



INSIGHT

Beyond Bricks and Mortar: Rethinking Permanent Establishment in Kenya's Digital Age

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An emerging trend in recent tax disputes in Kenya suggests that the Kenya Revenue Authority (KRA) is adopting an increasingly expansive approach to Permanent Establishment (PE) and profit issues. In several ongoing appeals, KRA has sought to assert PE based on minimal or indirect local activity, and to apply the Profit Split Method (PSM) to allocate a portion of global profits to Kenya—often with limited regard for the actual scale or nature of the local contribution.

This approach appears to be driven by post-BEPS confidence, particularly following Action 7 and Actions 8–10, which emphasise economic substance and value creation over legal form. In many cases, KRA has argued that support functions such as liaison, business development, facilitation, or infrastructure access create a sufficient nexus to justify profit reallocation—even where these functions are routine or outsourced.

The reality is that the international tax system has undergone a major recalibration over the past decade. At the heart of this transformation lies the concept of PE—once a narrowly defined threshold based on physical presence, now evolving to accommodate the complexities of e-commerce, digital services, and cross-border business fragmentation.

The OECD's BEPS Action 7 (2015), aimed at preventing the artificial avoidance of PE status, marked a turning point. It offered not just technical revisions to treaty language, but also an ideological shift—placing economic substance over formalistic structures. Since then, global jurisprudence has responded with a wave of decisions challenging how multinationals structure their operations.

As practising lawyers in Nairobi, we've seen these developments start to influence Kenya's legal landscape and how taxpayers approach cross-border structuring. This reflection explores how far we've come—and what international businesses with a Kenyan footprint need to do to stay ahead.

Recent Tax Appeals Tribunal cases in Kenya involving application of profit split methods and PE assessments reveal a discernible trend: KRA is aggressively pursuing a larger share of global income wherever there is any local contribution—however limited—to a multinational's value chain.

Global PE Jurisprudence Since BEPS Action 7

Following the 2015 BEPS reforms, several tax jurisdictions globally have reinterpreted PE rules through legislative and judicial means. For instance, India's Supreme Court made a landmark decision (in the Formula One of 2017) confirming that exclusive access to infrastructure could constitute a PE, based on control and permanence, regardless of length of time carried on.

The international rulings share a common thread: substance over form, and a willingness to confront outdated treaty interpretations where business models have clearly evolved.

Kenya's Emerging PE Landscape

The emerging trend in Kenya is that the courts are gradually aligning with global post-BEPS standards based on functional and economic criteria. Recent decisions by the Tax Appeals Tribunal (TAT) provide a glimpse into how Action 7 principles are being applied locally:

i. **Agency PE in Focus**

The Tribunal has ruled that local representatives negotiating or materially influencing contracts for foreign entities can trigger agency PE.

ii. **Infrastructure and Fibre Optics**

In cases involving long-term rights to use fibre optic infrastructure (for example, Indefeasible Rights of Use-IRUs), the Tribunal has emphasised presence and economic benefit.

iii. **Warehousing and Logistics**

Use of third-party warehousing may create a PE based on continuity, control, and local personnel involvement.

Key Takeaways

Kenyan businesses linked with global structures face significant risk in identifying and applying PE rules. Foreign firms deriving significant value from Kenyan users without any physical presence or limited risk service entities are also increasingly under pressure to enhance reporting of the income associated with the local clientele.

While the Tax Appeals Tribunal decisions to date have been mixed what emerges is that the Tribunal has occasionally agreed with KRA—especially where there is clear functional integration. The Tribunal has also expressed concern over the indiscriminate application of the profit split method. Notably, it has questioned whether local entities truly possess the unique intangibles or synergies required to justify such a method, and whether the facts presented support a coherent PE theory in line with treaty obligations.

For businesses, the message is clear: PE exposure and profit attribution risk now extends well beyond formal legal presence. Cross-border groups must proactively assess their local activities, document functional roles, and be prepared to challenge arbitrary reallocation attempts that lack solid economic or legal grounding.

For businesses operating across borders—especially those with operations, clients, or value chains touching Kenya—the concept of PE can no longer be treated as a technical afterthought. PE risk now stems not only from offices and agents, but also from digital platforms, contract negotiation practices, warehousing arrangements, and even rights over local infrastructure.

To adapt to the shifting landscape ushered in by BEPS Action 7, businesses must take proactive steps including reassessing local operations, especially where there is any form of agent involvement, shared infrastructure, or service delivery.

Companies should seek to review existing tax structures to ensure they align with current treaty interpretations and avoid artificial fragmentation and update intercompany agreements and business models to reflect economic substance and clearly document roles and responsibilities.

For international businesses expanding into the East African market, it helps a great deal to engage tax professionals early to advise on the local PE nuances and how these may impact on additional tax risk exposure.

In an environment where tax authorities are increasingly sophisticated and international tax rules more stringent, it pays to stay ahead of the curve. The rules have changed—and so must the way we do cross-border business.

CONTACTS

We regularly support businesses navigating tax residence, PE risk, and cross-border structuring, particularly in East Africa. If this is relevant to your operations, do not hesitate to contact:



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