

International Tax and Transfer Pricing Planning: Focus on Tax Treaties

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Mischief between Treaties and TP



Tax Treaties

- Provide a relief for tax
- For member states
- Provides for tax on various levels of income
- Provide for exchange of information

Transfer pricing rules

- Provide for taxation
- TP rules apply to all entities operating in a multinational scale
- Provides for tax on income at profit level

Both are provided for under the Income Tax Act
Cap 470 Laws of Kenya

Global Tax Planning



Some cases globally using international tax planning to reduce tax

- MIL Investments SA vs HMQ Tax Court of Canada- exemption from capital gains – Change of residence to use Luxemborg- Canada Treaty
- GlaxoSmithKline Inc – Minimization of withholding tax on dividends royalties through Netherlands treaty by moving shareholding and patents for royalties
- Prevost Car Inc minimization of withholding tax payable on dividends 5% from 10%

International leniency by courts to literal meaning against purposive interpretation

BEPS and Treaties



Genesis

- In 2012 a project through OECD was initiated by the G20 to assist in prevention of aggressive tax measures by corporates to erode revenue created and thereby shift profits
- Based on increased political discussions that corporates needed to pay their “fair share” of taxes

Common Reporting Standards



➤ OECD Convention on Mutual Administrative Assistance in Tax Matters

Finance Bill changes to include Country by Country Reporting with disclosures such as revenue, taxes paid, number of employees, accumulated revenue and assets

Assist with information to better improve KRA TP audits

Double Taxation Agreements



DTAs are agreements negotiated between countries or jurisdictions to provide for reciprocal rights of a territory with respect to taxation.

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

What are the objectives of DTA's?

- Eliminate double taxation;
- Encourage exchange of tax information;
- Promote foreign direct investment; and
- Provide avenues for dispute resolution

Effect of Capital vs Taxing needs

Source of DTAs



DTAs are based on model laws:

1. OECD Model Laws on Tax Convention
2. UN Model Double Taxation Convention
3. United States Income Tax Convention

Parties to the DTA then localize the DTAs depending on objectives

DTA Authority



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 DTA's

DTA Authority



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

- Domestic legislation implementing Article 2 (6) Constitution of Kenya, 2010.
- Provides the treaty entering, ratification and enforcement process.

Income Tax Act, 2014

- Section 41 – seeks to implement DTAs in domestic legislation.

How DTA's Work



DTAs typically eliminate double taxation through two major approaches

The exemption method:

The State of residence **does not tax the income** which according to the DTA may be taxed by the Source State or PE/Fixed Base

The credit method:

The State of residence calculates its tax basis of the taxpayer's total income including the income from the other State.

It then **allows a deduction from its own tax** for the tax paid in the other State

Concluded DTAs



UK	LN 14 of 1973
Germany	LN 20 of 1980
Canada	LN111 of 1987
Denmark	LN 5 of 1973
Norway	LN 6 of 1973
Sweden	LN 14 of 1973
Zambia	LN 10 of 1970
India	LN 61 of 1989
France	LN 140 of 2009
South Africa	LN 141 of 2014
South Korea	LN 218 of 2016
UAE	LN 218 of 2016
Iran	LN 60 of 2014
Qatar	LN 59 of 2015
Seychelles	LN 5 of 2015
Mauritius	LN 173 of 2019

