Current trends in international tax planning (focus on BEPS).

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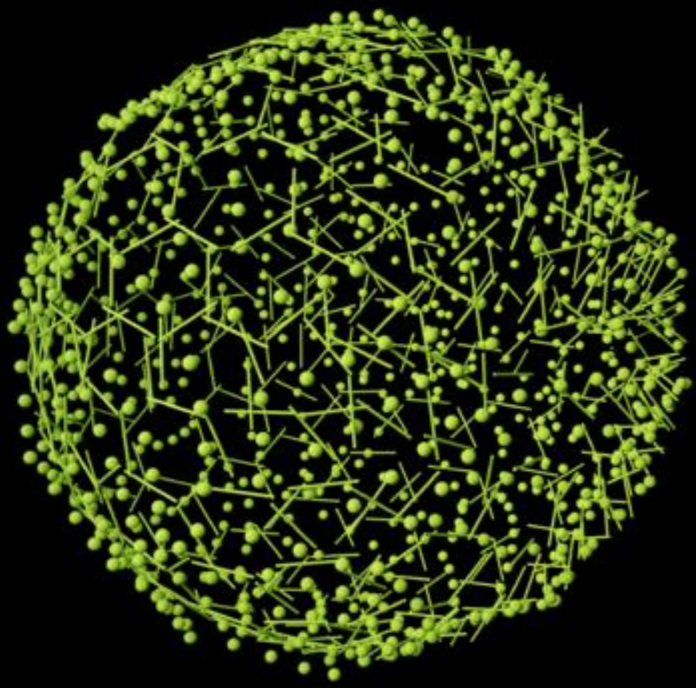
BEPS Summary and objectives



BEPS Objectives

Tax issues for developing countries

- Abuse of tax treaties- No source taxation or low taxes
- Excessive payments- Royalties and services fees
- Artificial tax losses
- Profit shifting through supply chain structures
- Holding structures without substance
- Debt finance
- Information access

Domestic legislation on tax avoidance/evasion

- Tax Procedures Act, 2015, Section 85 – Penalty double the principal tax. Equal penalty for tax agent
- Income Tax Act, 2014, Section 23 – Anti-avoidance rules

BEPS Objectives

Base Erosion and Profit Shifting (BEPS)

- Spearheaded by OECD in conjunction with G20- Final reports October 2015.

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

  - 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.

  - Three pillars, (the objectives of the Project)
    - reinforce the coherence of corporate income tax rules at the international level;
    - realign taxation with the substance of the economic activities; and
    - improve transparency.

BEPS Summary

Action	Action
Action 1: Addressing the Tax Challenges of the Digital Economy	**Action 9**: Assure that TP outcomes are in line with value creation: Risks/Capital
Action 2: Neutralizing the Effects of Hybrid Mismatch Arrangements	**Action10**: Aligning Transfer Pricing Outcomes with Value Creation: Other high risk transactions
Action 3: Designing Effective Controlled Foreign Company Rules	**Action 11**: Measuring and Monitoring BEPS
Action 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments	**Action 12**: Mandatory Disclosure Rules
Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance	**Action 13:** Transfer Pricing Documentation and Country-by-Country Reporting
Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances	**Action 14:** Making Dispute Resolution Mechanisms More Effective
Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status	**Action 15:** Developing a Multilateral Instrument to Modify Bilateral Tax Treaties
Actions 8: Assure that TP outcomes are in line with value creation: Intangibles	

BEPS Hierarchy

The Hierarchy of commitment

Minimum standards	• Action 5: Harmful tax practices • Action 6: Prevent treaty abuse • Action 13: Country by Country (CbC) reporting only • Action 14: Dispute resolution
Strengthening existing international standards	• Action 7: Permanent Establishment (PE) • Actions 8 - 10: Transfer Pricing • Action 13: Master file and local file
Common approach	• Action 1: Digital economy • Action 2: Hybrid mismatch arrangements • Action 4: Interest deductions
Best practices	• Action 3: Controlled foreign company (CFC) rules • Action 12: Aggressive tax planning arrangements

