EXPLANATORY MEMORANDUM

ON THE DOUBLE TAXATION AGREEMENT

BETWEEN

THE REPUBLIC OF SOUTH AFRICA

AND

THE REPUBLIC OF KENYA

It is the practice in most countries for income tax to be imposed both on the world-wide income derived by residents of the country and on income derived by non-residents which arises in the country. The effect of such a system is that income derived by a resident of one country from a source in another country is subjected to tax in both countries. As this position clearly discourages foreign investment, it is normal for countries which have trade relations to conclude double taxation agreements. Such agreements commonly provide that income of a particular nature will either be taxable in only one of the countries, or may be taxed in both countries with one of them allowing a credit for the tax imposed by the other.

The Agreement concluded with Kenya closely follows the OECD Model. In the explanation which follows, the general principles of each Article of the Agreement are set out.

The entire text has been made gender neutral.

Preamble

The Preamble records that the object of the Agreement is to avoid double taxation and fiscal evasion with respect to taxes on income.

Article 1

Persons Covered

The Agreement is made applicable to persons who are residents of one or both of the Contracting States except as otherwise provided. This means, *inter alia*, that a citizen of one of the States who is resident in a third State will not enjoy the benefits of the Agreement, apart from the non-discrimination provisions.

Article 2

Taxes Covered

Paragraphs 1 and 2 of this Article provide that the Agreement will apply to all taxes on income imposed by the two States irrespective of the manner in which they are levied.

Paragraph 3 lists the existing taxes imposed by each State and paragraph 4 provides that the Agreement will also apply to identical or substantially similar taxes which are subsequently imposed by either State.

Article 3

General Definitions

This Article defines various expressions which are used in the body of the Agreement. Several of these definitions are self-evident and are not further explained.

The definition of "South Africa" includes not only the sovereign territory but also those areas outside its territorial sea over which it may exercise jurisdiction in accordance with international law, for example, in relation to the exploitation of natural resources.

"Person" is defined to include an individual, a company and any other body of persons that is treated as an entity for tax purposes. The underlined words are of particular relevance to partnerships. Partnerships are not regarded as taxable entities in South Africa, rather, the income of a partnership is taxed in the hands of the partners. Accordingly, should a partnership consisting of a Kenyan resident and a resident of a third State derive income in South Africa, only the Kenyan resident will be entitled to the benefits of the Agreement on his/her share of the partnership income.

"International traffic" is defined as any transport by ship or aircraft operated by an enterprise of a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State. Special provisions are contained in Article 8 for the taxation of international traffic. The effect of the exclusion mentioned above is that should a Kenyan company operate a purely domestic airline operation within South Africa, that operation will not fall to be dealt with under Article 8, but rather under Article 7 which deals with business profits in general. This provision is intended to place that operation on the same footing as South African domestic airlines.

Paragraph 2 follows the OECD Model in providing that expressions not defined in the Agreement bear the meaning that they have under the domestic taxation laws of the States at the time of application of the provisions of the Agreement. Any meaning under the taxation laws will take precedence over a meaning under other laws of the State.

Article 4

Resident

The concept of "resident of a Contracting State" is used throughout the Agreement and is of importance in three cases:

(a) in determining the Agreement's personal scope of application as set out in Article 1;

(b) in solving cases where double taxation arises because of dual residence;

(c) in solving cases where double taxation arises as a consequence of taxation in the State of residence and in the State in which the income arose, the State of source.

This Article defines the meaning of the term and further solves cases of dual residence.

In paragraph 1, the term "resident of a Contracting State" is defined. The definition refers to the concept of residence adopted in the domestic law of each of the Contracting States. As criteria for taxation as a resident, domicile, residence, place of management or any other criterion of a similar nature are used in the definition.

The term "resident" also includes specific reference to the State itself.

Paragraph 2 provides solutions to the cases where individuals are residents of both Contracting States and sets out a step by step method of finally deciding which State has the sole right to claim the individual as its resident.

Paragraph 3 deals with companies and other bodies of persons who are not individuals but who are residents of both States and specifies that in these cases the State in which the place of effective management is situated will have the sole right to claim the company or body of persons as its resident.

