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LOCAL PRESENCE, FOREIGN PROFITS

Permanent Establishment and Profit Attribution Risk Across Africa

Why taxable presence, income ownership and profit attribution must remain separate enquiries - even when substantial activity takes place in the market jurisdiction.



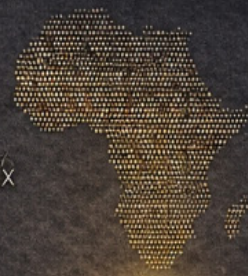
James Kairu Karanja
Co-Founder, TaxIQ Africa

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Local activity may justify a tax enquiry. It does not, by itself, prove local ownership of foreign profits.

Across African markets, revenue authorities are looking beyond formal structures. They are examining who speaks to customers, who develops the market, where technology and infrastructure sit, who deals with regulators, and whether local teams influence contracts.

That scrutiny is legitimate. The problem begins when visible local activity is treated as enough to move the foreign enterprise's customer revenue, trading margin or residual profit into the local tax base.

The legal routes vary. An authority may allege a fixed-place or dependent-agent permanent establishment, challenge the profit attributed to an existing branch, or use transfer pricing to increase the income of a separate local company. The economic objective is often the same: a larger share of the group's profit in the market jurisdiction.

A defensible analysis must resist one shortcut: collapsing presence, taxpayer identity and profit attribution into a single conclusion.

Three questions that must remain separate

NO.	Question	Required analysis
1	Is there a taxable presence?	Identify the specific place, person, agent, project or infrastructure through which the foreign enterprise is said to carry on business. A related company, local customers or market importance are not enough.
2	Which enterprise earned the income?	A multinational group is not one taxpayer. Contracts, technology, capital, risks and income must be traced to the correct legal and economic owner.
3	What profit is attributable locally?	A permanent establishment finding does not determine the amount taxable. Profit must be connected to the functions performed, assets used and risks controlled through the local presence.

A taxable presence is not a profit-attribution method.

How local presence becomes a claim over foreign profits

A recurring audit pattern can be seen across sectors:

1. Identify visible local activity - employees, customer contact, infrastructure, market knowledge, regulatory engagement or operational execution.
2. Recast that activity as core, unique or entrepreneurial.
3. Attribute local ownership of customer relationships, market intangibles or commercial risk.
4. Compress the foreign enterprise's technology, contracts, capital, procurement, governance and risk control into "coordination" or "administration".
5. Reject the existing cost-plus, product mark-up or one-sided transfer pricing method.
6. Apply a profit split, sales-based return or other formula that moves foreign income into the local tax base.

The concern is not the examination of substance. It is the leap from local importance to local entitlement without first proving the correct taxpayer, income owner and profit pool.

Where The Risk Is Highest

1. Local support that begins to look like selling

Marketing, regulatory liaison, customer communication, technical assistance and contract administration are often remunerated on a cost-plus basis. That treatment becomes vulnerable where local teams negotiate material terms, approve discounts, prepare contracts that are routinely accepted, or play the principal role leading to contract conclusion.

But support is not the same as sale. Product information, introductions, market intelligence and communication of decisions made abroad do not automatically make the local company the seller or owner of customer revenue.

2. Digital, payments and telecommunications infrastructure

Servers, fibre, landing stations, routers, racks, data centres, customer terminals and network access can create difficult permanent establishment questions. The key issue is not simply whether infrastructure exists locally, but whether the foreign enterprise has it at its disposal and carries on its business through it.

Purchasing connectivity, hosting or processing services does not normally place the provider's entire network or premises at the customer's disposal. Access must be distinguished from control.

3. Existing branches and local distributors

Where a branch already exists, the dispute often shifts from presence to attribution. Where a local distributor or service company is separately incorporated, the same economic result may be pursued through transfer pricing by reducing the foreign principal to a routine coordinator or service provider.

Both entities may perform commercially important functions. The analysis must price both contributions rather than make one disappear.

Four Analytical Errors To Avoid

Importance is not entitlement

A function may be indispensable without being unique, entrepreneurial or entitled to residual profit. Customs clearance, customer support, regulatory liaison and local market knowledge may be essential. The question is what an independent party performing comparable functions, using comparable assets and assuming comparable risks would earn.

Risk must be controlled, not merely experienced

The entity closest to customers may feel the immediate effects of default, currency shortages, warranty claims or reputational damage. That does not establish control. The analysis should identify who decides whether to accept, mitigate or decline the risk; who monitors it; who has the financial capacity to bear it; and whose capital is affected when it materialises.

Visible assets are not the only valuable assets

Workshops, warehouses and local employees are easy to see. Contractual dealer rights, licences, technology platforms, brand rights, capital and market-access permissions may be less visible but equally important. They should not be ignored merely because they sit outside the market jurisdiction.

Profit split is not a shortcut

A profit split may be appropriate where both parties make unique and valuable contributions, conduct highly integrated operations that cannot reliably be evaluated separately, or share closely related economically significant risks. It is not justified simply because both parties contribute, the local business is important, or foreign information is difficult to obtain.

