



# Safe Harbors & Hybrids in Tax Planning

## Presentation by:

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Friday, 1 January 2019

## Presentation Outline

- Double dips
- Withholding tax and DTAs
- Hybrid entities and structures
- Safe harbor
- Alternative dispute resolutions ADR
- Q & A Session

# Double Dips

# Double Dips - Introduction



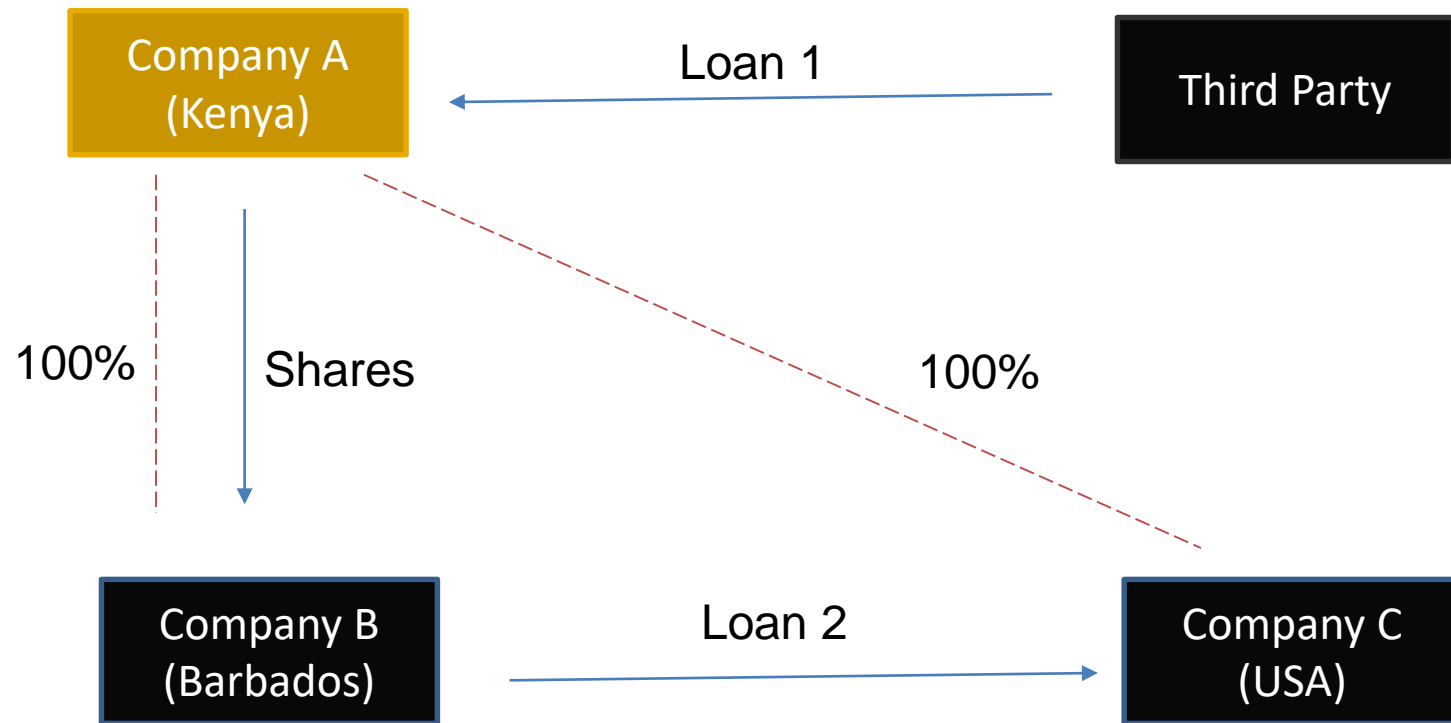
- Double dips are a type of hybrid financing structure whereby a company can take a tax credit for the same income twice.
- Double dip schemes exploit inconsistencies between countries tax laws while complying with the individual country's tax laws.
- Double dips mostly occur when tax deductions are taken in two different tax jurisdictions on the same loan, through intercompany financing arrangements.