Article 5

Permanent Establishment

One of the goals of the Agreement is to determine the right of a Contracting State to tax the business profits of an enterprise of the other Contracting State which arise through a permanent establishment situated in the first-mentioned State. The Article defines what is to be regarded as a permanent establishment.

Paragraph 1 gives a general definition of a "permanent establishment" as being a fixed place of business through which the business of an enterprise is carried on.

Paragraph 2 contains a list, which is not exhaustive, of what is regarded to be a permanent establishment, subject to the provisions of Paragraph 1.

Paragraph 3(a) provides expressly that a building site or construction, assembly or installation project will not constitute a permanent establishment unless it continues for more than six months. Supervisory activities carried on in a Contracting State in connection with such site or project will also constitute a permanent establishment if they continue for more than six months and irrespective of the fact that the enterprise carrying on such activities has no fixed place of business in that State.

Paragraph 3(b) introduces provisions dealing with the furnishing of services through employees or other personnel engaged by that enterprise for such purpose and specifies that a permanent establishment will be deemed to exist, despite there being no fixed place of business, if such services are rendered in a State for a period or periods exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

A number of preparatory or auxiliary activities which are treated as exceptions to the general definition laid down in paragraph 1 are set out in paragraph 4. The paragraph specifies that a "permanent establishment" will be deemed not to exist if the enterprise only carries on the various activities set out therein. The Contracting State in which these activities take place will in any event not have any, or negligible profits, to tax if these are the only activities which occur.

Paragraph 5 sets out the generally accepted principle that an enterprise will be treated as having a permanent establishment in a Contracting State if it carries on business in that State through an agent situated in that State, provided that the agent is not of an independent status and provided that such agent has the power to conclude contracts in the name of the enterprise.

Paragraph 6 deems an insurance enterprise, except in regard to reinsurance, to have a permanent establishment in the other Contracting State if it collects premiums in that territory or insures risks situated therein through a person other than an independent agent.

Paragraph 7 deals with the situation where an enterprise carries on business through an independent agent in the other Contracting State and provides that no permanent establishment will be deemed to exist if the activities are carried on through such an agent who is acting in the normal course of business and that conditions of a commercial or financial nature are not made or imposed that would differ from those generally agreed to by independent agents.

Paragraph 8 sets out the principle that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that for tax purposes a subsidiary company constitutes an independent legal entity and will be taxed in its State of residence on its own profits.

Article 6

Income from Immovable Property

Paragraph 1 provides that income from immovable property may be taxed in the State in which the property is situated. Income from agriculture and forestry is specifically included in this rule.

Paragraph 2 establishes the general rule that what constitutes fixed property will be decided under the law of the State in which the property is situated. Nevertheless, property accessory to fixed property and livestock and equipment used in agriculture and forestry are specifically included. So too are usufructs and payments for the right to extract minerals and other natural resources.

Paragraph 3 makes it clear that the rule established in paragraph 1 applies irrespective of the manner in which the property is exploited.

Paragraph 4 provides that the provisions of paragraphs 1 and 3 also apply to income derived from fixed property owned by an enterprise or which is used for the performance of independent personal services. In the absence of this provision, it might be argued that this income should be dealt with in terms of the provisions of Article 7 which establishes somewhat different rules for the treatment of business profits.

Article 7

Business Profits

This Article deals with the taxation of business profits and is to be read together with Article 5 as it uses the test of "permanent establishment" in determining where such profits are to be taxed.

Paragraph 1 specifies that the profits of an enterprise which is a resident of a Contracting State are taxable only in that State unless it carries on business in the other Contracting State through a permanent establishment situated in that other State in which case that other State may tax the profits which are attributable to:

(a) that permanent establishment;
(b) the sale of goods or merchandise which are the same or similar to that sold through that permanent establishment; or
(c) other business activities carried on which are of the same or similar kind as those effected through that permanent establishment.

However subparagraph (b) will not apply if the enterprise can demonstrate that there was a *bona fide* reason for these sales other than obtaining a benefit under this Agreement.

Paragraph 2 deals with the allocation of profits to a permanent establishment and specifies that the profits which are to be attributed to the permanent establishment are those which it would have made if it had been dealing with entirely separate enterprises under arms-length conditions and not with its head office.