Before profits can be split, the relevant profit pool and its owner must be identified. A transfer pricing method cannot create income ownership that does not otherwise exist.

Practice Illustrations

Customer-Facing Support and a Regional Advisory Centre

A foreign subscription-services provider used one local company to collect payments and handle customer queries, and another to provide legal, regulatory, finance and management support. The customer-facing company carried the stronger agency risk. The regional centre did not set pricing, negotiate subscriber contracts or conclude contracts. Any local taxable presence could not justify attributing revenue from unrelated markets. Key lesson: Analyse each affiliate separately. Customer support, regional advice and contract conclusion are not interchangeable.

A Local Branch and another Group Company's Network Income

A local branch handled customer communication and regulatory liaison. A different foreign group company owned the processing network, technology, customer contracts and principal risks. The tax authority nevertheless sought to attribute wider network income to the branch. The response focused on enterprise identity, control of infrastructure and who developed and operated the technology. Key lesson: A branch belongs to its own head office. It is not automatically the permanent establishment of every company in the group.

A Foreign Distributor Reduced to a Service Provider

A foreign enterprise held the principal manufacturer-dealer rights, procured products, arranged transport, supported technical standards, bore credit and compliance exposure and risked losing its territorial rights. The local company sold to customers, maintained workshops and provided after-sales services. Treating the foreign enterprise as a routine procurement coordinator would overstate the local contribution and understate the foreign one. Key lesson: Local substance deserves an arm's-length return. It does not automatically absorb the foreign distributor's trading margin.

Recharacterisation Should Remain Exceptional

There is a difference between adjusting a price and reconstructing the parties' business model. An authority may replace a non-arm's-length mark-up or margin with a more reliable result. It is a more intrusive step to turn a distributor into a procurement agent, a principal into a service provider, or a support company into the owner of the residual business.

That step should require convincing evidence that actual conduct fundamentally differs from the documented arrangement, or that the arrangement lacks the commercial rationality independent enterprises would accept. Substantial local functions alone should not trigger wholesale recharacterisation.

Avoid Double Taxation and Double Counting

A foreign enterprise may have a permanent establishment in a country where it also has a subsidiary. But the same local functions cannot be taxed twice. Any further attribution should reconcile:

- ☐ The income already earned by the local entity;
- ☐ The transfer pricing return already taxed locally;
- ☐ Withholding taxes suffered by the foreign enterprise;
- ☐ The specific additional functions, assets or risks said to remain uncompensated;
- ☐ Secondary adjustments, including deemed-dividend or withholding-tax exposure; and
- ☐ Treaty relief, foreign tax credits and mutual agreement procedure options.

The financial effect may extend beyond the primary income adjustment to penalties, interest, customs inconsistencies, exchange-control issues and economic double taxation.

A Practical Risk-Management Framework

1. Identify the relevant foreign enterprise: Document who contracts with customers, owns or licenses technology, holds market-access rights, employs the decision-makers, provides capital, controls risks and earns each material income stream.
2. Map the complete value chain: Trace customer origination, negotiation, approvals, procurement, development, financing, delivery, invoicing, support, risk management and dispute resolution. Do not analyse the local entity in isolation.
3. Test agreements against conduct: Compare intercompany contracts with emails, approval records, job descriptions, performance targets, customer communications, regulatory filings and actual decision-making.
4. Review infrastructure and premises: For fibre, servers, routers, data centres and offices, document ownership, access, exclusivity, operational control, maintenance, personnel access, permanence and the business function performed.
5. Segment the income: Separate local customer revenue, regional revenue, transit income, platform income, service fees, investment returns and income earned by other group entities.
6. Align PE and transfer pricing positions: The PE analysis, local file, master file, accounts, agreements, regulatory filings and corporate presentations should tell the same story.
7. Document foreign substance: Show the people, systems, assets, capital and governance through which the foreign enterprise performs its functions and controls its risks.
8. Model alternative outcomes: Even where the primary position is no PE or arm's-length remuneration, calculate credible alternatives to distinguish a supportable adjustment from an unsupported claim over regional or global profit.

Conclusion

African revenue authorities are right to test whether profit follows real economic activity. Multinational enterprises should not be able to separate returns from the people, assets and decisions that create them.

The opposite risk is overcorrection: treating every local employee, customer interaction, workshop, distributor, server or network connection as a claim over the foreign enterprise's wider profit.

First establish the nexus. Then identify the correct enterprise and income stream. Only then attribute the profit connected to the local functions, assets and risks.

For multinational groups, the strongest defence is not a clause stating that no permanent establishment exists. It is an operating model supported by consistent conduct, reliable transaction data and a functional analysis that explains how value is actually created.

For tax administrations, the same discipline strengthens legitimate source-country taxation. It protects the tax base without turning local presence into automatic ownership of foreign profits.

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info@taxiqafrika.com



African Headquarter GTC Towers,
14th Floor Nairobi Kenya



www.taxiqafrika.com



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