Double Taxation Avoidance Agreements
Establishing internationally collaborative taxation regimes
Nov 2019
Outline

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Revisiting the basics
Double Taxation

• The imposition of tax on the same income by multiple jurisdictions.

• Two forms exist:
  
  ➢ Economic double taxation – the taxation of the same income, in the hands of different taxpayers, by multiple jurisdictions.
  
  ➢ Juridical double taxation – the taxation of the same income, in the hands of the same taxpayer, by multiple jurisdictions.

• Implications of double taxation
  
  ➢ Discourages international trade;
  
  ➢ Discourage foreign direct investment; and
  
  ➢ Slows economic growth.

• Measures to avoid double taxation
  
  ➢ Double Taxation Avoidance Agreements (DTAAs)
Revisiting the basics
What are DTAAs?

Double Taxation Avoidance Agreements

• Bi-lateral international treaties/agreements purposed at allocating taxation rights between multiple jurisdictions.

• What are the objectives of DTAA’s?

  ➢ Eliminate double taxation
  ➢ Encourage exchange of tax information
  ➢ Promote foreign direct investment

14 DTAAs since independence: France, Germany, India, Iran, Norway, South Africa, Sweden, United Kingdom, Zambia, United Arab Emirates, Qatar, South Korea, Denmark and Canada.
Revisiting the basics
WHT rates where Kenya has a DTAA

<table>
<thead>
<tr>
<th>Payment</th>
<th>UK</th>
<th>Germany &amp; Canada</th>
<th>Denmark, Norway, Sweden, Zambia</th>
<th>India</th>
<th>France</th>
<th>South Africa</th>
<th>South Korea</th>
<th>Qatar</th>
<th>United Arab Emirates and Iran</th>
<th>Mauritius*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management or professional fees</td>
<td>12.5</td>
<td>15</td>
<td>20</td>
<td>10</td>
<td>**</td>
<td>**</td>
<td>**</td>
<td>**</td>
<td>**</td>
<td>**</td>
</tr>
<tr>
<td>Royalties</td>
<td>15</td>
<td>15</td>
<td>20</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Dividends</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>5</td>
<td>5 or 10*</td>
</tr>
<tr>
<td>Interest</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>10</td>
<td>12</td>
<td>10</td>
<td>12</td>
<td>10</td>
<td>10</td>
<td>5</td>
</tr>
</tbody>
</table>

*K Kenya Mauritius DTAA – the operation of the Kenya Mauritius DTAA was invalidated following a ruling by the High Court of Kenya, which noted that due process was not followed prior to the gazettement of the DTAA.

**Management fees or business profits?
## Revisiting the basics

**WHT rates where Kenya does not have a DTAA**

<table>
<thead>
<tr>
<th>Payment subject to WHT</th>
<th>Resident payee or Non-Resident with a Kenyan PE</th>
<th>Non-resident payee without a Kenyan PE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management fee</td>
<td>5%</td>
<td>20%</td>
</tr>
<tr>
<td>Royalties</td>
<td>5%</td>
<td>20%</td>
</tr>
<tr>
<td>Leasing equipment</td>
<td>N/A</td>
<td>15%</td>
</tr>
<tr>
<td>Dividend</td>
<td>5%</td>
<td>10%</td>
</tr>
<tr>
<td>Interest from financial institutions and Government 2 year bearer bonds</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>Interest from bearer certificates</td>
<td>20%</td>
<td>25%</td>
</tr>
<tr>
<td>Housing bond interest</td>
<td>10%</td>
<td>15%</td>
</tr>
<tr>
<td>Rents</td>
<td>10%*</td>
<td>30%</td>
</tr>
<tr>
<td>Pension and taxable withdrawals from pension/provident funds</td>
<td>10% - 30%</td>
<td>5%</td>
</tr>
<tr>
<td>Insurance commissions:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agents</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>Brokers</td>
<td>5%</td>
<td>20%</td>
</tr>
<tr>
<td>Contractual fees</td>
<td>3%</td>
<td>20%</td>
</tr>
<tr>
<td>Consultancy and agency fees</td>
<td>5%</td>
<td>20%</td>
</tr>
<tr>
<td>Surplus Pension fund withdrawal/s</td>
<td>30%</td>
<td>30%</td>
</tr>
</tbody>
</table>

*Withholding tax on rent payable to a resident person for use or occupation of immovable property was introduced with effect from 1 January 2017. It is to be noted, however, that only persons appointed to be withholding tax agents can withhold tax on the rent.*
DTAA authority
DTAA authority
Where do DTAA’s derive their legal standing?