# Double Dips - Example



- Company A, a company incorporated in Kenya, a high tax country, acquires a loan of \$275.
- Company A then invests the \$275 million in shares of its Barbados subsidiary (a low tax county).
- The Barbados subsidiary then loans the \$275 million to a United States subsidiary of A (A high tax country).

# Double Dips - Example



# Double Dips - Conclusion

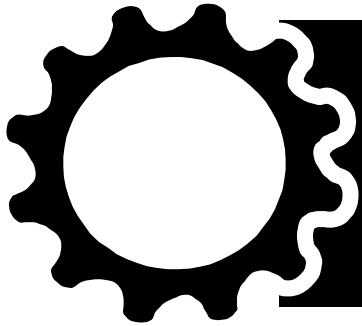


- From the financing agreement described, the group will receive double deduction for the same loan.
- They will receive an interest deduction in Kenya and in the USA. The loan amount will only be taxed in Barbados, a low tax jurisdiction.
- Group effective tax rate will be reduced.

# Withholding Tax (WHT) & Double Tax Agreements (DTAs)

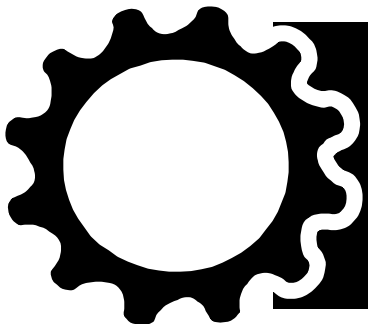
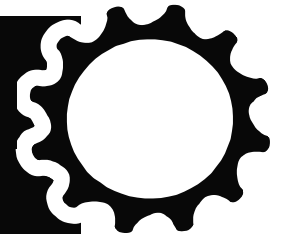


# WHTs



WHT is tax deducted at source on certain payments to both resident and non-resident persons on income from various sources.

Depending on the income source, WHT can either be a final tax or an advance payment.



We set out a highlight of WHT in Kenya in the next slides.

# Legal provisions



- Section 35 of the Income Tax Act (ITA) provides that every person shall deduct tax from certain sources of income including:
  - Interest, agency fees, dividends, royalties, management, professional and training fees;
  - Commissions;
  - Amounts withdrawn from registered pension or provident fund;
  - Payments to non-residents for the use or occupation of property; and
  - Winnings from betting and gaming

# WHT rates for payments made to residents



Nature of payment	Rate
Management or professional fees: (> 24,000) - Managerial, technical, agency, consultancy fees and Training fees	5%
Contractual fees: (>24,000) - Building, civil and engineering works	3%
Royalties - Software license	5%
Interest:	
Bank interest and other sources	15%
Bearer instruments	
- 2 years;	25%
- Beyond 10 years w.e.f 12.06.09	10%
Dividends: EA citizens (Uganda and Tanzania) are now considered Kenyan residents for purposes of WHT on dividends	5%

# WHT rates for payments made to residents



Nature of payment	Rate
Management or professional fees:	20%
Royalties - e.g. software licenses	20%
Dividends	10%
Contractual fees (building /civil/engineering)	20%
Rents: Real estate	30%
Interest	15%

# Double Taxation Agreements



- These are agreements between two nations that aim to avoid or eliminate double taxation of the same income in two countries.
- DTA's prescribe the state that shall have the taxing rights to a particular income.
- Further, the DTA's prescribe rates of tax that will be charged on members of the other contracting state.

# Double Taxation Agreements



- Kenya has the concluded DTA's with a number of countries and a number are in the pipeline under negotiation/ consideration

Country	Status	Entry into force
Canada	In-force	8 January 1987
Denmark	In-force	15 March 1973
France	In-force	1 November 2010
Germany	In-force	1 January 1980
India (Renegotiated)	In-force	13 July 2017
Korea	In-force	3 April 2017
Norway	In-force	10 September 1973
South Africa	In-force	1 January 2015
Qatar	In-force	25 June 2015
Sweden	In-force	28 June 1973

