



PRIVATE EQUITY IN EAST AFRICA: WHY TAX CERTAINTY IS NOW PART OF THE INVESTMENT THESIS

As East Africa attracts more private capital, tax can no longer be treated simply as a structuring issue at entry or a compliance exercise at exit. It is increasingly part of the investment risk itself.

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Private equity and venture capital have become an important source of capital for East African businesses. From financial services and technology to healthcare, consumer markets, infrastructure and renewable energy, private capital is increasingly stepping into areas where traditional sources of long-term financing may be constrained.

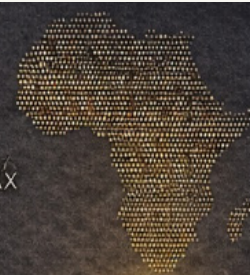
But as investment activity becomes more sophisticated, so too has the tax environment surrounding it. Revenue authorities are looking beyond the portfolio company and examining the entire investment architecture: where the fund is established, where investment decisions are made, who performs functions locally, how acquisitions are financed, how management and advisory fees are remunerated and, ultimately, where value is realised when an investment is sold.

“Tax certainty is becoming part of the investment thesis.”



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The Offshore Structure Is No Longer The End Of The Analysis

Historically, Africa-focused funds have commonly invested through jurisdictions offering established legal systems, investor protection, access to treaty networks and efficient fund structures. Mauritius has been particularly important in this regard.

The commercial rationale for such structures remains relevant. But increasingly, the existence of an offshore investment vehicle does not, by itself, determine where the underlying investment return will be taxed. African revenue authorities have progressively focused on questions including capital gains, interest deductions, management fees, withholding taxes, treaty entitlement and anti-avoidance provisions. Differences between national tax systems can also create uncertainty and economic or juridical double taxation.

For an East African investment committee, therefore, the question should increasingly be less “Where should we establish the investment vehicle?” and more “Can the entire structure withstand scrutiny in every jurisdiction through which the investment, management functions and eventual exit proceeds flow?”

That is a much broader inquiry.

Exit Taxation Deserves Attention At Entry

One of the most consequential developments for private equity has been the increasing willingness of source countries to examine offshore transfers whose underlying economic value is substantially derived from assets situated locally.

A fund may legally dispose of shares in an offshore holding company. Economically, however, the transaction may represent the disposal of an East African operating business. That distinction matters.

Revenue authorities are increasingly interested in offshore share transfers where the underlying assets sit in their jurisdiction, while the distinction between treating investment returns as capital gains and treating them as trading income can materially alter the tax outcome.

For private equity investors, this means exit tax modelling should not begin when the sale process starts. It should form part of the original investment model.

A transaction that appears attractive on an assumed tax-free or treaty-protected exit can produce very different returns if, several years later, a revenue authority asserts taxing rights over an indirect disposal, challenges the availability of treaty protection or characterises the return differently. The tax assumptions underpinning the expected IRR therefore deserve almost as much scrutiny as the commercial

Treaty Access Is Increasingly About Substance, Not Paperwork

The use of investment hubs also raises another issue: whether the fund or holding structure can actually access the benefits expected under a double tax treaty.

Traditional analysis often concentrated on establishing treaty residence and obtaining the required documentation. Today, the inquiry is considerably deeper.

Questions around limitation-of-benefits provisions, underlying ownership, residence, economic substance and treaty-shopping are particularly important for private equity structures. The difficulty is compounded by the fact that private equity funds particularly partnership and other non-CIV structures do not always fit comfortably within treaty frameworks originally designed around more conventional corporate investment.

For East African investors, this creates a practical challenge. A structure may be legally valid and commercially conventional but still produce controversy if the intermediary entity appears to do little more than receive and transmit investment income.

Fund managers therefore need to be able to explain not only what the structure is, but why it exists, who controls it, what functions are undertaken within it and how its governance operates in practice. The paperwork must follow the commercial reality not attempt to manufacture it afterwards.