International Law

- **Vienna Convention on the Law of Treaties (VCLT)**
  - **Article 2** – Defines a treaty as an international agreement concluded between States and governed by international law.
  - **Article 27**: Provides one cannot invoke internal law for failure to perform a treaty- Supremacy of the DTAA’s

Domestic Legislation

- **Article 2 (6) Constitution of Kenya, 2010**
  - The supreme law of the land.
  - Provides – ‘Any treaty or convention ratified by Kenya shall form part of the Law of Kenya under this Constitution.

- **Treaty Making and Ratification Act, 2012**
  - Provides the treaty entering, ratification and enforcement process.

- **Income Tax Act, 2014**
  - Section 41 – seeks to implement DTAA’s in domestic legislation.
  - Section 41 (5) – Limitation of Benefits clause.
DTAA authority
Domestic Legislation vs. International Law

Income Tax Act, 2014
- Section 41 (5) – Limitation of Benefits clause.
- Seeks to limit the application of DTAA in domestic legislation.

• Hierarchy of Laws
- Per VCLT, international law trumps domestic law. Can the Income Tax Act limit the application of DTAAs on the domestic level?

• DTAAs Post-2010
- Some DTAAs post-2010 (Kenya India DTAA) – expressly note that DTAA provisions may be limited through domestic legislation.

  – Sec 41 (5) -2014“where an arrangement made under this section provides that income derived from Kenya is exempt or excluded from tax, or the application of the arrangement results in a reduction in the rate of Kenyan tax, the benefit of that exemption, exclusion, or reduction shall not be available to a person who, for the purposes of the arrangement, is a resident of the other contracting state if fifty per cent or more of the underlying ownership of that person is held by an individual or individuals who are not residents of that other contracting state for the purposes of the agreement”.
Model DTAAs
Model DTAAs
International collaboration

- States free to structure DTAAs in ways that best captures their mutual interest.
- The DTAA models available are:
  - OECD Model Tax Convention on Income and on Capital;
  - United Nations Model Double Taxation Convention between Developed and Developing Countries; and
  - US Model Income Tax Convention
- Which model does Kenya adopt?
- Should Kenya reconsider revising some DTAAs?
DTAA format

- **Articles 1 and 2:** Scope of the Convention
  - Persons covered
  - Taxes covered
- **Articles 3 to 5:** Definitions
  - General definitions
  - Residency status
  - Permanent establishment
- **Articles 6 to 21:** Taxation of income
  - Income from immovable property
  - Business profits
  - International shipping and air transport
  - Associated enterprises
  - Dividends
  - Interest
  - Royalties
  - Capital gains
  - Income from employment
  - Directors’ fees
  - Entertainers and sportspersons
  - Pensions
  - Government service
  - Students
  - Other income
- **Article 22:** Taxation of capital
  - Capital

This highlights the beneficiaries of the DTA, and taxes covered.

This defines specific terms utilised in the DTA.

This provides the basis for taxation of the various income heads noted, as well as allocating taxation rights to the relevant State.

This provides the basis for the taxation of capital.
DTAA format

- Article 23: Methods for elimination of double taxation
  - Exemption method
  - Credit method
- Articles 24 to 30: Special provisions
  - Non-discrimination
  - Mutual agreement procedure
  - Exchange of information
  - Assistance in the collection of taxes
  - Members of diplomatic missions and consular posts
  - Entitlement to benefits
  - Territorial extension
- Articles 31 and 32: Final provisions
  - Entry into force
  - Termination

This provides the methods through which relief from double taxation can be sought.

