyan law and the Kenya-UK Double Taxation Agreement.

Under Section 2 of the Income Tax Act, a PE includes a dependent agent who habitually concludes contracts or plays the principal role leading to their conclusion.

The Tribunal observed that Travelport Kenya:

- attracted and onboarded customers
- negotiated product pricing
- concluded agreements with travel agents
- coordinated delivery and customer support services

These activities were considered core business operations rather than preparatory or auxiliary services.

The Tribunal further observed that the Kenyan entity played a central role in attracting customers and facilitating commercial transactions that ultimately generated revenue for the foreign enterprise.

Accordingly, the Tribunal concluded that the functions performed by the Kenyan entity were integral to the success of the foreign enterprise's operations in Kenya and therefore created a Permanent Establishment.

Transfer Pricing Policy Rejected

The taxpayer had applied the Transactional Net Margin Method (TNMM) using a cost-plus mark-up model to justify its remuneration.

Under this model, the Kenyan subsidiary was treated as a routine service provider performing marketing and customer support services, earning a modest mark-up on operating costs.

However, the Tribunal upheld the KRA's rejection of the transfer pricing analysis on the basis that:

- the functional analysis understated the Kenyan entity's actual role
- the Kenyan entity was not merely performing routine marketing services
- the transfer pricing methodology therefore failed to produce an arm's-length result

The Tribunal held that the Kenyan subsidiary performed value-creating functions, warranting greater attribution of profits to Kenya.

This finding reinforces the principle that transfer pricing policies must align with the economic reality of the business operations rather than contractual descriptions alone.

Burden of Proof Lies with the Taxpayer

The Tribunal reaffirmed the statutory position that the taxpayer bears the burden of proof when challenging a tax assessment.

Under:

- Section 56 of the Tax Procedures Act
- Section 30 of the Tax Appeals Tribunal Act

the taxpayer must demonstrate that the Commissioner's decision is incorrect.

The Tribunal found that the taxpayer failed to produce sufficient documentary evidence to displace the KRA's assessment.

This finding highlights the importance of maintaining comprehensive audit documentation, financial records, and transfer pricing support files during tax disputes.



Importance of Contract Review in International Tax Structuring

A critical lesson emerging from this decision is the importance of ensuring that intercompany agreements and commercial contracts are regularly reviewed for tax implications.

Tax authorities increasingly examine not only the written terms of contracts but also the actual conduct of the parties to determine whether the contractual arrangements reflect economic reality.

Contracts governing cross-border group arrangements should therefore be carefully reviewed to ensure that they clearly define:

- the scope of services performed by each entity
- the allocation of risks and responsibilities
- the authority to negotiate or conclude contracts
- the ownership and control of intellectual property
- the remuneration structure for services performed

Where contracts are poorly drafted or inconsistent with the actual functions performed by the parties, tax authorities may disregard the contractual framework and recharacterize the arrangement for tax purposes.

Regular legal and tax review of commercial agreements can therefore significantly reduce exposure to Permanent Establishment and transfer pricing disputes.

The Thin Line Between Auxiliary Services and Core Functions

The Travelport decision also highlights the thin line between preparatory or auxiliary activities and core business functions.

Auxiliary activities generally include functions that merely support the business operations of a foreign enterprise without directly contributing to revenue generation.

Typical examples include:

- marketing support
- promotional activities
- training services
- market research
- administrative support

However, where the local entity begins to perform activities that directly drive commercial transactions, those activities may be recharacterised as core functions.

Indicators that services may constitute core functions include:

- negotiating prices or commercial terms with customers
- concluding or facilitating contracts on behalf of the foreign enterprise
- managing customer relationships and revenue generation
- performing strategic sales functions
- exercising authority that effectively binds the foreign enterprise

The classification of these functions has a direct impact on the applicable transfer pricing method.

Entities performing limited-risk support services are typically remunerated using cost-plus methodologies under the Transactional Net Margin Method, while entities performing strategic or entrepreneurial functions may warrant higher profit allocation or alternative transfer pricing methods.

Accordingly, businesses must carefully evaluate their functional profiles to ensure that transfer pricing policies accurately reflect the commercial substance of their operations.

Practical Implications for Multinational Businesses

This decision highlights several important risks for multinational enterprises operating in Kenya.

(a) Increased Permanent Establishment Exposure

Kenyan subsidiaries performing the following activities may create PE exposure for foreign related parties:

- negotiating contracts or pricing
- concluding agreements with customers
- delivering services or products on behalf of the foreign enterprise
- playing a principal role in generating revenue for the foreign enterprise

Entities structured as marketing, distribution, or support subsidiaries must therefore carefully evaluate whether their functions exceed preparatory or auxiliary activities.



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(b) Transfer Pricing Documentation Must Reflect Actual Functions

Transfer pricing documentation must accurately reflect:

- the true functional profile of the Kenyan entity
- the commercial reality of group operations

(c) Documentation and Audit Readiness are Critical

Taxpayers must maintain robust documentation including:

- detailed transfer pricing analyses
- functional analyses aligned with OECD guidelines
- supporting accounting records and transaction trails

Failure to provide documentation may lead to assessments being upheld solely on evidentiary grounds, even where substantive arguments may exist.

Key Takeaways

The Travelport decision reinforces a clear regulatory trend in Kenya:

- KRA is increasingly scrutinizing multinational structures involving marketing and distribution subsidiaries

- the Permanent Establishment threshold is being interpreted broadly where subsidiaries perform commercially significant functions
- transfer pricing policies that undervalue local economic contributions may be rejected
- tax authorities are increasingly relying on substance-over-form analysis when evaluating multinational group structures

Multinational groups operating in Kenya should therefore reassess their operating models, transfer pricing arrangements, and contractual structures to mitigate tax exposure.

The decision is also particularly significant for the travel distribution ecosystem, including airlines, travel technology platforms, global distribution systems, travel agents, hospitality operators, and other intermediaries operating within the tourism and travel value chain.

For Further Information

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