

PRINCIPLES OF TAX PLANNING

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Presentation agenda



- ☐ General principles of taxation, revisited
- ☐ What is tax planning
 - ☐ Tax avoidance vs. Tax evasion
- ☐ Types of tax planning structures seen around
- ☐ Responses by governments to tax planning

General principles of taxation



General principles in tax planning



- ❑ Basis of any taxation, and therefore tax planning:
 - ❑ Tax (income, VAT) is payable by any person, except where the tax provisions exclude the charge.
- ❑ Tax planning is still pegged on the old as well as the newly added principles of taxation, but specifically the following:
 - ❑ Certainty: taxpayers should not be subjects to the arbitrariness and discretion of the tax officials.
 - ❑ Economy: that the cost of collection tax should be the minimum possible both to the government and the taxpayer.
 - ❑ For tax planning – does the cost you pay to advisers, setting up structures justify the tax savings, short-term, long-term
 - ❑ Other cost considerations? Reputational risk

General principles in tax planning



☐ Flexibility:

- ☐ It should be possible for tax authorities without undue delay, to revise the tax structure, both with respect to its coverage and rates, to suit the changing requirements of the economy and of the Treasury.
- ☐ Similarly, the taxpayer should be able to easily revise its tax planning structure when need arises

☐ Simplicity: just as the tax system should not be too complicated, so shouldn't the tax planning structures - should be easy to understand, administer and not breed problems of interpretation and legal disputes.

Tax planning



What is tax planning?



- ❑ Tax planning:
 - ❑ Legally structuring one's affairs to pay the least amount of tax possible

“Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then however unappreciative the Commissioners of Inland Revenue or his fellow-taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.”

Duke of Westminster v IRC [1936] AC 1–19

What is tax planning?



Tax avoidance or tax evasion?

- ☐ Tax evasion – illegal
 - ☐ failing to pay tax that is legally due,
 - ☐ failing to report assessable income,
 - ☐ improperly claiming deductions contrary to Tax statutes:
 - ☐ Not incurred; or
 - ☐ Not deductible.
 - ☐ Claiming input credits for goods that VAT has not been paid on
 - ☐ Non-remittance of PAYE that have been deducted from staff wages and salary
 - ☐ Failing to lodge tax returns in an attempt to avoid payment.

What is tax planning?



- ☐ Signs of tax evasion -
 - ☐ Not being registered for VAT despite exceeding the threshold
 - ☐ Not charging VAT at the correct rate
 - ☐ Non-issuance of tax receipts upon sale
 - ☐ Providing false invoices
 - ☐ Using a false business name, address, or taxpayers identification number (TIN) and VAT registration number
 - ☐ Keeping two sets of accounts, and
 - ☐ Not providing staff with P9

What is tax planning?



- ❑ Tax planning involves tax avoidance or the reduction of the tax incidence.
- ❑ Do everything **legally** possible to reduce your tax bill.

“There is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible as nobody owes any public duty to pay more than the law demands.

Learned Hand (An American Judge)

Tax planning techniques



Deferral



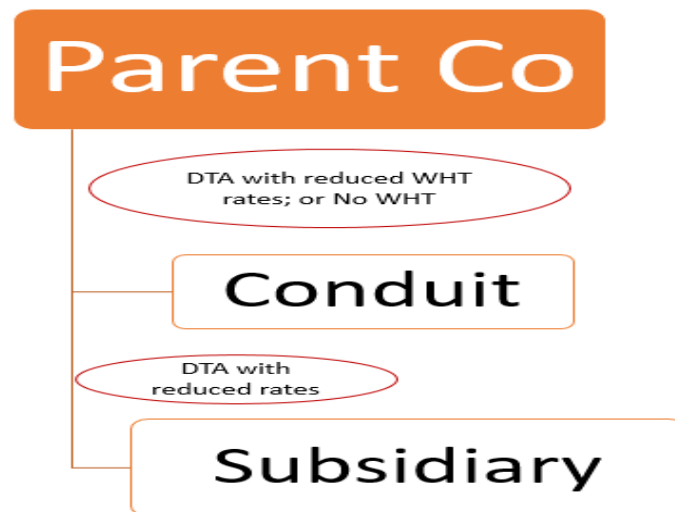
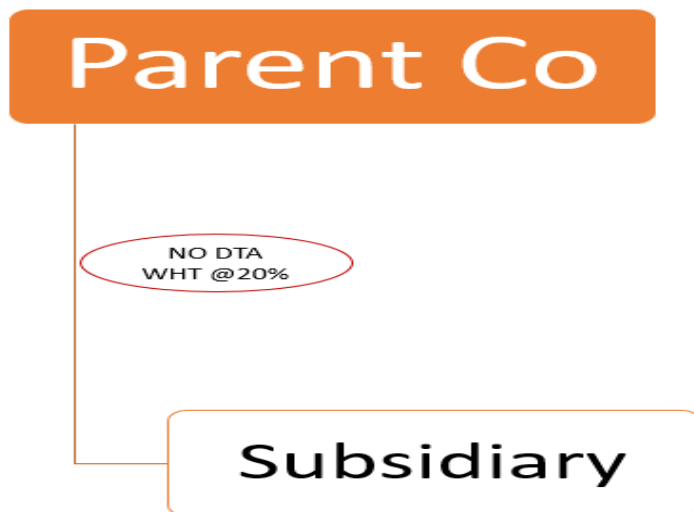
- ☐ Defer in claiming a deduction in ascertaining taxable income
- ☐ Deferral input VAT (6 months within which to claim credit)
- ☐ Deferral in payment of dividends
 - ☐ Use of intermediary Hold Co in a country with DTA with KE
 - ☐ Counter-measures:
 - ☐ Non- distribution - Section 24 of the Income Tax Act
 - ☐ General anti-avoidance provisions - Section 23

