Treaty watch: Kenya South African, EAC, South Korea & Kuwait DTAs

Introduction

Kenya has recently ratified its Double Tax Agreements ("DTAs") with South Africa, the East African Community (ñEACò), Kuwait & South Korea.

DTAs are agreements negotiated between countries or jurisdictions to outline the rights of a territory with respect to taxation of specific types of incomes. The main aim of a DTA is to eliminate double taxation of income and capital and curb tax avoidance and evasion. They also serve to enhance capital import and export neutrality and hence encourage cross-border investments. DTAs accomplish this by indicating which country has the right to tax a specific income between the source and the resident state; and/or the process of alleviating the double taxation.

Below is a discussion on the salient issues regarding each of the DTAs.

1. Kenya's DTA with South Africa

1.1. Signing of Treaty

Kenya signed its DTA with South Africa on November 26, 2010.

1.2. Commencement of the treaty

South Africa ratified the treaty on May 24th, 2011 but Kenya did not ratify the treaty until October 10, 2014. The Kenyan ratification was gazetted through Legal Notice 141 of 2014.

Given that the treaty now has the force of law in both States, it is anticipated that its provisions will apply to taxation matters between the two States as from January 1, 2015.

1.3. Crucial Treaty Provisions

a. Reduced Withholding Tax Rates

The Kenya Income Tax Act Cap. 470 (ñITAò) imposes withholding tax at the rate of 20% on royalties, 10% on dividends and 15% or 25% on interest payments made to non-residents. Withholding tax has been capped at 10% of the gross payment in instances where dividends, interest or royalties are paid to South African residents.

b. Removal of Source Taxation of Independent Personal Services

Under the Kenyan ITA, any payments made to non-residents with respect to management services are subject to withholding tax at 20%. The Kenya-South Africa DTA provides that income derived by an ***individual*** who is a resident of a Contracting State in respect of independent personal services is taxable only in the State of his/her residence unless he or she meets the residency criteria in the other contracting state.

This has the implication of barring imposition of Kenyan withholding tax on payments made to South African resident individuals providing professional services & vice versa.

c. Exemption from Taxation of Visiting Professors, Teachers and Researchers

Ideally, professors, teachers and researchers are subject to similar rates of personal taxation as individuals in employment or self-employment. However, the Kenya-South Africa DTA provides for exemption of visiting professors, teachers and researchers from local taxes in a Contracting State. Notwithstanding, there are prerequisite conditions that must be met.

These provisions will encourage pedagogical and research-based partnerships.

d. Non-Discrimination Provisions-Resident Rates to apply to PEs

The DTA contains non-discrimination provisions which are tailored to ensure that there is no fiscal discrimination between nationals of either Contracting State who are residing in the other Contracting State.[1]

[1] See Art, 24 of the Kenya-South Africa DTA.

To this end, nationals of one state who are resident in the other are not to be subjected to more burdensome taxation than that which nationals of the latter State in the same circumstances would be subjected.

Similarly, it provides that a permanent establishment which an enterprise of one Contracting State has in the other Contracting State should not be subjected to less favourable taxation than is levied on enterprises of that other State carrying on the same activities. This has the implication that PEs of South African companies operating in Kenya ought to be taxed at 30% as opposed to the 37.5% foreign rate which would constitute discrimination.

e. Alleviating Double Taxation

Double taxation will be alleviated in instances where a single item of income is subject to tax in both contracting states. This will be effected in a contracting state by deducting the tax paid in the other country from the tax payable i.e. the credit method.

2. The East African Community DTA

The key object of this treaty is to avoid double taxation and prevent fiscal evasion with respect to taxes. The signatories to this treaty are Kenya, Uganda, Tanzania, Rwanda and Burundi.

2.1. Signing of the Treaty

This treaty was signed by the EAC Partner States on November 30, 2010.

2.2. Commencement of the treaty

Before the treaty can come into force, each of the five contracting states must complete the procedures required for treaty enforcement by their respective laws. Thereafter, they are to notify the other contracting states of the same. Once the last of the five partner states has given such a notification, the agreement will enter into force and shall be applicable with respect to any income with effect from the first day of January of the following year.

Rwanda was the first contracting State to ratify this treaty on June 7, 2012. Kenya's ratification in October 2014 (vide Legal Notice 142 of 2014) has been the second. We continue to await the treaty's ratification by the other EAC States, failure to which Kenya and Rwanda will remain unable to benefit from the favourable provisions of the treaty they have ratified.

3. Kenya - South Korea DTA

3.1. Signing of Treaty

The treaty was signed in Nairobi on 8th July 2014.

3.2. Commencement of the treaty

The treaty is not yet in force. The treaty will enter into force upon the exchange of ratification instruments with South Korea.

Currently the Kenyan Government on October 30th 2014, approved for the treaty ratification. The Kenyan ratification process will be completed when Parliament passes the law for ratification and it is assented to by the President.

4. Kenya - Kuwait DTA

4.1. Signing of Treaty

The treaty was signed on November 12 2013 in Kuwait City.

4.2. Commencement of the treaty

The treaty is not yet in force. It will enter into force after the two countries exchange ratification instruments.

The Kuwait Cabinet on June 3rd 2014 approved a Bill that would ratify the signed treaty. Kenyan ratified the treaty on October 31st.

4.3. Crucial treaty provisions

The treaty provides for a maximum rate of 5% for dividends & 10% for interest & royalty payments.

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