



International Tax Workshop
Substance and cross-border Tax
Planning
Presentation by:

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Presentation agenda



☐ Introduction

☐ Substance

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☐ Tax Planning

☐ Global Measures

☐ Kenyan Legislation.

Substance?



SUBSTANCE

FORM

Substance over form is an accounting concept which means that the economic substance of transactions and events must be recorded in the financial statements rather than just their legal form in order to present a true and fair view of the affairs of the entity.

The expression 'substance' does not normally appear in the actual text of tax treaties but has been equated to economic substance. Without so-called 'economic substance' the tax authorities could ignore your carefully planned and tax optimized structure and your company could lose the benefits offered by treaties for the avoidance of double taxation.

Determining Substance



- There, a number of tests to determine substance such as 'residency',
- 'beneficial ownership', ‘
- 'qualifying persons',
- ‘ Treaty Shopping’
- 'base erosion' and
- increasingly anti-avoidance articles such as a 'general purpose' tests.
- In addition, modern tax treaties increasingly contain a 'general anti-avoidance rule' (GAAR).

International Tax Planning



Every company's strategy is to maximize shareholders value using techniques such as;

a) No/reduced tax in the state of investment using

- No physical presence
- Maximize deductible expense
- Transfer pricing
- Global Value chain structures

b) No/reduced tax on cross border profit migration using;

- No WHT on income payments
- No Tax on transfer of profit drivers-restructuring by moving assets/risks

International Tax Planning



- c) Reduce tax at the Ultimate parent using
- Holding companies and
- double tax treaties

International Tax Planning ...



Divert	<ol style="list-style-type: none">1. Business restructuring/transfer of ownership of intellectual property-Functional and risk remuneration (routine functions-low return)2. Use of PE/Business profit provisions in the DTA:<ul style="list-style-type: none">•Commissionaires•Limited risk distributor•Warehousing
Deduct	<ol style="list-style-type: none">1. Double deduction of expenses, Non deduction of WHT and non-inclusion as taxable income.2. Use of Low/no WHT in the DTA (Dividends, Management fees, Interest and Royalties)
Defer	<ol style="list-style-type: none">1. Use of a holding company in a low tax jurisdiction or2. Country with favorable treaty networks

Substance; Global Approach



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.

The Action addresses mismatch in tax outcomes due to entity characterization or debt/equity characterization.

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 6:



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.
- **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 7



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:**.
- **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

BEPs Action 8-10



This targets "cash-boxes" such as,

- Capital-rich entities without any other relevant economic activities Seen as primary cause of BEPS for Transfer pricing purposes.
- Value creation has to be aligned activity consistent with the ALP.
- Cash-boxes are likely to be eliminated
- Risks should be allocated between parties using the same delineation of the actual transaction approach.

BEPs Action 13; Country –by– Country Reporting.



It is a three-tiered standardised approach to transfer pricing documentation. This standard consists of

- (i) a master file containing standardised information relevant for all MNE group members;
- (ii) a local file referring specifically to material transactions of the local taxpayer; and
- (iii) a Country-by-Country Report containing certain information relating to the global allocation of the MNE group's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

Local legislation and Substance



Taxation of a Branch/PE

- The definition of a PE includes agency PE.
- Payments made by a PE to head office not subject to WHT only if treated as a non deductible expense for the branch.

Thin capitalization Rules;

The use of Ratio method for Extractive as well as other Sectors. Sec 16(2)(j).

Q&A