Action 15: Multilateral instrument

BEPS Implementation

Domestic Law changes	Transfer Pricing	Treaties	Monitoring
Changes recommended for national law or regulations	**Changes to OECD TP Guidelines- 2017**	**OECD MLI and OECD MTC 2017**	**Monitoring by OECD**
Action 1: Digital Economy	**Actions 8- 10**: TP outcomes are in line with value creation	**Action 2**: Hybrid Mismatch Arrangements	**Action 5**: Countering Harmful Tax Practices More Effectively
Action 2: Hybrid Mismatch Arrangements		**Action 6**: Treaty Abuse	**Action 11**: Measuring and Monitoring BEPS
Action 3: CFC Rules		**Action 7**: Permanent Establishment Status	**Action 13:** Transfer Pricing Documentation and CbCR
Action 4: Interest Deductions		**Action 14:** Dispute Resolution Mechanisms	**Action 14:** Dispute Resolution Mechanisms
Action 5: Countering Harmful Tax Practices More Effectively		**Action 15:** MLI	
Action 12: Mandatory Disclosure Rules			
Action 13: Transfer Pricing Documentation and CbCR			

BEPS Inclusive Framework- July 2016

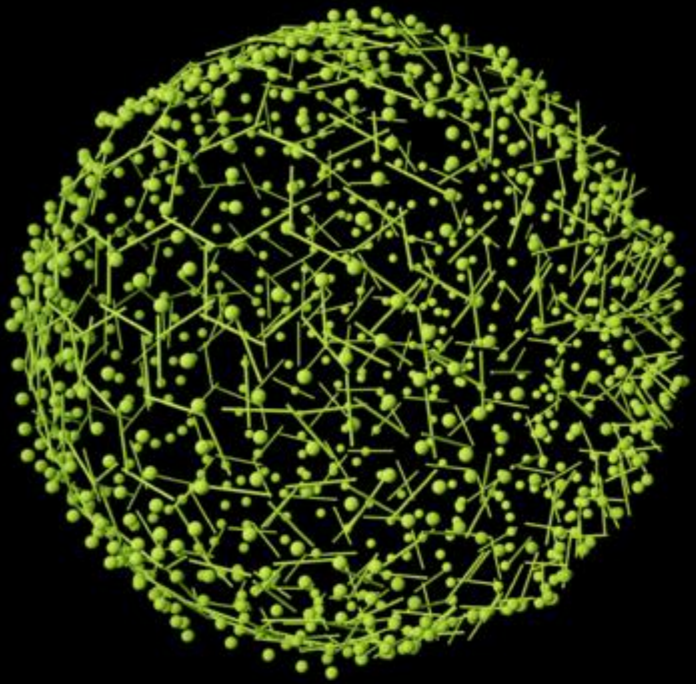
ICPAK
Uphold Public Interest

To support timely, consistent and widespread implementation of the BEPS package interested countries and jurisdictions that have not yet committed to the BEPS package called upon to join the framework on an equal footing.

- **African BEPS Inclusive framework members**
  - Angola
  - Benin
  - Botswana
  - Burkina Faso
  - Cameroon
  - Congo
  - Côte d'Ivoire
  - Democratic Republic of the Congo
  - Djibouti
  - Egypt
  - Kenya
  - Liberia
  - Nigeria
  - Senegal
  - Sierra Leone
  - South Africa

Minimum Standard- All OECD countries committed to implementing.	
Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance	
Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances	
Action 13: Transfer Pricing Documentation and Country-by-Country Reporting	
Action 14: Making Dispute Resolution Mechanisms More Effective	