This provides for special concerns addressed by the DTA, such as exchange of information and non-discrimination provisions.

This highlights the process required in order for the DTA to come into force as well as termination procedures.
Focus on key DTAA provisions
Focus on key DTAA provisions
Permanent Establishment - Article 5

<table>
<thead>
<tr>
<th>UN Model Tax Convention</th>
<th>OECD Model Tax Convention</th>
</tr>
</thead>
<tbody>
<tr>
<td>A PE includes a building site or construction or assembly project or supervisory activities in connection therewith which exists for more than six months.</td>
<td>A PE includes a building site, a construction, assembly or installation, project which exists for more than twelve months.</td>
</tr>
<tr>
<td>Provides for ‘services permanent establishments, whereas furnishing of services, including consultancy services, for a period or periods aggregating to more than 183 days (six months) within any 12 month period.</td>
<td>No special provision covering services</td>
</tr>
<tr>
<td>‘Delivery’ does not form part of preparatory and auxiliary services.</td>
<td>‘Delivery’ is expressly listed as a function that constitutes part of preparatory and auxiliary services.</td>
</tr>
</tbody>
</table>

· Key issues to note—Commentary to Article 5:
  · **Auxiliary nature or preparatory:** The decisive criterion on activities being of a preparatory or auxiliary character is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. A fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity.
  · **Fixed place of business:** “Again the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise.”
<table>
<thead>
<tr>
<th>UN Model Tax Convention</th>
<th>OECD Model Tax Convention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allows for the taxation of certain profits not attributable to the PE such as sales of similar goods or merchandise as well as other business activities of the same or similar kind carried on by the enterprise in the source country.</td>
<td>Only profits attributable to the PE are taxable.</td>
</tr>
<tr>
<td>There is a restriction on expenses/fees for the use of patents.</td>
<td>Accored the same right as resident enterprises to deduct the trading expenses other than restrictions imposed on resident enterprises.</td>
</tr>
</tbody>
</table>
Focus on key DTAA provisions

**Other income**

Items of income of a resident of a Contracting State, wherever arising, not dealt with in the DTAA

<table>
<thead>
<tr>
<th>UN Model Tax Convention</th>
<th>OECD Model Tax Convention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provides for source country taxation of other income, as an exception to the general approach of allowing only residence country taxation of income not expressly dealt with in the underlying DTAA</td>
<td>Maintains residence taxation of income not expressly dealt with in the underlying DTAA.</td>
</tr>
</tbody>
</table>

• Article 21 (3) of the UN Model Tax Convention provides for source based taxation of other income. It gives States the right to tax other income where their domestic legislation provides for the taxation of that income.

• Kenya-UK DTAA – Mainly based on the OECD Model. Grants UK favourable taxation rights at Kenya’s expense- (e.g. management fees for a PE, other income ) VS

• Kenya-India DTAA –Based on UN Model for some articles but revised some clauses in line with OECD Model. Attempts to balance taxation rights between the two entities (other income, deductibility of expense).

• *Does management and professional fees form part of other items of income?*
Focus on key DTAA provisions
Management and professional fees

<table>
<thead>
<tr>
<th>UN Model Tax Convention</th>
<th>OECD Model Tax Convention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Covered under article 14</td>
<td>Covered under article 7 following the repeal of article 14</td>
</tr>
<tr>
<td>Taxable as Independent Personal Services in the contracting state unless:</td>
<td></td>
</tr>
<tr>
<td>- The independent person has a fixed base regularly available to him in the other State for the purpose of performing his activities; or</td>
<td></td>
</tr>
<tr>
<td>- Spends an aggregate of 183 days in a year in the other state</td>
<td></td>
</tr>
<tr>
<td></td>
<td>▪ Taxed as business profits in the contracting state unless a PE is created.</td>
</tr>
<tr>
<td></td>
<td>▪ Prior to its deletion only provided for taxation of professional income if the independent person has a fixed base regularly available to him in the other State for the purpose of performing his activities</td>
</tr>
</tbody>
</table>

• **Profit from services- Commentary to article 5 OECD:** “The profits from services performed in the territory of a Contracting State by an enterprise of the other Contracting State are not taxable in the first-mentioned State if they are not attributable to a permanent establishment situated therein”.  

