

# MONTHLY **NEWSLETTER**

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# Insights on Legal Tax Planning in Intellectual Property Transactions in Kenya in the wake of The Finance Bill, 2033

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## 1. Introduction

The global growth of information and financial technology in the recent past has been astounding. With it, new areas of commerce in the cross-border realm have emerged raising complex legal and commercial questions. Attendant to these developments is the concept of intellectual property as invaluable capital to any business. With this new property, the age-old burden of taxation inevitably attaches thus calling into play the concept of tax planning in order to communicate the true nature of transactions and commercial agreements that have a bearing on intellectual property so as to determine with certainty what is subject to tax, is a tax-deductible expense or otherwise exempt from tax.

## 2. What is Intellectual Property and Related Transactions?

Intellectual property refers to the creations of the human mind which are often intangible but at times manifested in tangible output. They include inventions; artistic works such as drawings, curving, paintings; literary works such as books among others. There are rights that attach to these creations gives the makers/owners exclusive or prescribed rights on their use. The rights may be in the form of patents, copyright, industrial design, trademark, trade secret, utility models among others.

In the commercial sense, these rights are tradable as property and the right holder may give another person limited or exclusive right of use by assignment or licence depending on the nature of the commercial transaction. These transactions are often documented by way of agreements that communicate the intention of the parties and how the rights are to be treated, utilised and the proprietor remunerated.

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### 3. What is Legal Tax Planning?

Tax Planning involves a considered analysis of the economic situation to enable a taxpayer benefit from all the elements of commerce and fiscal policy in lowering tax liability such as taking advantage of rebates and exemptions. However, combining this economic aspect with the legal aspect in the securitisation and documentation of intellectual property transactions brings to fore the aspect of tax planning in the legal sense i.e. employing the law to foresee potential tax conflicts and avert them through clear and precise documentation that avoids ambiguity at the time of determining the nature of a commercial transaction for tax purposes.

### 4. Interface between Tax Planning and Intellectual property Transactions

Kenya operates under a self-assessment regime. This implies that an individual determines what he/she believes to be tax payable, makes that declaration by way of returns to the tax authorities and makes payment for the same. This implies that the self-assessment model relies on the honesty and truthfulness of the taxpayer to make accurate and correct declarations.

With the above in mind, it is possible that a taxpayer may not to make full and accurate declarations as expected. As such, the law gives tax authorities in jurisdictions operating under this model the power to audit the returns and declarations made by taxpayers.

To enable tax authorities, determine what payable income is by auditing the taxpayer's returns, the taxpayer is required by law to keep all documentation that may be necessary to make one's tax liability determinable. The time limit for keeping these documents is capped at five years or a lesser time that may be specified. This period may however be stretched in cases of gross or wilful neglect, evasion or fraud.

In relation to intellectual property transactions, the documents that must be kept by the taxpayer in support of its tax position includes agreements on intellectual property licencing, assignment, among others. The wording, drafting and meaning attributed to these agreements are key in determining a person's tax liability.

The elegance or otherwise in the craft of these agreements bring to fore the interface of tax law and intellectual property law. Different agreements, communicating various intentions of the parties, have to bring out the true commercial nature with clarity and avoid ambiguity that would erroneously attach a tax liability or deny any of the parties a benefit that would accrue under the applicable tax regime.

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## 5. Key Insights – A Kenyan Experience

In the recent past, the High Court in the case of *Seven Seas Technologies Limited v Commissioner of Domestic Taxes (Income Tax Appeal 8 of 2017) [2021] KEHC 358 (KLR) (Commercial and Tax) (10 December 2021) (Judgment)* was called to make a distinction on the obligation to withhold tax in relation to sale of copyrighted material on the one hand and payment for licence to acquire rights to use a copyrighted material.

What fell for the Court's determination was first a distinction between a fee or payment made to a copyright holder as consideration for the right to exploit a copyright; and payment made for the purchase of copyrighted material. What the Court was called upon to determine here, goes to the root of the contract that gave rise to the payment that the tax authorities seek to attach a tax burden on it.

In this case the taxpayer, Seven Seas Technologies Limited, a distributor of computer software licenses, pursued the argument that by purchasing a software, it acquired copyrighted material and not any right to the intellectual property i.e. copyright to the software. In essence, it was not the user of the software and did not acquire any right to exploit the software like rights to the source code in the software. The Court agreed with it.

This intersection of tax law and copyright law, has shown the importance of prudent draftmanship which in this case played out in the distinction between 'copyright and copyrighted material' to which the former attracts royalty and therefore an obligation to withhold tax while the former doesn't. This distinction, among other technical distinctions ought to be clear in intellectual property transaction documentation and licence agreements so as to leave no room for ambiguity.

Be that as it may, the importance of proper draft Manship in contracts that involve intellectual property cannot be gainsaid. Its reliance by tax authorities in determining whether a tax liability attaches or not makes it a critical aspect in any commercial transaction. This has been epitomised by the Court of Appeal in the case of *Commissioner of Domestic Tax vs Barclays Bank of Kenya Ltd [2020] eKLR* where the Court has to determine whether payment by Barclays Bank to international card companies such as Mastercard and Visa, amounted to royalties to which they were obligated to withhold tax on the royalties. The Court stated that: -

*'How are we to determine whether payments made by the respondent to the card Companies constitute royalty? Is it as the respondent suggests, by reference only to terms of written Agreement agreements between respondent or the Card Companies? In our view, it is by considering the terms of the statute, written agreements, and the totality of the relationship between the Respondent and card Companies, including actual dealings between parties. '*

With the above key insights, it is evident that the investment in proper, accurate and



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well-reasoned draftmanship is an invaluable asset for any commercial transaction to enable the parties communicate their intent and the true position attendant to their commercial transaction.

## **6. The Finance Bill, 2023 – Prospects and Challenges under a Preferential Regime**

Every financial year, the National Treasury proposes a raft of measures to the country's fiscal laws aimed at raising the necessary revenue for delivery of services and to finance public expenditure. To that end therefore, the Finance Bill, 2023 has been published with a raft of legislative proposals.

Touching on intellectual property, the Bill proposes the amendment of Section 18A of the Income Tax Act, Cap. 470 Laws of Kenya to bring taxation of intellectual property income under the preferential tax regime.

Under this proposal, the Bill if enacted to law, gives the formula for the determination of intellectual property subject to tax and takes into account the research and development costs, acquisition, outsourcing costs among other expenses.

Development of intellectual property being a time and capital incentive exercise, this proposed amendment is timely as it allows developers of intellectual property greater benefit and reward for their inventions and developments.

With the new prospects, as shown above, the investment into proper legal documentation spells the thin line on whether an intellectual property developer may benefit from the amendment or not since such documentation in the form of agreements are key in determining the true nature of a commercial transaction and what rights, liabilities and privileges attach.

## **7. Conclusion**

From the above insight, it is evident that as the global commercial landscape evolves, the fiscal regime is equally catching up. However, somewhat from experience, with this drag race, at times veering into uncharted waters, the investment in a dynamic legal team that takes care of these eventualities through tax planning and legal advisory is critical in any commercial and corporate strategy.

***Note:** For further discussion and insights on intellectual property documentation and tax planning, contact the author on [info@kipkenda.co.ke](mailto:info@kipkenda.co.ke).*