BEPS Actions analysis and Impact



BEPS Action 2

Neutralizing the Effects of Hybrid Mismatch Arrangements

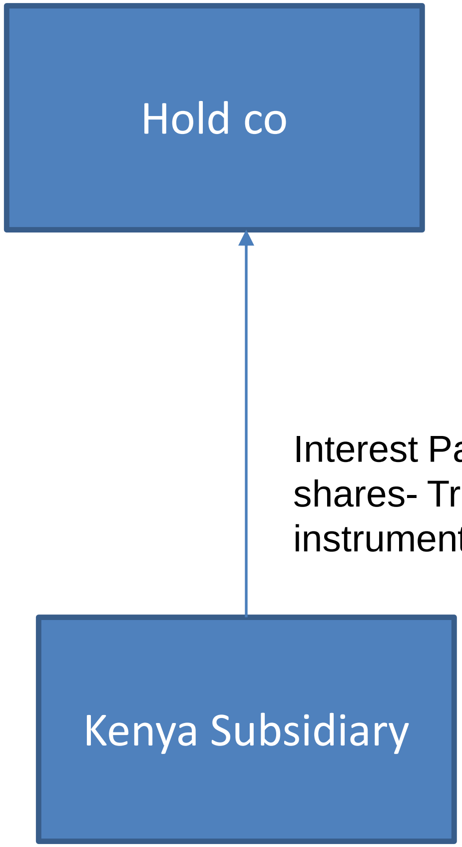
- Hybrid mismatch arrangements – arrangements that exploit differences in the tax treatment of instruments, entities or transfers between multiple jurisdictions.
- Action addresses mismatch in tax outcomes:
  - ✓ Payments made under a hybrid financial instrument (Debts, shares, finance leases) or payments made to or by a hybrid entity (transparent entity) that give rise to a deduction with no taxable inclusion.
  - ✓ Payments that give rise to a double deduction due to dual residency for tax purposes
- Recommendations take the form of linking rules that align the tax treatment of an instrument or entity with the tax treatment in the counterparty jurisdiction (**deny deduction or include in the taxable income**)

BEPS Action 2

Hybrid Mismatch Arrangements

Interest expense allowable in Kenya.

Interest Income foreign sourced could be treated as dividends in Holdco- Preference shares treated as equity instruments



Interest Payment on Preference shares- Treated as debt instrument in Kenya

Anti Hybrid rule: Deny deduction in Kenya if income not included in the taxable income of the Hold Co.

BEPS Action 6: Treaty Abuse

Preventing the Granting of Treaty Benefits in Inappropriate Circumstances'

- Refers to a tax avoidance mechanism purposed at taking advantage of tax relief offered by DTAs in multiple jurisdictions.
- BEPS Action 6 recommends that DTAs 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"*

BEPS action 6 cont'd……….

- **Simplified limitation of benefits provision (LOB)**
  - Define a qualified person (Shareholding percentage in the list) (**Section 41 (5) ITA similarity**)
  - Regardless of above, benefits to be limited to **active conduct** of a business which shall not include the following activities or any combination thereof:

a) operating as a holding company;

b) providing overall supervision or administration of a group of companies;

c) providing group financing (including cash pooling); or

d) making or managing investments, unless these activities are carried on by a bank, insurance

- **Application of A principal purpose test rule (PPT) :** obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit.

