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Kenya – Mauritius DTA ratified by the Republic of Kenya

Introduction

The Government of the Republic of Kenya has recently ratified the Double Taxation Treaty (DTA) with Mauritius through the publication of a legal notice to that effect in the Kenya Official Gazette on 23 May 2014 and becomes effective on 1 January 2015. The DTA was signed on 7 May 2012 together with an Investment Promotion & Protection Agreement (IPPA) and ratified by the Republic of Mauritius. This is a significant event reinforcing the economic relationship between the economic powerhouse of East Africa. According to the World Bank, Kenya has maintained economic stability and fiscal discipline and the economy is expected to grow at 5.8-6% this year. It is anticipated that the DTA will further boost Foreign Direct Investments (FDI) into Kenya and reinforce the position of Mauritius as jurisdiction of choice for international investors bringing capital into Africa.

General overview & effects of DTAs

It is not unusual for a business or an individual who is resident in one country to make a taxable gain (earnings, profits) in another. This person may find that he is obliged by domestic laws to pay tax on that gain locally and pay again in the country in which the gain was made thus leading him to suffer from double taxation. Because this is inequitable and may discourage cross border investments, many nations make bilateral Double Taxation Agreements (DTAs) with each other. DTAs are international tax agreements which aim at reducing or eliminating the unfair burden of double tax on the same income (or "base") and for identical or overlapping periods (or "incidence") due to connecting factors.

The key components of a DTA are:

(i) source rules define the agreed source of various income;
(ii) assignment rules allocate the taxing rights to one or both states;
(iii) relief rules eliminate or relieve juridical double taxation.

A DTA will achieve the objective of eliminating double taxation through various methods, namely that of **Exemption, Credit** and **Tax Sparing** or a combination of these methods.

The **Exemption Method** is for the residence country to exclude foreign income from its tax base and the exclusive right to tax such incomes goes to the source country. This is known as complete exemption method and is sometimes followed in respect of profits attributable to foreign permanent establishments or income from immovable property.

The **Credit Method** reflects the underlying concept that the resident remains liable in the country of residence on its global income, however as far the quantum of tax liabilities is concerned credit for tax paid in the source country is given by the residence country against its domestic tax as if the foreign tax were paid to the country of residence itself.

With **Tax Sparing** the investor is allowed to preserve to himself/itself benefits of tax incentives available in the country of investment for such investments. This is done through the Tax Sparing method, where the tax credit is allowed by the country of its residence, not only in respect of taxes actually paid by it in the country of investment but also in respect of those taxes the country of investment forgoes due to its fiscal incentive provisions under its tax legislation.

Last but not least, a DTA will also often provide a reduced rate of withholding tax than is otherwise applicable in the source country. They also provide the resident state with the right to tax capital gains (subject to certain restrictions).

Benefits of DTAs

DTAs have a number of benefits which may be summed up to be as follows:

(i) Allow for clarity on tax rights between States
(ii) Enable the sharing of tax between States
(iii) Relieve juridical double taxation
(iv) Provides for non-discrimination of nationals
(v) Allows for international business to be transacted with certainty to the benefit of a broad cross section, such as companies and individuals
(vi) Allows better planning through predictability
(vii) Prevents fiscal evasion

These benefits taken together promote and foster economic trade and investment between the two treaty signatories. In fact there is a demonstrated correlation between DTAs and increase in foreign direct investment, especially in emerging economies.

Salient features of the Kenya – Mauritius DTA

Application of the DTA

The DTA applies to persons who are residents of one or both of the Contracting States.

The term resident includes any person who, under the laws of that State, is liable to tax by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature.

Person means an individual, a company, a trust and any other body of persons which is treated as an entity for tax purposes.

Thus, any legal structure which is treated as an entity for tax purposes can potentially benefit from the DTA.

Income from Immovable Property & Business Profits

Under the DTA, income derived by a resident of a Contracting State from immovable property, may be taxed in the Contracting State **in which such property is situated.**

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 is carrying on business in the other contracting state through a permanent establishment, then that Contracting state will attribute to it that profit that it would be expected to make if it were a distinct and separate enterprise in the Contracting state.

Permanent Establishment

The term Permanent Establishment will include the following:

(i) A fixed place of business through which the business of an enterprise is wholly or partly carried on
(ii) A building site or construction, installation or assembly project including supervisory activities in connection therewith only if the site, project or activity lasts more than 12 months
(iii) Furnishing of service including consultancy services by an enterprise through employees

or other personnel provided such activities continue for same or connected project for a period(s) of more than 6 months within any 12 month period

Withholding tax/Capital Gains Tax

The following applies in respect of Withholding Tax:

Income	Withholding tax rate (WHT) under DTA	WHT in Kenya
Dividend	5%/10%[1]	10%
Interest	10%	15%/25%[2]
Royalties	10%	20%
Capital Gains on disposal of shares	Taxed only in the resident state (Mauritius does not tax capital gains)	Nil

Under the DTA, capital gains arising from transfer of shares of a company shall be taxable only in the state in which alienator is a resident. Accordingly, where the alienator is a resident of Mauritius (such as a Mauritius company), it is Mauritius that will have the right to tax any gains that arise upon a disposal of the shares. However as capital gains are not subject to tax in Mauritius, the said gains shall not be subject to tax in Mauritius.

Summary of benefits under the DTA

Where an investment into Kenya is made by a resident of Mauritius (such as a Mauritius Company) this will lead to:

(i) a reduction in WHT on dividends from 10% to 5% where beneficial owner owns at least 10% of the company paying out the dividends
(ii) A reduction in WHT on interests from 15%/25% to 10%
(iii) A reduction in WHT on royalties from 20% to 10%
(iv) There is no effect on capital gains tax as there is (currently) no capital gains tax on gains made upon the disposal of shares in Kenya.
(v) Further the DTA provides for tax sparing credit and this will not dilute any incentive that has been given in Kenya.

Conclusion

With the ratification of the Kenya – Mauritius DTA, Mauritius boasts one of the best networks of DTAs and IPPAs with the Africa continent. With this growing number of bilateral agreements, Mauritius is positioning itself as a safe, trusted and well-established international financial center for international investors looking at doing business in Africa. It also consolidates its aspirations to be the natural choice of business and investment gateway into Africa.

[1] 5% applies where beneficial owner owns at least 10% of the company paying out the dividends/10% applies in all other cases
[2] 15% applies to bank interest/25% in other cases

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About the author

Assad Abdullatiff is the Chief Executive of AXIS Fiduciary Ltd, a leading Mauritius-based independent trust company providing a full spectrum of fiduciary and corporate services to an international client base. Assad holds an LLB (Hons) and an LLM in Business Law and is admitted to the Bar of Mauritius. Assad counts many years of experience in the financial services sector in Mauritius, and prior to joining AXIS was an Assistant Director at the Board of Investment of Mauritius, where he was the Head of the Financial Services Cluster and responsible for the promotion of Mauritius as an International Financial Centre. Assad has been a speaker at various international conferences on the topic of the development of Mauritius as a world class financial centre. He is a full member of the Society of Trust and Estate Practitioners (STEP), a member of STEP Council and past Chairman of the STEP Mauritius branch.