Paragraph 3 recognises the fact that in calculating the profits of a permanent establishment, allowance must be made for certain expenses, wherever incurred, which were incurred for the purposes of the permanent establishment. For example, if the head office incurs general administrative expenses it is most likely that a portion of those expenses was in fact incurred on behalf of the permanent establishment and it will therefore be necessary to allocate that portion of the expenses to the permanent establishment in determining its profits. The emphasis here is on the fact that the expenses must have been actually incurred. Payments by the permanent establishment to the head office of the enterprise or any of its other offices, which are notional in nature such as royalties, fees or other similar payments in return for use of patents or rights, or by way of commission for specific services performed, management fees or, except in the case of a banking enterprise, interest on loans to the permanent establishment are prohibited. Likewise these notional amounts, if charged by the permanent establishment to the head office of the enterprise or any of its other offices, will not be taken into account in determining the profits of the permanent establishment except for interest on a loan if the business of the enterprise is banking.

Paragraph 4 provides for profits attributable to a permanent establishment to be determined on the basis of apportionment if this method is customary in a Contracting State. However, the proviso specifies that the result of this method should still be in accordance with the principles of this Article.

Paragraph 5 deals with the situation where a permanent establishment which, although carrying on other business, also carries on purchasing for its head office. The paragraph provides that the profits which are attributed to the permanent establishment cannot be increased by the addition of a notional profit from such purchase transaction.

Paragraph 6 stipulates that the method of allocation of profits to the permanent establishment should not be changed merely for the reason that a different method may result in more profit becoming taxable in the State of residence of the permanent establishment. This also establishes a degree of certainty regarding the tax treatment to be expected in the State in which the permanent establishment is situated.

It is possible that the term "profits" could include other items of income which are dealt with in other Articles of the Agreement. Paragraph 7 stipulates that the preceding provisions of Article 7 shall not affect the provisions of such other Articles. An example of this is where profits include interest which is dealt with separately under Article 11.

Article 8

Shipping and Air Transport

Paragraph 1 provides that profits derived by an enterprise of a Contracting State from the operation of aircraft in international traffic are taxable only in that State. Thus, for example, profits derived by South African Airways from its flights into and out of airports in Kenya are taxable only in South Africa.

Paragraph 2 provides that profits derived by an enterprise of a Contracting State from the operation of ships in international traffic may also be taxed in the source State. However, the source State has an obligation to reduce the tax so imposed by 50 per cent.

Paragraph 3 specifies that profits which are incidental to international traffic operations, in particular, the occasional rental on a bare boat basis of ships or aircraft used in international traffic, are also taxable in accordance with Article 8. It should be noted that where such income is not incidental to international traffic operations, but rather constitutes an independent business in its own right, it will fall to be dealt with under Article 7 as business income.

Paragraph 4 specifies that profits envisaged in paragraphs 1 and 2 shall include profits from the use or rental of containers, trailers, barges and related equipment for the transport of containers, which are used in international traffic for the transport of goods or merchandise.

Paragraph 5 makes the above rules also applicable where the business is conducted through a pool, a joint venture or an international operating agency.

Article 9

Associated Enterprises

This Article deals with associated enterprises and in paragraph 1 provides that a Contracting State may recalculate the profits of the enterprises if they have created conditions between themselves which would not be created by enterprises dealing at arms-length with each other. This paragraph is effective in dealing with the effects of transfer pricing between associated enterprises. The concept of what is regarded to be an associated enterprise is also set out in this paragraph.

The recalculation of profits envisaged in paragraph 1 may of course result in double taxation if, for example, one of the Contracting States increases the profits of its enterprise, and subjects the increased amount to tax, although such increased amount may already have been subjected to tax in the hands of its associated enterprise in the other Contracting State.

The provisions of paragraph 2 oblige that other State to make a corresponding adjustment to the profits of the associated enterprise and, in so doing, avoid double taxation. It should be noted that the paragraph provides for consultation between the States in deciding on such adjustment in accordance with the provisions of Article 24.

Paragraph 3 stipulates that the provisions of paragraph 2 will not apply in the case of fraud, gross negligence or willful default.