Awaiting ratification

- EAC
- Kuwait
- Italy
- Netherlands
- Turkey

DTA Rates



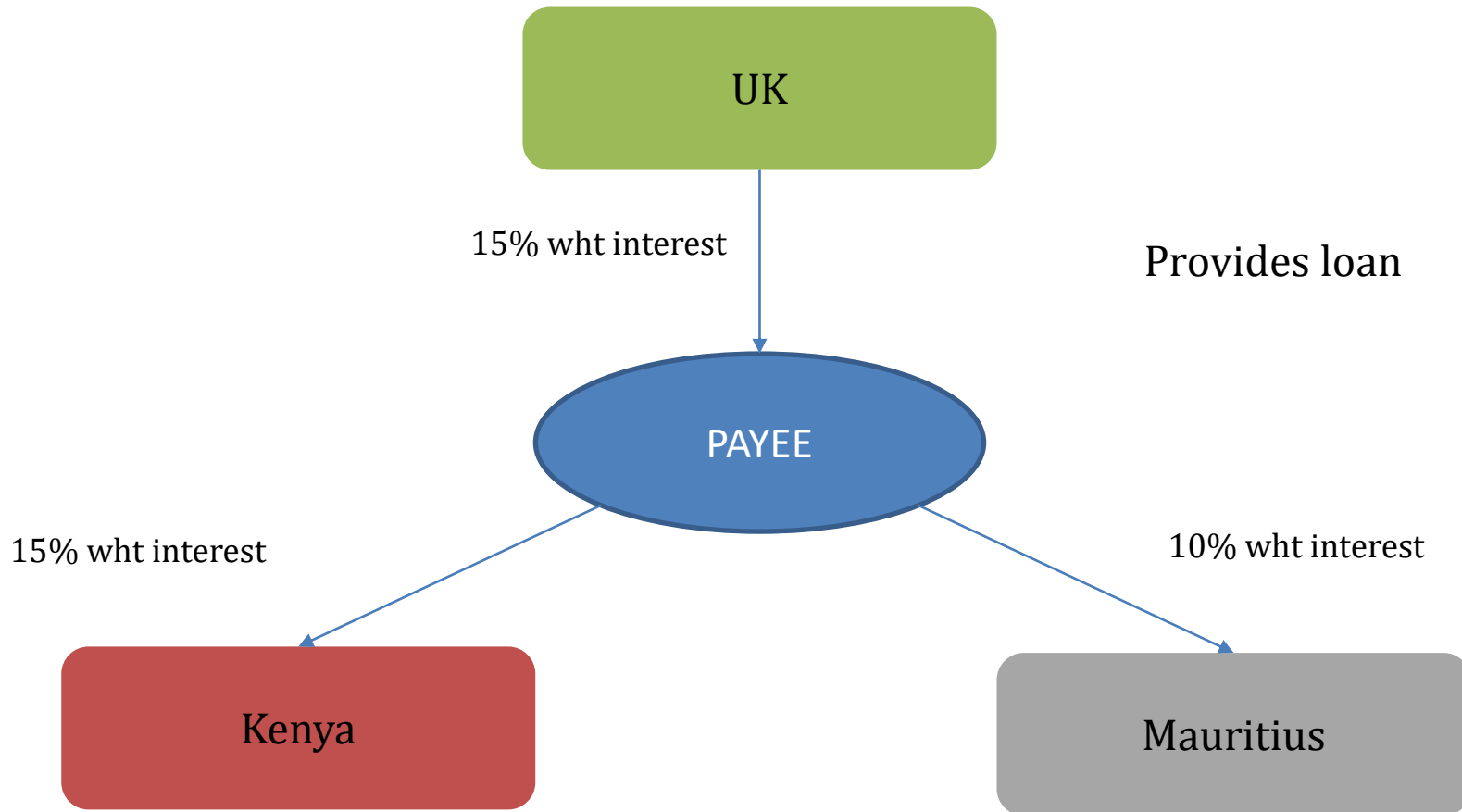
	Management fees (Company)	Dividends	Royalties	Interest
UK	12.5%	10%	15%	15%
Germany & Canada	15%	10%	15%	15%
Denmark Norway Sweden Zambia	20%	10%	20%	15%
India	10%	10%	10%	10%
France	0%/20%	10%	10%	12%
Mauritius [^]	0%/20%	5%*	10%	10%
South Africa	0%/20%	10%	10%	10%
South Korea	0%/20%	10% α	10%	12%
UAE	0%/20%	5%	10%	10%
Iran	0%/20%	5%	10%	10%
Qatar	0%/20%	10% ^π	10%	10%
Seychelles	10%	5%	10%	10%