# Double Taxation Agreements



Country	Status	Entry into force
United Arab Emirates	In-force	22 February 2017
United Kingdom	In-force	30 July 1977
Zambia	In-force	1 January 1964
Signed but not yet in force		
China		
East Africa Community		
Italy		
Kuwait		
Mauritius		
Netherlands		
Seychelles		

# Double Taxation Agreements

Nature of payment	UK %	Germany & Canada %	Denmark, Norway Sweden Zambia %	India %	France %	South Africa % *	South Korea %	Qatar %	Iran %*	UAE %*
Management or professional fees	12.5	15	20	17.5	As business profits					
Royalties	15	15	20	20	10	10	10	10	10	10
Dividends	10	10	10	10	10	10	10	10	5	5
Interest	15	15	15	15	12	10	12	10	10	10
Pension	5	5	5	5	5	-	-	-	-	-
Entertainment sport and promotion	20	20	20	20	20	-	20	20	-	-
Rent(real estate)	30	30	30	30	30	-	-	-	-	-
Rent(Others	15	15	15	15	15		-	-	-	-



# Hybrid Structures

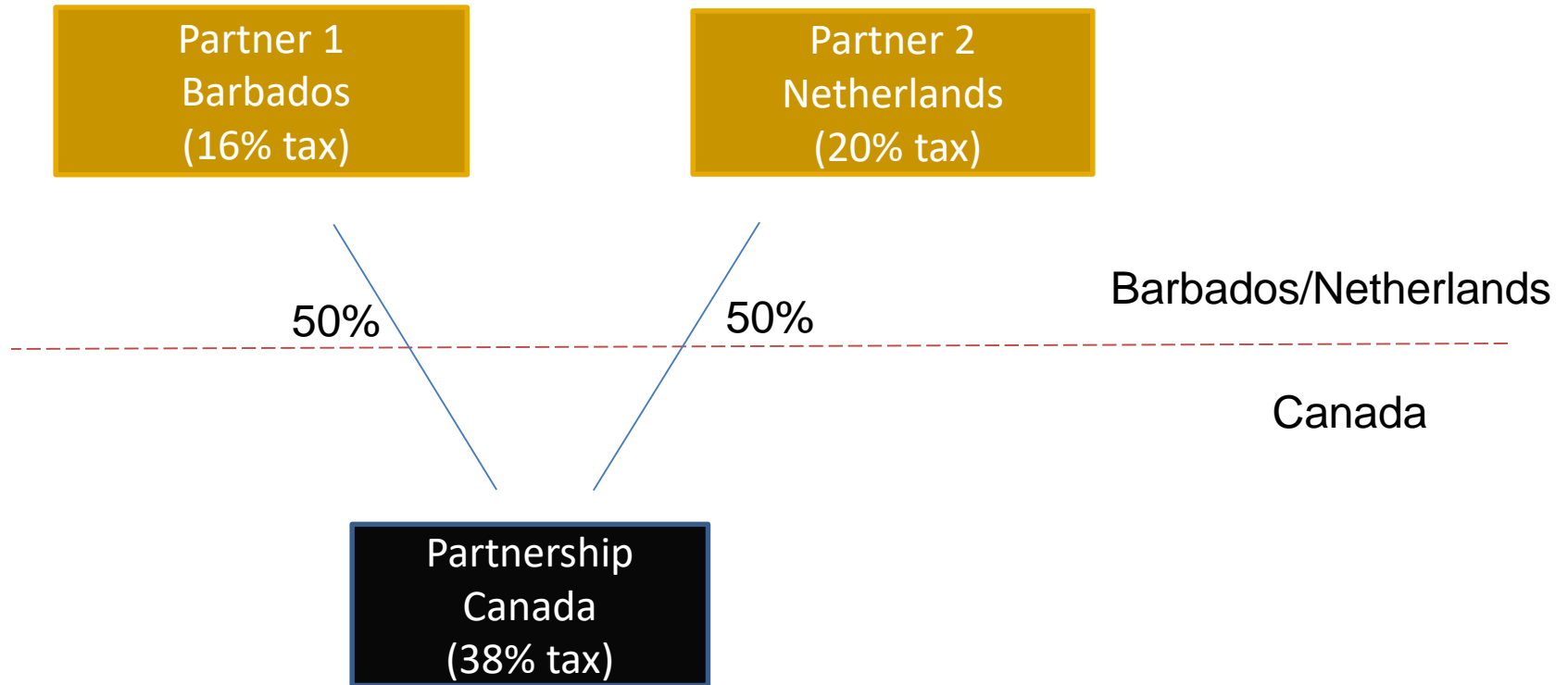
# Hybrid Structure - Introduction



## Hybrid entity

- A hybrid entity is a multinational company subjected to corporate income tax in one national jurisdiction that qualifies for tax transparent treatment in another resulting in significant tax savings.
- For example when a company is a partnership in one jurisdiction and a corporation in another.

# Hybrid Structure - Example



# Hybrid Structure - Example



- In Canada, partnerships are taxed on the individual partners.
- If the partners are corporates incorporated in lower tax jurisdiction countries, they will be subject to tax in their respective countries.
- Through this structure, an entity can realise a significant tax saving.

# Hybrid Structure - Example



- In Kenya however, Section 3(1) of the ITA states that tax derived from Kenya must be taxed in Kenya, whether a partnership or not. This will therefore not be relevant in Kenya.

# Hybrid mismatch



- Hybrid Mismatch is an arrangement:
  - ✓ intended to secure a tax advantage within a multinational group.
  - ✓ results from the difference in tax treatment of the same financial instrument or entity between different jurisdictions.
  - ✓ arises from both hybrid financial instruments and hybrid entities.

# Safe Harbors

# Safe Harbor - Definition



- A Safe Harbour is a provision in a law that affords a taxpayer protection from liability if they carry out a transaction in a certain way as approved by revenue authorities.
- Generally, safe harbours will provide circumstances under which the KRA will accept transfer prices declared by the taxpayer.