Article 10

Dividends

Paragraphs 1 and 2 of this Article provide for the common international tax treatment of cross-border dividends, in terms of which the source State in which the dividends are declared may impose a limited withholding tax on the non-resident shareholder and the State of residence of the shareholder in which the dividends are received has an unlimited taxing right.

The limitation on withholding tax rates in the source State imposed by paragraph 2 is 10 per cent of the gross amount of the dividends if the recipient is the beneficial owner of the dividends, i.e. the limitation does not apply to nominee shareholders.

The mode of application of these limitations shall be settled by the competent authorities of the two States.

Tax on the profits of the company will not be affected by this paragraph.

Paragraph 3 contains the standard definition of what constitutes a dividend.

Paragraph 4 provides that the provisions of this Article will not apply in cases where a resident of one State carries on business in the other State through a permanent establishment or fixed base situated therein and derives dividends from shares the holding of which is effectively connected with the permanent establishment or fixed base. In other words, the holding must be part of the business assets of the permanent establishment. The source State is therefore not limited in its taxing rights which are then exercised under the provisions of Article 7 of the Agreement.

Paragraph 5 deals with the limitation of the right of one of the States to impose tax on dividends declared by, or the undistributed profits of, a company which is a resident of the other State. One situation in which tax may be imposed, is where the shareholding is effectively connected with a permanent establishment or a fixed base situated in that other State, as mentioned in relation to paragraph 4 above.

The second situation can best be explained through an example of a Kenyan company which carries on business through a branch in South Africa. The paragraph provides that South Africa may not impose tax on the dividends declared by the Kenyan company, even though its profits are partly derived in South Africa, except in so far as the dividends are received by South African resident shareholders.

Article 11

Interest

This Article deals with the taxation of income in the form of interest.

Paragraph 1 specifies that interest which arises in a Contracting State and is paid to a resident of the other Contracting State may be taxed in the State of residence.

Paragraph 2 gives a right of taxation to the source State as well but limits the amount of tax to 10 per cent of the gross amount of the interest provided that the beneficial owner of the interest is a resident of the other Contracting State.

Paragraph 3 contains the standard definition of what is to be regarded as interest.

Paragraph 4 specifies that if the beneficial owner of interest carries on business in the Contracting State in which the interest arises through a permanent establishment or a fixed base situated in that State, the interest may be taxed in that State if the debt-claim in respect of which the interest is paid is effectively connected to that permanent establishment or fixed base. The provisions of Article 11 will not apply to such interest but rather the provisions in Article 7 in the case of a permanent establishment or Article 14 in the case of a fixed base. This paragraph is similar to paragraph 4 of Article 10 dealing with dividends.

Paragraph 5 lays down the principle that the State of source of the interest is the State of which the payer of the interest is a resident. It also provides for an exception to this rule in the case of interest-bearing loans which have an economic link with a permanent establishment or a fixed base operated in the other Contracting State by the payer of the interest. If the loan was contracted for the requirements of the permanent establishment or fixed base and the interest is borne by such permanent establishment or fixed base, the paragraph specifies that the source of the interest is the Contracting State in which the permanent establishment or fixed base is situated.

The purpose of paragraph 6 is to restrict the operation of the provisions of this Article with regard to the taxation of interest in cases where there is a special relationship between the beneficial owner of the interest and the payer or between both of them and a third party. If, in the presence of this relationship, the interest paid exceeds the interest which would have been paid in the absence of such a relationship, the provisions of this Article will not apply to the amount of the interest which is considered to be excessive and such excessive amount will remain taxable in accordance with the laws of both Contracting States. The limitation placed on the source State under paragraph 2 will in such circumstances be negated in respect of the excessive amount. This is an anti-avoidance provision.

Article 12

Royalties

This Article deals with royalties and paragraph 1 provides that royalties which arise in a Contracting State and are paid to a resident of the other Contracting State may be taxed in the State of residence.

Paragraph 2 gives a right of taxation to the source State but limits the amount of tax to 10 per cent of the gross amount of the royalties, provided that the beneficial owner of the royalties is a resident of the other State.

The competent authorities of the Contracting States shall settle the mode of application of this limitation by mutual agreement.

Paragraph 3 defines which payments will constitute royalties for purposes of the Article. It includes amounts normally understood as royalties, such as patents, copyrights, trade marks, etc, and also includes payments for the use of, or right to use, industrial, commercial or scientific experience (know-how).