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Focus on key DTAA provisions
Management/professional fees

OECD Application

• Commentaries to the 2017 OECD Model Tax Conventional note ‘The effect of the deletion of Article 14 is that income derived from professional services or other activities of an independent character is now dealt with under Article 7 as business profits.’

• Commentary to article 5: the profits from the sale of goods that are merely imported by a resident of a country and that are neither produced nor distributed through a permanent establishment in that country are not taxable therein and the same principle should apply in the case of services. The mere fact that the payer of the consideration for services is a resident of a State, or that such consideration is borne by a permanent establishment situated in that State or that the result of the services is used within the State does not constitute a sufficient nexus to warrant allocation of income taxing rights to that State.

KRA’s interpretation

➢ Where not expressly mentioned, management fees are taxable as other income. The DTAA's between Kenya and France/South Africa/UAE and Qatar do not have an article on management fees.
Recent developments
Recent developments
Base erosion and profit shifting

Base Erosion and Profit Shifting (BEPS)

- **Tax avoidance** strategies that *exploit gaps* and *mismatches in tax rules* to artificially shift profits to *low or no-tax* locations.

BEPS strategies – tax avoidance or tax evasion?

- Not necessarily illegal, but:
  - Undermine the fairness and integrity of tax systems.
  - Enable multinational enterprises (MNEs) gain a competitive edge over enterprises operating on a domestic level.

Domestic legislation on tax avoidance/evasion

- **Tax Procedures Act, 2015, Section 85** – introduces severe penalties (double the principal tax) should a tax payer be found engaging in tax avoidance schemes. Equal penalty for tax agent.

- **Income Tax Act, 2014, Section 23** – empowers the Commissioner to assess tax on transactions designed to avoid or reduce tax liability.

BEPS Inclusive Framework

- Spearheaded by OECD in conjunction with G20.
- OECD has developed 15 standards Action Plans.
- Incorporated into the 2017 OECD Model Tax Convention.
- Four Action Plans directly affect DTAs:
  - Action 2: Neutralizing the Effects of Hybrid Mismatch Arrangements.
  - Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances.
  - Action 7: Preventing the Artificial Avoidance of PE status.
  - Action 14: Dispute resolution- Making Dispute resolution more effective.
Recent developments
Base erosion and profit shifting...Cont’d

BEPS Action 2: Neutralizing the Effects of Hybrid Mismatch Arrangements

• Hybrid mismatch arrangements – arrangements that exploit differences in the tax treatment of instruments, entities or transfers between multiple jurisdictions.

• **Transparent entities** - Treated as income of a resident of contracting state subject to the same being taxed in that contracting state.

• **Dual residents** - Competent authorities to determine otherwise no tax relief or deduction.

• Aims to prevent double deduction (double non-taxation)- Exemption in both states or reduced tax rates.

• Refers to the interaction of domestic tax systems that may lead to income not being taxed anywhere.

BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances’ Treaty Abuse

• Refers to a tax avoidance mechanism purposed at taking advantage of tax relief offered by DTAAAs in multiple jurisdictions.

• BEPS Action 6 recommends that DTAAAs structured to prevent double taxation as well as double non-taxation (preamble clause).

• **Required preamble Clause** “Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions”.

**Article 29, Entitlement to Benefits (Signing MLI):** An entity qualifies to the entitlement to DTAA benefits if they meet:

– **A principal purpose test rule:** obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit.
Action 6: Preventing Tax Treaty Abuse

**Purposes of DTAs- Pre BEPS**

- To avoid double taxation but not exclude taxation
- Tax Treaty System Allocates tax rights – Includes right not to tax to prevent ‘double taxation’ & encourage foreign investment.