BEPS Action 7: PE

Preventing the Artificial Avoidance of Permanent Establishment Status

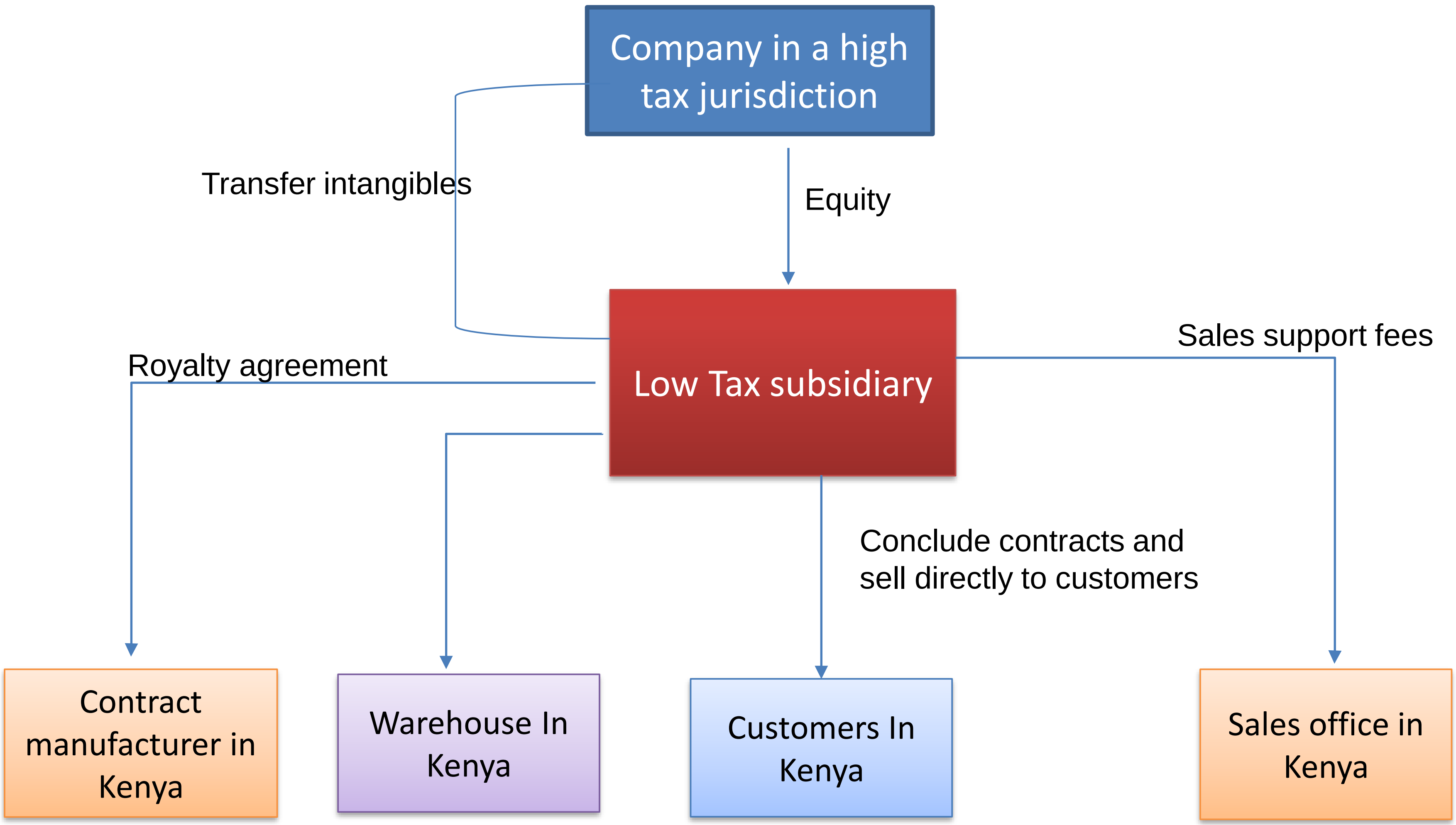
- Permanent establishments redefined with an objective to prevent artificial avoidance of PE status and PE threshold reduced.

Key issues:

- **Commissionaire arrangements:** Taxpayers replace subsidiaries that traditionally acted as distributors by commissionaire arrangements, with a resulting shift of profits out of the country where the sales took place without a substantive change in the functions performed in that country. On the basis on non binding contracts
  - ➢ If intended to result in conclusion, then 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.
  - ➢ Not possible to avoid PE status by fragmenting a cohesive operating business into several small operations or splitting contracts in order to argue that each part is merely engaged in preparatory.

PE avoidance

Supply Chain Structure



BEPS Action 14:MAPs

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 provides 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

BEPS Action 15: MLI

Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

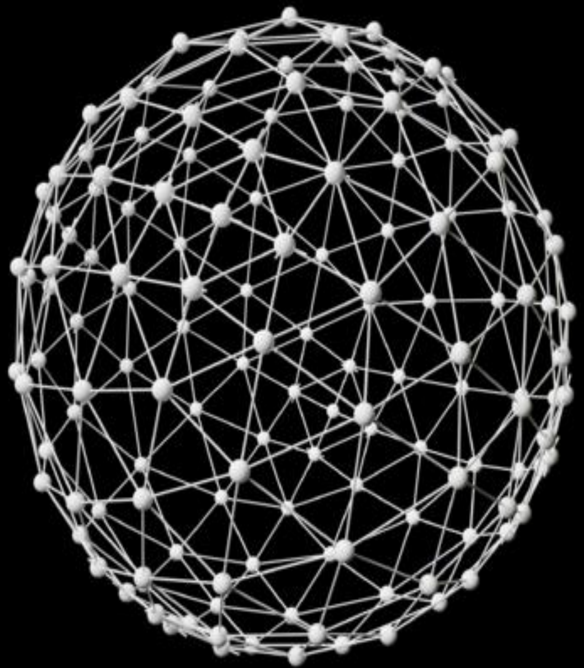
- The OECD has developed Multilateral Convention to Implement Tax Treaty Related Measures to prevent Base Erosion and Profit Shifting (MLI).
- MLI is meant to implement agreed changes under BEPS project across the network of existing agreements without the need to bilaterally renegotiate each such agreement.
- The Convention therefore modifies all Covered Tax Agreements
- For the MLI to apply, both Contracting Jurisdictions have to be parties to the MLI. Kenya has not given any indications on being party to the MLI

