Issue 1009

Kenya & UAE Double Tax Agreement

Kenya has taken significant steps towards enhancing her tax system in line with modern times and the dynamic international tax landscape. In this regard, we endeavor to keep you updated on the prevailing changes and amendments to the various tax laws and practices affecting business operations in this region.

In exercise of the powers conferred by Section 41 of the Income Tax Act, the Cabinet Secretary for the National Treasury has recently ratified the double taxation treaty between Kenya and the United Arab Emirates by way of Legal Notice 218 of 2017.

The UAE has a liberal taxation system offering lucrative tax incentives to resident, foreigners and multi-national corporations making it a global business centre and a strategic business partner for Kenya.

Significant among these incentives are no corporate or income tax (with the exception of oil and gas companies and subsidiaries of foreign banks), no personal income tax, no withholding taxes, tax free zones amongst other tax benefits.

The double taxation agreement is a noteworthy development towards enhancing the countries' tax systems and strengthening economic relations between the two economies.

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We have summarized below the key provisions of the Kenya UAE DTA:

Residence

The residence status in the case of dual resident entities shall be the place of effective management.

In the case of a dual resident individual, the tiebreaker clause will be mutual agreement between the competent authorities of the contracting states.

Permanent establishments

The definition of a Permanent Establishment (PE) under this treaty is based on a combination of OECD model indicative list of a PE and the UN model provisions.

Article 5 defines a PE as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

A PE similarly encompasses:

- A building site or construction, assembly project and supervisory activities in connection to a drilling rig used for exploration of natural resources project if the project activity lasts for more than 6 months;

- The furnishing of services, including consultancy services, by an enterprise in the other contracting country through its employees or personnel for a period aggregating more than 4 months within any 12-month period; or

In the absence of a fixed base, a dependent agent that habitually exercises the authority to conclude contracts on behalf of the enterprise or maintains a stock of merchandise from which he regularly delivers on behalf of the enterprise.

A PE is deemed to exist when a non-resident insurance enterprise collects premiums or insures risks in the source country, other than through an independent agent.

The UAE is a hub for Multi National Enterprises (MNE). It is anticipated that MNEs will extend their networks to Kenya through Permanent establishments as part of the UAE's economic diversification efforts.

The Kenyan Revenue Authority (KRA) has been particularly diligent in scrutinizing the tax affairs of PEs. Further to the provisions outlined in the DTA, it is important for PEs to substantiate where economic value in the value chain is created to mitigate against potential tax risks.

Taxation of income from hydrocarbons

The treaty categorically states that domestic tax laws and regulations will apply with regards to taxation of income derived from hydrocarbons and its associated activities.

This is an indication of the intent of the treaty partners to resolutely protect the profits derived from their valuable hydrocarbon resources.

Taxation of immovable property

Income derived by a resident of a contracting state from immovable property will be taxed in the state in which the property is situated.

A notable highlight is a 50% reduction in the tax chargeable will be enjoyed where the beneficiary of the income derived is the state itself, county government, local authority, political subdivision or local financial institutions fully owned by the government.

The definition of immovable property for this purpose is as outlined in the domestic laws of the treaty states. Ships and aircraft are not regarded as immovable property.

Business profits

The profits of a company shall be taxable only in the country where the company is resident unless the enterprise operates a PE in the other state.

The treaty embodies the Arm's Length Principle, in line with normal international tax practice, in determining the profits attributable to a PE.

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Business profits

The profit attributable to a PE shall be the profits the PE is expected to make if it were a distinct and separate enterprise, dealing wholly and independently with the Head Office and operating under conditions prevailing in the regular market.

The treaty affirmatively allows for the deduction of executive and general administrative expenses charged by the PE to the head office of the enterprise or its affiliates in determining the taxable income of an enterprise.

It also further allows for the deduction of interest expenses on money borrowed from the head office of the enterprise or its affiliates in determining the taxable profits of a PE.

Royalties, commissions and management fees charged to the PE by the head office or its affiliates are however not claimable as an expense when ascertaining the taxable income.

The provision expressly states that profits will not be attributable to a PE simply because it has purchased goods or merchandise for the enterprise.

Shipping & air transport

The treaty provides that profits derived from the operation of ships or aircraft shall be taxable only in the place of effective management.

In the event where an enterprise derives such profits from operations in the other state, they shall be deemed to be an amount not exceeding 5% of the full amount received by the enterprise on these operations. The tax charged shall be reduced by 50%.

National ship and aircraft carriers such as the Emirates and Kenya Airways stand to benefit from this tax reprieve.

Withholding tax rates

There are currently no withholding taxes applicable in the UAE thus Kenya is bound to benefit prominently from the favourable Withholding tax rates offered in the treaty.

The reduced Withholding tax rates applicable under the treaty are as summarised below:

	Kenya	UAE	Treaty Rates
Dividends	10%	N/A	5%
Interest	15%	N/A	10%
Royalties	20%	N/A	10%
Professional & Management fees	20%	N/A	0%

Withholding tax on dividends or interest will not be applicable where the recipient is the government, political subdivision or a local authority, the Central Bank, government agencies or specified and agreed financial institutions of the other contracting state.

These provisions are skewed towards encouraging direct investment by the governments of the treaty partners. The anticipation is that the UAE, which has a superior financial muscle, will leverage on these tax benefits and invest in Kenya.

Article 23 of the DTA provides that any other income of a resident of a contracting state that has not been specifically discussed in the DTA is only subject to tax in the country where the income is recognized.

The provision seemingly captures professional fees, management fees and commissions. Kenya imposes withholding tax on such income at 20% whilst UAE does not impose Withholding tax.

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Limitation of benefits

The Kenyan income tax regime has an anti-treaty shopping provision meant to deny tax benefits if the dealings between the treaty partners are without commercial substance or only with tax benefit motive.

A relief or exemption of Kenyan tax under a DTA is not available to a person, who, for the purposes of a DTA, is a resident in the other contracting state unless:

- more than 50% of the underlying ownership of that person is held by an individual or individuals who are residents of that other contracting state; or
- the resident of the other contracting state is a company listed on a stock exchange in that other contracting state.

Investors intending to invest in Kenya should therefore ensure the above requirements are met in order to qualify for DTA relief.

Effective date

The final step required is a notification by each of the treaty partners of the completion of the procedures required by their laws for the treaty to enter into force.

The DTA will be effective from 1 January following the year in which the aforementioned formal notification takes place.

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Conclusion

The DTA with UAE has provisions on elimination of double taxation, non-discrimination clauses, mutual agreement procedure, and exchange of information with a view to reducing fiscal leakages.

International trade in Kenya has been on an upward trajectory thus the ratification of the treaty is only apt and timely as Kenya expands its economic ties and treaty networks. The treaty has attractive provisions geared towards encouraging government involvement in investment opportunities in the treaty states.

Taxpayers that are eligible for benefits under the treaty should be aware of the reduced rates on dividends, interest and royalties. Investors should also be cautious about the limitation of benefits rules and global anti-tax avoidance provisions when determining the relevance of this treaty to their establishments.

Get in touch

- Please get in touch with us to find out more about how this affects you.

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