# Benefit of Safe Harbors



- It simplifies and reduces compliance costs-for qualifying controlled transactions.
- Provides certainty to taxpayers that the price charged or paid will be accepted by the tax administrations.

# Concerns over safe harbors



- May lead to taxable income being reported that is not in accordance with the arm's length principle.
- May increase the risk of double taxation or double non-taxation when adopted unilaterally.
- Opens avenues for inappropriate tax planning.
- May raise issues of equity and uniformity.

# Alternative Dispute Resolution

# Alternative Dispute Resolutions



- ☐ Below are the steps leading to Alternative Dispute Resolution:
  - i. Tax Decision
  - ii. Objection by Taxpayer
  - iii. Objection decision which should be done within 60 days
  - iv. Appeal to Tax Appeals Tribunal

# Alternative Dispute Resolutions



- ❑ The ADR Framework is a document which governs the ADR process in KRA.
- ❑ The objectives of the framework is to provide:
  - i. A taxpayer focused approach to dispute resolution.
  - ii. Internal structures to support tax dispute resolution through oversight,
  - iii. monitoring and management of the ADR processes.

# Alternative Dispute Resolutions



- i. Support for creation of a central database on tax disputes handled in
- ii. ADR to guide future dispute resolution for consistency.
- iii. Guidelines for the parties during the ADR discussions.
- iv. Timelines for resolving tax disputes so as to bring efficiency to the process.
- v. An additional approach for dispute management & resolution of tax disputes.

# Alternative Dispute Resolutions



## Features of the ADR framework

- **Suitability Test:** The Framework provides for factors to consider in assessing suitability of Cases for ADR. Not all disputes may be settled under ADR
- **Conduct:** ADR Discussions must be held within an environment of decorum, flexibility and parties must subscribe to standards of conduct and rules.
- **Timelines:** 90 days as in (Section 55 TPA Act).

# Alternative Dispute Resolutions



## Features of the ADR framework

- **Tribunal Court initiated ADR:** dependent on Court deadlines given
- **Documentation:** ADR discussions must be supported by relevant documentation.
- **Termination of Discussions:** Upon lack of cooperation by either party, conduct unbecoming of ADR discussions, mutual agreement to terminate.



# Thank You



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