**Post BEPS**

- DTA aim to end ‘double non-taxation’ & harmful tax practices
- “treaty shopping” - taking advantage of “better” tax treaties to lower the total tax burden for the multinational group.
# Action 6: Prevent treaty abuse

<table>
<thead>
<tr>
<th>Consideration</th>
<th>Overview of Actions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A-Treaty shopping</strong></td>
<td>Limitation On Benefits clause (LOB) Principal Purpose Test rule (General Anti Abuse rule)</td>
</tr>
<tr>
<td><strong>A-Cases where a person tries to circumvent the provisions of domestic tax law using treaty benefits</strong></td>
<td>Precision as a general principle that the purpose of treaties is not to restrict the taxation by a State of its own residents – except for specific cases to be listed in the treaty – so allows the application of anti-abuse rules by the contracting states for their residents</td>
</tr>
<tr>
<td><strong>B - Clarification that tax treaties are not intended to be used to generate double non-taxation</strong></td>
<td>Statements that avoiding tax evasion and avoidance is also a purpose of the treaty (change of title, of the preamble and of the introduction of the Model Convention)</td>
</tr>
<tr>
<td><strong>C - Tax policy considerations that countries should consider before deciding to enter into a tax treaty</strong></td>
<td>Insert in the Introduction to the OECD Model a section C “Tax policy considerations that are relevant to the decision of whether to enter into a tax treaty or amend an existing treaty”</td>
</tr>
</tbody>
</table>
Proposed changes Income Tax Bill on DTA

- Proposal to expand the limitation on application of DTA by excluding the below persons (in the other treaty partner state) from benefiting from a double tax treaty:
  - A holding company;
  - Supervision or administration of a group of companies;
  - Entities providing group financing (including cash pooling); or
  - Entities making or managing investments.
- DTA Would not apply where a company is formed to just provide financing or administration support e.g. a shared service centre (SSC).

Kenya India DTA Amended

- The Kenya India DTA, initially concluded in 1985, was revised, with an effective date of 01 January 2018 incorporated BEPS action plans. E.g. PE definition now includes sales outlets and warehouses providing storage facilities for others and service PEs.
Recent developments

• Action 7 aims to prevent the artificial avoidance of PE through redefining the threshold for creating a PE including a focus on the use of commissionaires

• The term “permanent establishment” includes especially:
  a) A place of management;
  b) A branch;
  c) An office;
  d) A factory;
  e) A workshop, and
  f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
Role of the PE Concept

Country of residence

Enterprise

Country of source

Business activity

Art. 7(1): source state may only tax business profits if the business activity constitutes a PE

Art. 5: definition of permanent establishment

Art. 7: rules on profit allocation
Article 5 OECD Model (2014) – Pre BEPS

- Art. 5(1) Fixed place of business PE
- Art. 5(2) Positive list (examples)
- Art. 5(3) Construction PE
- Art. 5(4) Negative list (exceptions)
- Art. 5(5) Dependent agent PE
- Art. 5(6) Independent agent
- Art. 5(7) Subsidiary
**Article 5 OECD Model (2017) – Post BEPS**

<table>
<thead>
<tr>
<th>Article 5(1)</th>
<th>Fixed place of business PE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article 5(2)</td>
<td>Positive list (examples)</td>
</tr>
<tr>
<td>Article 5(3)</td>
<td>Construction PE</td>
</tr>
<tr>
<td>Article 5(4)</td>
<td>Negative list (exceptions)</td>
</tr>
<tr>
<td>Article 5(4.1)</td>
<td>Anti-fragmentation rule</td>
</tr>
<tr>
<td>Article 5(5)</td>
<td>Dependent agent PE</td>
</tr>
<tr>
<td>Article 5(6)</td>
<td>Independent agent</td>
</tr>
<tr>
<td>Article 5(7)</td>
<td>Subsidiary</td>
</tr>
<tr>
<td>Article 5(8)</td>
<td>Closely related enterprises</td>
</tr>
</tbody>
</table>
# Action 7: Avoidance of PE Status

