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Global Tax Alert

Kenya gazettes Double Taxation Avoidance Agreement with Mauritius

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Executive summary

The High Court of Kenya nullified a Double Taxation Avoidance Agreement (DTA) between Kenya and Mauritius in March 2019. An EY Tax Insights article with more details on the invalidation of the DTA can be found here.

Pursuant to the nullification of the DTA, on 26 June 2020, the Government of Kenya gazetted a subsequent DTA between Kenya and Mauritius. The DTA is considerably similar to the initial DTA and provides for reduced withholding tax rates on dividends, interest and royalties. The DTA also addresses other pertinent matters including the exchange of information between the two countries and mutual agreement procedures.

This Alert summarizes the key provisions of the DTA.

Detailed discussion

Scope

The DTA applies to residents of either Kenya or Mauritius. Even though the DTA does not have an anti-abuse rule, it cannot assumed that shell or conduit entities will be automatically resident in Mauritius.

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Taxes covered

The DTA covers direct taxes administered under the *Income Tax Act*, CAP 470 of the Laws of Kenya. Namely, it covers corporate income tax, withholding tax, Pay as You Earn (PAYE) and capital gains tax (CGT). Mauritius does not have any CGT regime so the DTA covers only income tax, including Corporate Social Responsibility.

Creation of a permanent establishment

The definition of a permanent establishment (PE) is largely modelled on the OECD's[1] Model Tax Convention on Income and on Capital. A PE would include a fixed place of business including a building or construction site that has existed for over 12 months.

Moreover, the DTA provides for a service PE when services are provided for an aggregate of a 6-month period in any 12-month period.

A fixed place will not constitute a PE if, the nature of activities conducted through the fixed place are auxiliary or preparatory functions.

In the absence of a fixed place of business, a PE may arise when a resident of a Contracting State has in the other Contracting State, a dependent agent who has the general authority to conclude contracts in the name of the resident. This excludes situations where the activities are limited to the purchase of goods or merchandise for the foreign enterprise on whose behalf he is acting.

Additionally, an insurance company, will constitute a PE if it collects premiums in the other Contracting State or insures risks situated therein through a person other than through an independent agent. A PE will, however, not arise if the insurance business relates to re-insurance business.

Income from immovable property

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.

Business profit

The business profit of a foreign enterprise of a Contracting State shall only be taxable in the other Contracting State if the foreign enterprise carries on business through a PE situated in the other Contracting State.

Expenses including executive and general administrative expenses incurred by the PE, within or outside the state it is located, shall be deductible in the computation of the taxable profit of the PE.

However, payments made by the PE to its head office or any of the other offices of its head office with respect to royalties or similar payments, commissions, management fees or interest shall not be deductible expenses unless they relate to an actual reimbursement of expenses.

Interest paid will be deductible if the PE is engaged in banking activities. Conversely, if the interest is received by a PE engaged in banking activities, it will constitute taxable income of the PE.

Dividends, interest and royalties

The DTA provides for reduced withholding taxes rates as tabulated below:

		Nonresident non-DTA rates (%)	
Description	Reduced DTA Rates	Kenya	Mauritius
Dividends	5/10 (a)	15	0
Interest	10 (b)	15	0 (b), 15
Royalties	10	20	0 (c), 15

a. The 5% rate applies if the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends.

b. Interest arising in a Contracting State shall be exempt from tax in that state if it is derived and beneficially owned by:

- The Government, a political subdivision or a local authority of the other Contracting State

Or

- Any institution, body or board which is wholly owned by the Government, a political subdivision or a local authority of the other Contracting State

Under the Mauritian domestic laws, no withholding tax applies to interest paid to a nonresident not carrying on any business in Mauritius (a) by a corporation holding a Global Business License (GBL) under the *Financial Services Act* (FSA) out of its foreign source income; (b) by a bank holding a banking license under the *Banking Act* insofar as the interest is paid out of gross income from its banking transactions with nonresidents and corporations holding a GBL under the FSA. Interest income is also exempt in a number of other instances such as interest income of a nonresident individual from a Mauritian bank and interest on bonds and sukuks quoted on the stock exchange held by a nonresident company.

No withholding tax arises if the royalty is paid out by a company of the foreign source income of the Mauritian company.

The reduced withholding tax rates are only applicable if the recipient of the income is the beneficial owner of the income.

Capital gains tax

Capital gains realized by a resident of a Contracting State from the transfer of immovable property[2] located in other Contracting State, will be taxable in the other Contracting State. Capital gains on the sale of shares is taxable only in the country of residence, even if the value of the shares is attributable to immovable property situated in the source country.

Employment income

Gains or profits derived from employment by a resident of a Contracting State shall be taxable only in that state unless the employment is exercised in the other Contracting State in which case the remuneration derived from that other state will be taxable in that other state.

However, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall only be taxable in the first mentioned state if:

- The recipient is present in the other state for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the fiscal year concerned.
- The remuneration is paid by or on behalf of an employer who is not a resident of the other state.
- The remuneration is not borne by a PE which the employer has in the other state.

Elimination of double taxation

Residents of the two states will now be entitled to a foreign tax credit relief for income taxed in the other Contracting State. The relief will not exceed the tax payable on the income had the relief not been granted.

Exchange of information

The two states have agreed to exchange relevant information for the enforcement of the DTA as well as for the administration of the domestic taxes imposed in the Contracting States.

Next steps

The implementation of the DTA is awaiting the exchange of instruments and each Contracting State notifying each other of the completion of the necessary activities.

It is expected that the DTA will take effect on 1 January the year following the completion of the above prerequisite activities.

Taxpayers should bear in mind the limitation of benefit rules that are provided under the *Income Tax Act* when determining the applicability of the various benefits provided by the DTA.

Endnotes

1. OECD stands for Organisation for Economic Co-operation and Development.
2. Under the DTA Immovable property shall have the meaning which it has under the law of the Contracting State in which the property in question is situated.

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