Mauritius DTA



Particulars	Rates as per DTA and Protocol (%)	Non-Resident Tax Rates in Republic of Kenya (%)	Non-Resident Tax Rates in Republic of Mauritius (%)
Dividends	8	15	Exempt
Interest	10	15	Exempt / 15
Royalties	12	20	15
Technical fees	10	20	10
Capital gains on sale of shares	0 / 5	5	Exempt

Treaty Shopping



Domestic vs International Law



Income Tax Act, 2014

- Section 41 (5) – Limitation of Benefits clause.
- Seeks to limit the application of DTA in domestic legislation. •

Hierarchy of Laws

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

DTAs Post-2010

- Some post-2010 (Kenya India DTA) – expressly note that DTA 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”.*

Resident



2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- (a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him ; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests) ;
- (b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode ;
- (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the Contracting State of which he is a national ;
- (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

Company

Place of effective
management

Management fees vs Business Income



ARTICLE 7

BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other Contracting State but only so much of them as is attributable to that permanent establishment.

Management fees?

ARTICLE 14

INDEPENDENT PERSONAL SERVICES

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

KRA interprets
as “other fees”

Mutual Agreement Procedures



Article 25

Mutual Agreement Procedure

1. Where a person considers that the actions of one or both of the Contracting States result or will result for that person in taxation not in accordance with the provisions of this Agreement, that person may, irrespective of the remedies provided by the domestic law of those States, present a case to the competent authority of the Contracting State of which the person is a resident or, if the case comes under paragraph 1 of Article 24, to that of the Contracting State of which the person is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Agreement.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Agreement. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Agreement. They may also consult together for the elimination of double taxation in cases not provided for in the Agreement.

Exchange of Information



Article 26

Exchange of Information

1. The competent authorities of the Contracting States shall exchange such information as may be necessary for carrying out the provisions of this Agreement or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions in so far as the taxation thereunder is not contrary to the Agreement, in particular for the prevention of fraud or evasion of such taxes. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

The competent authorities shall, through consultation, develop appropriate conditions, methods and techniques concerning the matters in respect of which such exchanges of information shall be made, including, where appropriate, exchanges of information regarding tax avoidance.

Assistance in the Collection of Taxes



Assistance in the Collection of Taxes

1. The Contracting States shall lend assistance to each other in the collection of revenue claims. This assistance is not restricted by Articles 1 and 2. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article.

2. The term “revenue claim” as used in this Article means an amount owed in respect of taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, in so far as the taxation thereunder is not contrary to this Agreement or any other instrument to which the Contracting States are parties, as well as interest, administrative penalties and costs of collection or conservancy related to such amount.

3. When a revenue claim of a Contracting State is enforceable under the laws of that State and is owed by a person who, at that time, cannot, under the laws of that State, prevent its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purposes of collection by the competent authority of the other Contracting State. That revenue claim shall be collected by that other State in accordance with the provisions of its laws applicable to the enforcement and collection of its own taxes as if the revenue claim were a revenue claim of that other State.

McKinsey vs CDT



Tax Appeal no 199 of 2020:

Dispute on KES 180mil withholding tax on management fees.



Facts

- Operates as a branch of an SA company.
- Kenyan branch paid management fees to SA head office
- KRA claiming professional fees not addressed in DTA
- Taxable under S35(1)
- Art 7 of the DTA on business profits
- Previous DTAs had Art 14 on management or professional fees

Ruling

- ITA defines business to include professional services as provided by SA
- Professional services to be taxed under Art 7
- Thus right to tax falls with SA
- KRA failed to establish that the SA entity hadn't formed PE in Kenya

TJNA vs KRA



Petition no 494 of 2014:

Dispute on Mauritius Treaty.



Issues

- Preferential rates given to Mauritians are better than Kenyan residents
- Enacted without due regard to constitutional provisions
- Approvals by Cabinet and Parliament not done
- Not subjected to public participation

Ruling

- Legal Notice 59 of 2014 was not tabled before parliament in accordance with S 11 of the Statutory Instruments Act of 2013 and therefore void
- Legal Notice 179 of 2019?



Thank You

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