<table>
<thead>
<tr>
<th>PE type</th>
<th>Change</th>
<th>How?</th>
<th>Target</th>
</tr>
</thead>
</table>
| Fixed place of business  | Auxiliary/Prep. Exceptions Art. 5(4)        | Making all subparagraphs subject to a “preparatory or auxiliary” condition | • Digital businesses (warehousing)  
• Exempted “core functions” (e.g. purchasing for sales entities) |
| Art. 5(1)                |                                             |                                                                      |                                                                                            |
| New Art. 4.1.            | New Anti-fragmentation rule                 |                                                                      | • Segmentation of cohesive business operations, complementary functions in supply chain structures |
| Construction PE          | OECD Commentary                             | SAAR as example                                                      | • Split up of contracts                                                                   |
| Art. 5(3)                |                                             |                                                                      |                                                                                            |
| Agency PE                | Dependent Agent Definition Art. 5(5)        | • Extends definition to an agent who “habitually plays the principal role leading to the conclusion of contracts that are concluded without material modification” by the principal  
• contracts are performed by the principal | • Commissionaires  
• Sales/marketing service providers  
• Rep offices  
• Contracts negotiated in the source state but approved/finalized online |
| Independent Agent        | Independent Agent Definition 5(6)           | No independence if one acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related | • Independent agents who are practically dependent agents |
| Definition 5(6)          |                                             |                                                                      |                                                                                            |
BEPS Implications

- **Commissionaire arrangements:** commissionaire arrangements, where the sales takes place without a substantive change in the functions performed in that country on the basis on non binding contracts
  
  – *Commissionaire activities intended to result in conclusion= PE.*

- **Auxiliary or preparatory activities/character:** each of the exceptions included therein is restricted to activities that are otherwise of a “preparatory or auxiliary” character.
  
  – *preparatory or auxiliary can create a PE*

- **Anti-fragmentation:** fragmenting a cohesive operating business into several small operations or splitting contracts in order to argue that each part is merely engaged in preparatory.
  
  – *Not possible to avoid PE status by fragmenting or splitting contracts*
Proposed changes Income Tax Bill - PEs

• Proposal to expand definition to include a warehouse, a farm or plantation, a sales outlet, supervisory activities in connection with a project site

• Service PE: The provision of services through employees who are in Kenya for more than 91 days in a given year.

• A branch to be taxed in the same way as a local company. @30% for taxable income up to KES 500 million; and @35% for income above KES 500 million.

• Proposal for 10% tax on the repatriation of branch income (a summation of the after-tax profits and any reduction in the net assets of the PE.)

• Payments made by a PE to head office not subject to WHT only if treated as a non deductible expense for the branch.
BEPS Action 14: Dispute resolution—Mutual Agreement Procedures

- MAPs are procedures that allow Competent Authorities from the governments of the Contracting States/Parties to interact with the intent to resolve international tax disputes.

- BEPS Action Plan aim to strengthen the effectiveness and efficiency of the MAP process—e.g., effective and timely resolution of disputes

- MAPs provide an alternative for resolving tax disputes giving rise to double taxation. Issues resolved through MAPs:
  - Permanent establishment issues;
  - Characterisation and classification of income;
  - Residency of a taxpayer;
  - Applicability of specific withholding tax rates; and
  - Adjustments arising from transfer pricing assessments.
Action 15: Multilateral Instrument ("MLI")

- Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS – MLI
- Signed on 7 June 2017 by 68 countries
- 11 African countries signed the MLI

<table>
<thead>
<tr>
<th>Burkina Faso</th>
<th>Cameroon</th>
<th>Cote d’Ivoire</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt,</td>
<td>Gabon,</td>
<td>Mauritius</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Senegal</td>
<td>Seychelles</td>
</tr>
<tr>
<td>South Africa</td>
<td>Tunisia</td>
<td></td>
</tr>
</tbody>
</table>

- EAC countries still did not sign – expected to sign 2018/2019
MLI - PE Provisions

• Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies
  – Notifications
  – Reservations

• Article 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions
  – Notifications
  – Options (A – B)
  – Reservations