Paragraph 4 provides that the provisions of paragraphs 1 and 2 will not apply if the beneficial owner of the royalties carries on business or performs independent personal services in the State in which the royalties arise through a permanent establishment or fixed base and the royalties are effectively connected with that permanent establishment or fixed base. In this case, the royalties are in effect regarded as part of the business profits of the permanent establishment or fixed base and may be taxed by the source State. This paragraph is similar to paragraph 4 of Article 10 dealing with dividends and paragraph 5 of Article 11 dealing with interest.

An example of where this paragraph would apply would be a Kenyan company with a permanent office in South Africa through which it sold franchise rights for the use of its product brand. South Africa would in this case be entitled to tax the franchise payments received by the Kenyan company.

Paragraph 5 is a deeming provision which establishes the source of royalties by laying down the principle that the State of source of the royalties is the State of which the payer of the royalties is a resident. It also provides for an exception to this rule in the case of royalties which have an economic link with a permanent establishment or a fixed base operated in the other Contracting State by the payer of the royalties. If the liability to pay the royalties was incurred by the permanent establishment or a fixed base and the royalties are borne by such permanent establishment or fixed base, the paragraph specifies that the source of the royalties is the Contracting State in which the permanent establishment or fixed base is situated.

Paragraph 6 contains an anti-abuse provision in respect of transfer pricing. Where the payer and recipient of a royalty are connected persons and the royalty is excessive, the source State may tax the portion which is excessive according to its laws.

Article 13

Capital Gains

The Article deals with the taxation of capital gains and covers all kinds of taxes which are imposed on such gains.

Paragraph 1 specifies that the right to tax gains derived from the alienation of immovable property is also given to the Contracting State in which the property is situated although the alienator may be a resident of the other Contracting State.

Paragraph 2 deals with the alienation of movable property which forms part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State. It provides that gains from the alienation of such property may also be taxed in the State in which such permanent establishment or fixed base is situated and also includes such gains arising from the alienation of the permanent establishment or fixed base as such and the enterprise as a whole.

Paragraph 3 provides that gains from the alienation of ships or aircraft operated in international traffic or movable property related to the operation of such ships or aircraft are taxable only in the State in which the enterprise is resident. This follows the principle laid down in Article 8 with regard to the taxation of the business profits of such an enterprise.

Paragraph 4 specifies that gains arising from the alienation of shares in a company deriving more than 50 per cent of their value directly or indirectly from immovable property located in a Contracting State, may be taxed in that State.

Paragraph 5 specifies that gains from the alienation of any property not covered by the preceding paragraphs of this Article shall only be taxed in the State of residence of the alienator of the property.

Article 14

Independent Personal Services

Paragraph 1 provides the general rule that income from independent personal services derived by a resident of a State may be taxed only in that State. The other (source) State is entitled to impose tax only if;

(a) the individual performing the services has a fixed base regularly available to the individual in that other State, and then it may tax only the income attributable to that fixed base; or

(b) the individual is present in that other State for more than an aggregate of 183 days in any twelve-month period commencing or ending in the fiscal year concerned, in which case the income attributable to those services in that State may be taxed in that State.

Paragraph 2 defines professional services but the definition is not exhaustive.

Article 15

Dependent Personal Services

Paragraph 1 lays down the principle that salaries, wages and other similar remuneration in respect of an employment is taxable only in the State of residence of the employee unless the services in respect thereof are rendered in the other Contracting State, in which case the remuneration arising from the services rendered in the other State may also be taxed in that other State.

Paragraph 2 limits the right of taxation of the State in which the services are rendered (the source State) in that remuneration for services rendered in that State is taxable only in the State of residence if the following conditions are all met:

(a) the employee is present in the source State for a period or periods not exceeding 183 days in any twelve-month period commencing or ending in the fiscal year concerned, and
(b) the employer who pays the remuneration, or on whose behalf the remuneration is paid, is not a resident of the source State, and
(c) the relevant remuneration is not borne by a permanent establishment or fixed base which the employer has in the source State.

It is important to note that all three requirements must be met before the provisions of the paragraph operate.