The Local Investment Team May Be The Hidden Tax Risk

Perhaps the more interesting issue for East Africa lies not in the investment holding structure at all, but in the people managing the investment.

Private equity is inherently hands-on. Successful investment requires people who understand the local market, originate opportunities, assess businesses, interact with management teams, monitor performance and often play an important role in strategic decisions.

The difficulty is that the stronger the local investment capability becomes, the more important the question becomes as to whether those activities create a taxable presence for an offshore fund manager.

Local advisory companies are frequently established to identify and evaluate opportunities while attempting to preserve investment decision-making at fund-manager level. Yet tax authorities may challenge such arrangements where the actual functions performed locally extend beyond genuinely preparatory or advisory activity.

This produces an uncomfortable paradox: the very local presence that makes an investment manager commercially effective can increase its tax exposure.

Artificially restricting local teams from participating meaningfully in investment decisions is unlikely to be an attractive long-term answer. Nor is simply describing substantive management activity as “advisory” where the facts show otherwise.

A better approach is deliberate operating-model design: clearly defining decision rights, governance, investment committee processes, delegated authority, remuneration and the relationship between regional teams and the offshore fund manager. This is as much a transfer pricing and operating-model question as it is a permanent establishment question.

East Africa Does Not Necessarily Need Lower Taxes. It Needs Greater Predictability.

There is an understandable tension between revenue mobilisation and attracting international capital. East African governments should expect investors to contribute an appropriate share of tax where economic activity and value creation occur locally. But uncertainty carries its own economic cost.

If investors cannot determine with reasonable confidence whether treaty relief will apply, whether an offshore exit will be taxed, whether a local advisory team creates a permanent establishment or whether the same return could be taxed in multiple jurisdictions, that uncertainty eventually enters the investment model as a risk premium.

The objective should not be to create privileged tax treatment for private equity. It should be to create predictable tax treatment.

Certainty over investment-manager activities, indirect transfers, treaty qualification, fund structures and cross-border remuneration can allow revenue authorities to protect the tax base while giving investors a clearer framework within which to deploy capital.

What Should Investors Be Asking?

Investment Lens	Question To Test
Entry	Does the investment structure have a genuine commercial rationale and sufficient substance to support the intended tax treatment?
Operations	Where are the important investment and management decisions actually being made?
Transfer pricing	Are local advisory, management and support entities appropriately characterised and remunerated for what they really do?
Financing	Are interest, management charges and other cross-border payments commercially supportable and defensible?
Treaties	Is treaty entitlement sustainable when ownership, substance and anti-abuse provisions are considered?
Exit	Could an offshore disposal nevertheless trigger taxation in the country in which the underlying portfolio company operates?
Disputes	If two jurisdictions assert taxing rights over the same return, is there an effective route to relief from double taxation?

These are not merely tax due-diligence questions. Increasingly, they are investment governance questions.

The Bigger Opportunity

East Africa needs private capital.

Private equity brings more than financing. At its best, it introduces institutional governance, operational discipline, access to international networks and capital to scale businesses that may otherwise struggle to finance their growth.

Tax administrations equally have a legitimate interest in ensuring that sophisticated cross-border structures do not remove locally generated value from the tax base.

Those objectives do not have to conflict.

The opportunity is to move from a system in which the tax treatment of private equity is frequently determined through audits and disputes after the investment has been made, towards one in which investors and tax authorities have greater certainty before capital is committed.

For fund managers, that requires tax considerations to move closer to the investment committee. For governments, it requires clear legislation, credible guidance and effective dispute-prevention mechanisms.

For East Africa as an investment destination, the competitive advantage may ultimately lie not in offering the lowest tax rate, but in something considerably more valuable: a tax system in which investors can reasonably know the rules of the game before they invest.

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TaxIQ Africa provides specialist transfer pricing, international tax and tax controversy support to businesses and investors operating across African markets. Our work combines technical tax analysis with a practical understanding of how cross-border investment structures operate in African markets.

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