• Article 14 – Splitting-up of Contracts

• Article 15 - Definition of a person closely related

• MLI has 17 articles – and commentary on options
# Overview of PE Options Taken under the MLI by African Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Article 12</th>
<th>Article 13</th>
<th>Article 14</th>
<th>Article 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burkina Faso</td>
<td>Opted in</td>
<td>Opted in - A</td>
<td>Opted in</td>
<td>Opted in</td>
</tr>
<tr>
<td>Cameroon</td>
<td>Opted in</td>
<td>Opted in - A</td>
<td>Opted in</td>
<td>Opted in</td>
</tr>
<tr>
<td>Cote d’Ivoire</td>
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<td>Opted in - A</td>
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<td>Egypt</td>
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<td>Gabon</td>
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<tr>
<td>Mauritius</td>
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<tr>
<td>Nigeria</td>
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<td>Senegal</td>
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<tr>
<td>Seychelles</td>
<td>Opted out</td>
<td>Opted out</td>
<td>Opted out</td>
<td>Opted out</td>
</tr>
<tr>
<td>South Africa</td>
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<td>Opted in - A</td>
<td>Opted out</td>
<td>Opted in</td>
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<tr>
<td>Tunisia</td>
<td>Opted in</td>
<td>Opted in - A</td>
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</tr>
</tbody>
</table>
### Matching principal - Option country X versus Option country Y

<table>
<thead>
<tr>
<th>Articles</th>
<th>NL</th>
<th>Nigeria</th>
<th>Impact on treaty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article 12 - Artificial avoidance of PE - Commissionaire</td>
<td>Opted in</td>
<td>Opted in</td>
<td>Article 12 would apply</td>
</tr>
<tr>
<td>Article 13 - Artificial avoidance of PE - activity exemptions</td>
<td>Opted in - A</td>
<td>Opted in - A</td>
<td>Opted A would apply</td>
</tr>
<tr>
<td>Article 14 - Splitting up of contracts</td>
<td>Opted in</td>
<td>Opted in</td>
<td>Article 14 would apply</td>
</tr>
<tr>
<td>Article 15 - Définition closely related per</td>
<td>Opted in</td>
<td>Opted in</td>
<td>Article 15 would apply</td>
</tr>
<tr>
<td>Article 12 - Artificial avoidance of PE - Commissionaire</td>
<td>Opted in</td>
<td>Opted in</td>
<td>Article 12 would apply</td>
</tr>
<tr>
<td>Article 11 - Restrict a party’s right to tax</td>
<td>Opted out</td>
<td>Opted out</td>
<td>Article 11 would not apply</td>
</tr>
<tr>
<td>Article 8 – Dividend transfer</td>
<td>Opted in</td>
<td>Opted out</td>
<td>Article 8 (1) would not apply</td>
</tr>
</tbody>
</table>
Recent developments
Kenya India DTAA revised

- The Kenya India DTAA, initially concluded in 1985, was revised in 2016 and later ratified on 29 June 2017, with an effective date of 01 January 2018.

- The revised Kenya India DTAA introduced a number of key changes, including:

<table>
<thead>
<tr>
<th>Issue</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residency</td>
<td>Introduces the ‘Place of incorporation’ as a determinant for residency.</td>
</tr>
<tr>
<td>Permanent establishment</td>
<td>Expands the definition of a PE to include sales outlets and warehouses providing storage facilities for others. Additionally, services companies including consultancy firms will be deemed to have a PE after an aggregate of 90 days.</td>
</tr>
<tr>
<td>Business profits</td>
<td>Gives the contracting parties the right to limit the allowability of executive and general administrative expenses through domestic legislation. Similarly, the revised DTAA expressly disallows head office expenses (royalties, patents, commissions and interest).</td>
</tr>
<tr>
<td>Limitation of Benefits</td>
<td>Gives contracting parties the right to use domestic legislation to address tax avoidance and evasion issues.</td>
</tr>
<tr>
<td>DTAA guaranteed WHT rates</td>
<td>Reduces the applicable WHT rates in relation to certain payments.</td>
</tr>
<tr>
<td>Students</td>
<td>Exempts remuneration earned by a student from an employment which he or she undertakes for six consecutive years during his or her full time education in either of the contracting states. Previous DTAA covered students and apprentices while the new DTAA strictly encompasses students.</td>
</tr>
</tbody>
</table>
Case study
Case study

A US based manufacturing company, ManCo, wishes to expand its business to the Sub-Saharan region. ManCo wishes to set up a legal entity in Kenya, ManKE, as well as a holding company, HoldCo, in the United Kingdom (UK). Further, ManCo will set-up a Shared Services Centre (SSC) in South Africa (SA).