Equity vs Debt financing



- ☐ Use of Debt as a means of financing entities
 - ☐ Interest is a deductible expense (vis-à-vis dividend)
 - ☐ Financing not from Parent/Hold Co, use a low tax Treasury co.
 - ☐ Interest at low WHT rates (if DTA exists)
 - ☐ Interest income: no or low rate of tax in the receiving countries
- ☐ Counter-measures:
 - ☐ Thin Cap. Rules
 - ☐ Anti-treaty shopping rules – substance vs. form; BO
 - ☐ Transfer Pricing cons.
 - ☐ General anti-avoidance provisions - Section 23

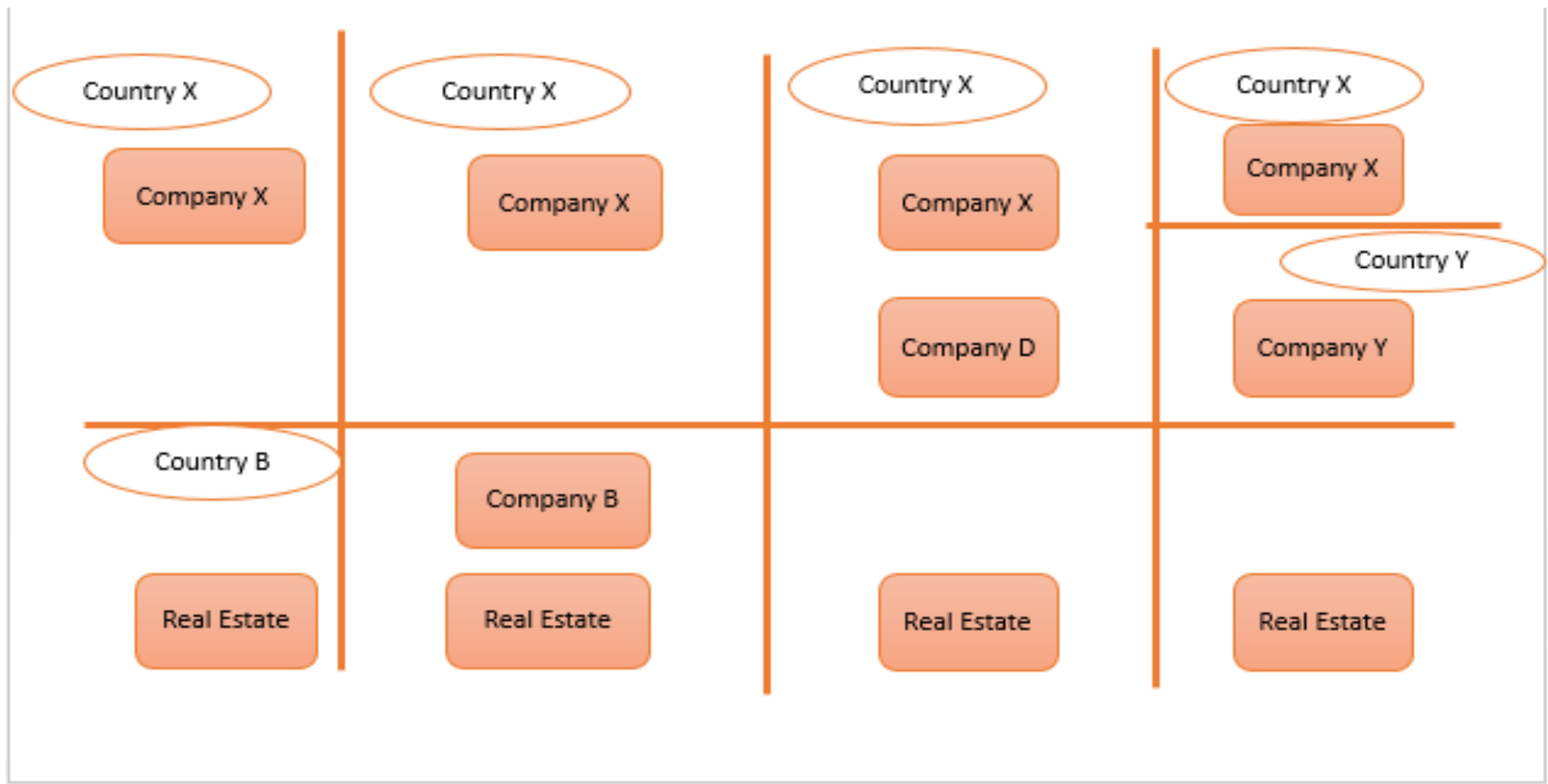
Withholding tax planning



❑ Counter-measures:

- ❑ Local GAARs
- ❑ Anti-treaty shopping rules – substance vs. form; BO
- ❑ CbCR
- ❑ Harmful Tax practices

Indirect transfer of assets



Indirect transfer of assets



- ❑ Mostly used by: Telecommunication Companies, Extractive industries and financial businesses
- ❑ Direct transfer of the assets or local company holding the real estate – subject to CGT
- ❑ Use of intermediate companies with countries with DTA
 - ❑ Anti-treaty shopping rules – substance vs. form; BO
 - ❑ Harmful Tax practices
- ❑ Zain Case in Uganda, transfers happening in the Netherlands: Ruled in favor of URA (approx. US\$85m)

Tax avoidance counter-measures



Capped deductions



- ☐ Interest Expense
 - ☐ Fixed ratio
 - ☐ Thin Cap ratio – 3:1
 - ☐ EBITDA
 - ☐ Calculate the EBITDA for an entity
 - ☐ Apply a fixed rate as prescribed in the local law to the EBITDA
 - ☐ Transfer pricing
 - ☐ Excess interest:
 - ☐ Fully disallowed
 - ☐ Carried over to other periods

Capped deductions



- ☐ Management / Technical fees
 - ☐ Use of arm's length principle (ALP) – the benefit test
 - ☐ Services rendered? No duplication
 - ☐ At what cost?
 - ☐ Benefit to the recipient?
 - ☐ Remuneration
 - ☐ Pegged as a percentage of Total revenue

Capped deductions



- ❑ Royalties
 - ❑ Use of arm's length principle (ALP) – DEMPE analysis
 - ❑ Development, Enhancement, Management, Protection and Exploitation
 - ❑ Prior approval by the Central Banks (for forex purposes)

Offshore indirect transfers



- ☐ Is there reasonable commercial purpose or economic substance of the intermediate holding company
- ☐ Offshore indirect transfers
 - ☐ Bilateral – MLI / DTA renegotiations
 - ☐ Unilateral changes in Law -
- ☐ Restrictions on treaty entitlement
 - ☐ The Principle Purpose test - Substance of the transaction
 - ☐ Beneficial ownership – treaty residence and substance

EU related measures



- ☐ Listing (black-listing) of non-cooperative jurisdictions for tax purposes, based on
 - ☐ Tax transparency
 - ☐ Fair taxation
 - ☐ Implementation of BEPS measures
- ☐ Economic substance requirements
 - ☐ Management
 - ☐ Meetings by BOD held on location, no. of those meetings
 - ☐ BOD with relevant knowledge and experience to make decisions

Other measures targeting tax avoidance – Kenya's angle



- ❑ S.23 of ITA: Transactions designed to avoid tax liability – in the opinion of the Commissioner
 - ❑ S. 85 of the TPA - Penalty under– double the amount of tax avoided
 - ❑ S 92 of TPA – offences by tax agent – for assisting a taxpayer to create a tax avoidance scheme **or abets / aides a taxpayer to evade tax**
- ❑ S.24 of ITA: avoidance of tax liability by non-distribution of dividends

Other measures targeting tax avoidance – Kenya's angle



- ❑ S. 41A of ITA: exchange of Information Agreements (EOI)
- ❑ S. 41 (5) of ITA – Limitation of Benefits - Beneficial Owner of the payments under a Double Taxation Agreement

Wrap up



Is it tax avoidance or evasion?



- ☐ Tax evasion has a negative impact on our tax system.
 - ☐ Significant loss of revenue to the Governments.
 - ☐ Perpetrators gain an unfair advantage in a competitive market
 - ☐ Others do not meet their fair share of tax obligations.
- ☐ As a result, the burden of tax not paid by tax-evaders falls on other law abiding taxpayers.

Wrap-up



- ❑ Tax planning is no longer straight as an arrow
 - ❑ Be aware of the context in which the transaction is being structured
 - ❑ Be aware of the anti-avoidance measures both at global (BEPS) and local jurisdictions
- ❑ Multi-disciplinary team to evaluate the structure: legal, accounting, PR
- ❑ Certainty
 - ❑ Seeking rulings from the local tax office (where possible) before implementation
 - ❑ If caught, consider ADR (to save face from publications in the media)

Questions



THANK YOU

