



Tax Alert

The Tax Appeals Tribunal (“TAT”, “Tribunal”), on 17 December 2024, delivered Judgement in an appeal filed by a company in Kenya (“the Appellant”) against the KRA, “the Respondent”) in Tax Appeal No. E826 of 2024

January 2025

In the Judgement, the TAT ruled in favour of the Appellant setting aside KRA's tax demand of KES 436,056,888 in a case where KRA had placed the obligation to deduct and remit Pay-As-You-Earn (PAYE) taxes on the Appellant, for employees seconded to work for the Appellant's foreign related company.

One of the indices of employment is establishing who has control over the employee. In this case, the secondees were under the direct control and supervision of the related entity

Background

KRA's tax Assessment of KES 436,056,888 was based primarily on its review of the terms of the contractual agreements entered between the Appellant, its related entity and the employees, while setting up the secondment arrangement.

Based on its analysis, the KRA concluded that the Appellant remained the exclusive employer of the secondees, and therefore maintained an obligation to deduct and remit PAYE taxes on the employment income earned by the seconded employees during their secondment

The Appellant objected to the assessment, arguing that the KRA had misinterpreted the employment on secondment contracts



between the Appellant, its foreign related entity and the seconded employees.

More specifically, the Appellant argued that KRA had failed to recognise that the Appellant maintained an employer-employee relationship in the contracts as a residual employer only, while an active contract of service existed between the secondees and its related entity.

The Appellant's Case

The Appellant argued that the contentious issue for determination by the Tribunal was whether the foreign related entity was the employer of the secondees while they were employed in the related entity, in order to establish whether the Kenyan entity (“Appellant”) was the one obligated to account for PAYE or the foreign related entity.

One of the ways to make this determination was to look at the standard indices of employment, i.e. the standard or measure of establishing employment.

One of the indices of employment is establishing who has control over the employee. In this case, the secondees were under the direct control and supervision of the related entity, making it the substantive employer during the secondment period.

Other indices of employment include the level of integration of the employee, where the services are performed and for whose economic benefit are the services provided for.

The Appellant argued that the secondees provided their employment services in the jurisdiction of the related entity, and therefore the employment obligations did not accrue in Kenya. They contended that in any event, the secondees' employment income was earned in and was already being taxed abroad, and thus, the Appellant had no obligation to account for PAYE taxes in Kenya.

The Appellant also highlighted that the contractual terms of the engagement between the related entities established that the residual employment costs paid by the Kenyan entity were recharged to the foreign related entity and were therefore ultimately borne entirely by the foreign related entity. Further, that the Respondent's assessment was in any event based on erroneous figures and calculations based on a misunderstanding of the facts.

Citing several precedents from case law, the Appellant argued that a secondment involves temporarily transferring a worker to another employer, making the host employer the substantive employer during this period. The Appellant claimed that the secondees were under the employment of the related entity, not the Appellant, during their secondment.

The Appellant emphasized factors such as control, integration and the method of payment to support this claim, arguing that the secondees were integrated into the foreign related entity operations and worked under its control. They also distinguished between a contract of service (employee) and a contract for service (consultant), asserting that the secondees had a contract of service with the related entity, making it responsible for their employment taxes.

The Appellant argued that while the Income Tax Act ("ITA") taxes the worldwide employment income of secondees who are also resident in Kenya, Kenyan citizens can offset or claim credits in Kenya, for the PAYE paid abroad on the same income. Therefore, the Respondent had no legal basis to demand PAYE on these payments, as it would result in double taxation.

The Respondent's Case

The Respondent argued that the secondees remained employees of the Appellant during their secondment period to the foreign related entity.

The Respondent based this on the assignment agreement, which stated that the secondees would continue to be employees of the Appellant and that the Appellant would pay their salaries and benefits. The Respondent contended that the Appellant was responsible for deducting and remitting

PAYE tax on the secondees' income, as per the provisions of the ITA that require an employer to do so. The Respondent also argued that the secondees qualified as tax residents in Kenya and their income, regardless of where it was earned, was subject to Kenyan tax laws.

The Respondent further argued that the reimbursement of salaries by the related entity to the Appellant did not alter the employment relationship or the tax obligations.

The Respondent maintained that the Appellant retained control over the secondees and was responsible for their tax compliance. The Respondent contended that the secondees' income was subject to tax under the Kenyan tax laws, and the Appellant was not absolved from the responsibility to deduct and remit PAYE.

Tribunal Findings

The Tribunal determined that the relationship between the Appellant and the secondees to the foreign related entity was that of a residual employer and employee, with the foreign related entity being the substantive employer during the secondment period.

The Tribunal found that the secondees were under the direct control and supervision of the related entity, and their employment income was earned and taxed abroad.





The Tribunal further recognised that a secondment is basically a temporary transfer of an employee to a different employer, or different workstation in a related organization. As such, the Tribunal emphasized that the secondment arrangement did not sever the employment relationship between the Appellant and the secondees but rather rendered it dormant during the secondment period.

Consequently, the Tribunal concluded that the Respondent's demand for PAYE on the secondees' income on the basis that the relationship between the secondees and the Appellant was that of a primary employer and employee was erroneous.

The Tribunal observed that whereas the ITA brings to charge the worldwide employment income of individuals deemed to be resident in Kenya, these provisions of the law must be read together with the provisions in the

same ITA that allow Kenyan citizens to offset or claim credits for the tax paid to foreign jurisdictions with respect to the same income.

The Tribunal noted that the secondees' income was accrued and derived in the foreign jurisdiction, and taxes were duly paid to the foreign government.

The Tribunal acknowledged that the secondees were entitled to set-off by way of credit for the taxes paid abroad against any tax charged in Kenya on their secondment income.

Therefore, the Tribunal found that the Respondent's assessment of PAYE on the secondees' income was erroneous and amounted to double taxation.

Conclusion

The Tribunal ruled in favour of the Appellant, setting aside the Respondent's tax demand and held that the Appellant had no legal

obligation to deduct and account for PAYE on the secondees' employment income while on assignment in another jurisdiction.

Implications for Businesses

Seconded income is income that is deemed to be income that is accrued in or derived from the jurisdiction of secondment, thereby falling beyond the scope of the ITA provisions on accounting for PAYE in Kenya.

Where the secondees are Kenyan citizens and tax resident in Kenya, they will be required to report their worldwide employment income in Kenya. However, the secondees will be entitled to offset any taxes paid on the secondment income in another jurisdiction against the taxes due on the same income in Kenya.

As such, it is important for seconding entities to comply with the tax laws of the host country and retain proper records of their tax payments to avoid double taxation of secondees' income and disputes with the KRA.

Entities seconding employees to foreign subsidiaries should also ensure clear contractual terms delineating the employer-employee relationship with a view to ensure tax compliance with the relevant tax jurisdictions involved.

Above said, it is crucial for secondment agreements to clearly state which entity bears secondees' costs, under whose supervision, rules and regulations the secondees operate during the secondment period and the statutory obligations of each entity in relation to the secondment.

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