ManKE will be ManCo’s trading entity in Kenya. It is intended that ManKE will receive funding as well as marketing and managerial services from the SSC in SA. Additionally, ManKE will receive professional services from HoldCo.

Noting the existence of a Kenya-UK Double Taxation Agreement (DTAA), ManCo expects to take advantage of the lower effective tax rates offered by the DTAA on the repatriation of profits (through dividend payments) from ManKE to HoldCo. Similarly, noting the Kenya-SA DTAA, ManCo expects to take advantage of the lower effective tax rate to reduce its withholding tax (WHT) liability when making interest payments to SSC.
Case study
Applicable WHT rates are as follows:

<table>
<thead>
<tr>
<th></th>
<th>United Kingdom</th>
<th>South Africa</th>
<th>Non-Residents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management and</td>
<td>12.5%</td>
<td>Taxed as business profits</td>
<td>20%</td>
</tr>
<tr>
<td>Professional fees</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Royalties</td>
<td>15%</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>Dividends</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Interest</td>
<td>15%</td>
<td>10%</td>
<td>15%</td>
</tr>
</tbody>
</table>
Case study...cont’d

The proposed organisational structure is set out below:
Case study – Part I

ManCo intends on utilising the SSC based in South Africa to fund its various sub-Saharan regional entities, inclusive of ManKE. Further, the SSC will also be tasked with providing the regional entities with marketing and management services.

Questions:

• Noting the existence of the KE-SA DTAA, what are the applicable withholding tax rates on interest payable by ManKE when making interest payments to SSC?

• Assuming that SSC advances interest free loans to ManKE, what are the arising WHT implications?

• In relation to the fees payable by ManKE to SSC for management and marketing services, are these taxable as business profits, or liable to withholding tax?

• Consider Section 41 (5) – can domestic law limit DTAA applications where the payments are to India? Consider BEPS and discuss the positions
Case study – Part II

ManKE receives payroll services from HoldCo, based in the UK. Additionally, ManCo expects to repatriate ManKE’s profits (through dividend payments) to HoldCo. Given the existence of the KE-UK DTAA, ManCo expects to benefit from the tax reliefs guaranteed in the underlying DTAA.

Questions:

• Are fees paid by ManKE to HoldCo for payroll services rendered subject to withholding tax? If yes, at what rate?

• Seeking to give more substance to HoldCo, ManCo opts to increase the services provided to ManKE by HoldCo. HoldCo and ManKE enter into a contract for services whereby HoldCo provides legal support during contract negotiations. In the provision of this service, HoldCo employees travel to Kenya from time to time, for an aggregate period of six months in one year. While in Kenya, HoldCo employees will be provided with an office in ManKE’s premises.
  • Given the arrangement above, is HoldCo likely to trigger a PE in Kenya?
  • If yes, what are the implications on the repatriation of profits from ManKE to HoldCo.

• What is the position on the payments of Interest and management fees where ManKE is a PE of UK and not a subsidiary while:
  • Paying UK
  • While paying SA- Is this DTAA applicable in view of definition of resident?
Case study – Part III

The Kenya Revenue Authority (KRA) approaches ManKE to carry out an audit of its tax affairs. A tax dispute ensues with the KRA challenging ManKE’s interpretation of the tax reliefs afforded by the Kenya-SA DTAA.

Questions:

• What dispute mechanisms are available to ManKE?

• What protections/guarantees are offered by the underlying DTAA in relation to dispute resolution?
Q&A