BEPS Action 5: HTP

Countering Harmful Tax Practices More Effectively

- Requiring substance for all preferential regimes
  - » Link core income generating activities to the business income;
  - » IP core income generating activities- performance of R&D activities
  - » A proportionate approach: the amount of benefiting income depends on the proportion of R&D expenditure incurred by the benefiting taxpayer.
- Improve transparency, including compulsory spontaneous exchange of certain rulings
  - » Compulsory exchange of information between tax authorities on taxpayer specific rulings.
- Ongoing review of preferential regimes- IP regimes reviews

Changes in the Kenyan Law- Affecting International Tax



Changes in Kenyan Law

Taxation of a Branch/PE

- The definition of a PE is set to be expanded to include a warehouse, a farm or plantation, a sales outlet, supervisory activities in connection with a project site and provision of services through employees who are in Kenya for more than 91 days in a given year.
- A branch of a foreign company to be taxed in the same way as a local company. That's, @30% for taxable income up to KES 500 million; and @35% for income above KES 500 million.
- In addition to the corporate tax, a branch will also be required to pay a 10% tax on the repatriation income, which is 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.

Changes in Kenyan Law

Definition of control changed

- The definition of **"control"** has been expanded beyond holding of shares or voting rights in a company.
- In the case of holding of shares or voting rights, the threshold reduced from 25% to 20% shares or voting rights in the company. Other added aspects include
  - Advanced a loan of not less than 75% of the book value of the total assets of the other person excluding loans from unrelated financial institutions;
  - Has guaranteed a loan of not less than 75% of the total indebtedness of the other person excluding guarantees from unrelated financial institutions;
  - Is the owner of intellectual property, which the other person wholly depends on for the manufacture, processing or carrying out of business;
  - Supplies (by himself or by persons specified by him) 90% or more of the purchases of the other person and in addition influences the prices and other conditions related to the supply;
  - Influences atleast 90% of the sales of the other person or persons specified by the other person and the price and conditions relating thereto; and
  - Is deemed by the Commissioner to control the other person by any other form.

Changes in Kenyan Law

Limitation for the application of a double tax treaty

- The Bill proposes to expand the limitation for application of a double tax treaty and entirely exclude the below persons (in the other treaty partner state) from benefiting from a double tax treaty:
  - A person operating as a holding company;
  - A person providing overall supervision or administration of a group of companies;
  - A person providing group financing (including cash pooling); or
  - A person making or managing investments.
- This means that the DTA will not apply where a company is formed to just provide financing or administration support e.g. a shared service centre (SSC).

Changes in Kenyan Law

Transfer pricing changes

- Transparency: Where the tested party is a foreign entity, information shall be availed to the Commissioner upon request.
- Penalty of 2% of the value of the controlled transaction for failure to maintain contemporaneous TP documentation.
- Commodity pricing
- CbCR reports to be filed by each ultimate parent entity or a constituent entity (resident for tax purposes in Kenya)- 100B revenue limit.
- Capital rich and low function person entitled to no more than a risk-free return- (HTP)

Changes in Kenyan Law

Kenya India double tax treaty changes

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

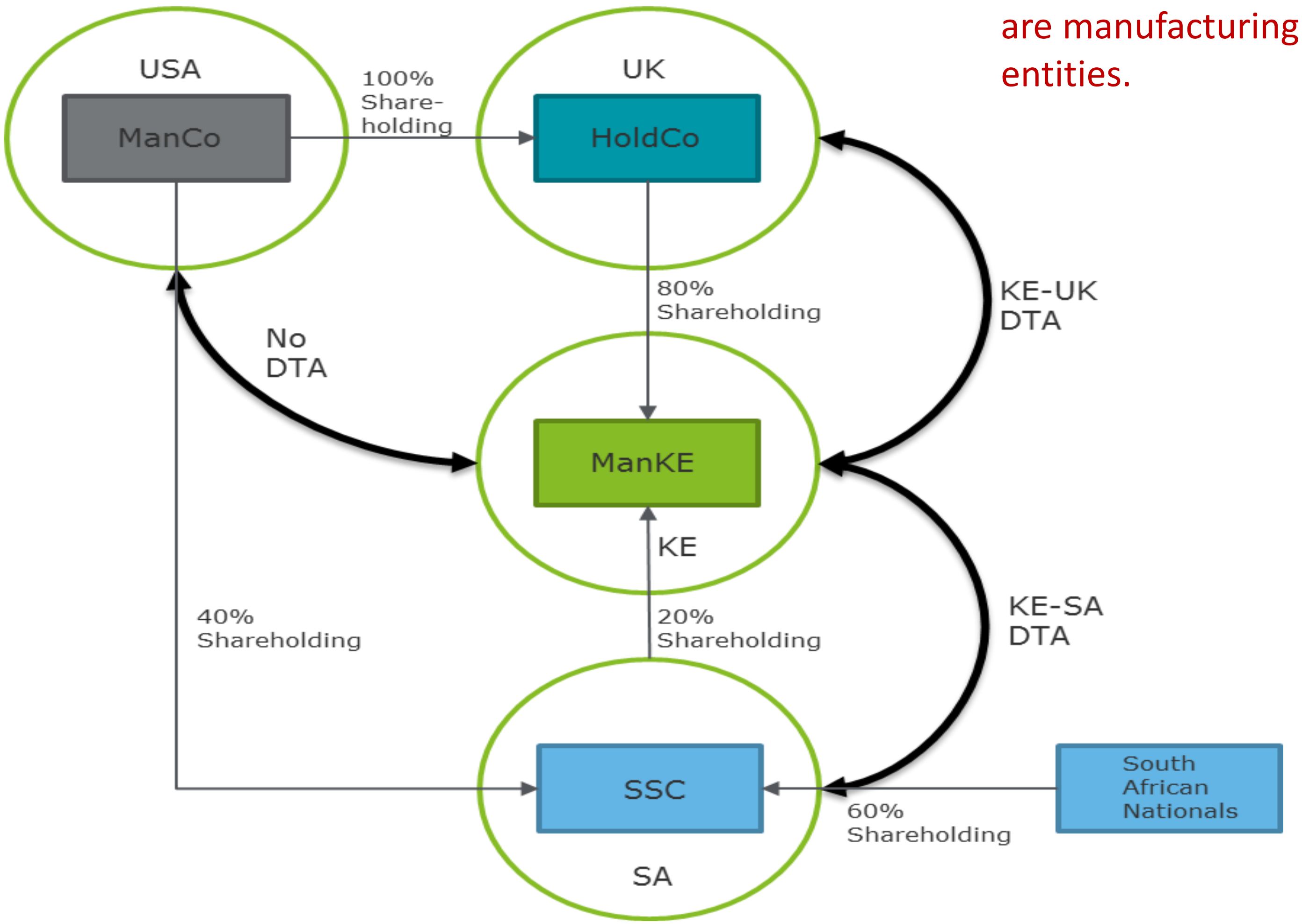
Issue	Change
Residency	Introduces the 'Place of incorporation' as a determinant for residency.
Permanent establishment	Expands the definition of a PE to include **sales outlets** and **warehouses** providing storage facilities for others. Additionally, services companies including consultancy firms will be deemed to have a PE after an aggregate of 90 days.
Business profits	Gives the contracting parties the right to limit the allowability of executive and general administrative expenses through domestic legislation. Similarly, the revised DTA expressly disallows head office expenses (royalties, patents, commissions and interest).
Limitation of Benefits	Gives contracting parties the right to use domestic legislation to address tax avoidance and evasion issues.
DTA guaranteed WHT rates	Reduces the applicable WHT rates in relation to certain payments.

Discussion

Discussion

Identify BEPS actions applicable and discuss impact on tax planning strategies

ManCo USA and ManKE are manufacturing entities.



Q & A

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