Paragraph 3 deals with remuneration derived by employees in respect of employment aboard a ship or aircraft operated in international traffic and it specifies that such remuneration may be taxed in the State of residence of the operator of such ship or aircraft.

Article 16

Directors' Fees

The Article provides that directors' fees may be taxed by the State in which the company paying the fees is resident. It does not, however, prevent the director from also being taxed on those fees in the director's State of residence.

Article 17

Entertainers and Sportspersons

In terms of paragraph 1 the income derived by entertainers and sportspersons may be taxed in the Contracting State in which their activities are exercised.

Paragraph 2 expands the principle laid down in paragraph 1 in that it specifies that in cases where income in respect of the activities of entertainers and sportspersons accrues to some other person rather than the entertainer or sportsperson, such income may still be taxed in the Contracting State in which such activities are exercised. This paragraph covers the frequent situation in which a professional sportsperson forms a company and competes in a sporting event in another country not in a personal capacity, but rather as an employee of that company. As the sportsperson's activities in the country continue for a very short period and do not constitute a permanent establishment, neither the sportsperson nor the company would under the normal provisions of the Agreement be taxable in that country.

Article 18

Pensions and Annuities

Paragraph 1 provides that pensions and other similar remuneration as well as annuities, may be taxed in the State in which they arise. The State of residence may also tax but must then give a credit for the source State tax. This provision is subject to paragraph 2 of Article 18 dealing with Government service.

Paragraph 2 provides the standard definition of an annuity.

Paragraph 3 gives the State of source of pensions and other similar payments made under a public scheme which is part of its social security system the sole taxing right, notwithstanding the provisions of paragraph 1.

Article 19

Government Service

Subparagraph 1(a) provides that salaries, wages and other similar remuneration, paid by a Contracting State, a political subdivision or a local authority thereof to an individual for services rendered, is taxable only in that State.

However, subparagraph 1(b) provides that such salaries, wages and other similar remuneration is taxable only in the other Contracting State if the services are rendered in that other State by a resident who is also a national of that other State and did not become resident of the other State with the express purpose of rendering the services. An example of this is a South African national, normally resident in South Africa, who is employed by the Kenyan High Commission. Such person would be taxable only in South Africa even though his salary is paid by the Kenya.

Paragraph 2 provides that, notwithstanding the provisions of paragraph 1, pensions and other similar remuneration paid by or out of funds created by, a Contracting State, a political subdivision or a local authority thereof for services rendered, shall be taxable only in that State. The pension and other similar remuneration would only be taxable in the other State if the recipient is both a resident and a national of that other State.

Paragraph 3 provides that the provisions of paragraphs 1 and 2 will not apply in respect of salaries, wages, pensions and other similar remuneration paid by a Contracting State, a political subdivision or a local authority thereof in respect of services rendered in relation to any business carried on by them. In such circumstances, the provisions of Articles 15, 16, 17 and18 dealing with remuneration other than of a public nature will apply.

Article 20

Professors, Teachers and Researchers

Paragraph 1 specifies that professors, teachers and researchers who are residents of a Contracting State and engage in teaching or research activities at educational institutions in the other Contracting State during a visit not exceeding in the aggregate two years from the date of first arrival in that other State, shall be exempt from tax in that other State in respect of remuneration for such activities, provided that such remuneration is derived from outside that other State.

Paragraph 2 specifies that the Article will not apply in respect of research which is wholly or mainly undertaken for the private benefit of a person or persons.

Article 21

Students

In terms of this Article, a student who is resident of one State but who is present in the other State solely for the purpose of undergoing education or training in that other State, will not be taxed in that other State on payments received for the purposes of the student's maintenance, education or training, if those payments are received from outside that other State.

Article 22

Other Income

This Article deals with the treatment of income which is not dealt with in other Articles of the Agreement and specifies in paragraph 1 that such items of income will be taxable only in the State of residence of the recipient thereof.

Paragraph 2 reintroduces the principle established in paragraph 4 of Article 10 dealing with dividends and paragraph 5 of Article 11 dealing with interest that if such income is connected to a permanent establishment or a fixed base which a resident of a Contracting State has in the other Contracting State, then such income may be included in the profits which are attributable to the permanent establishment or fixed base as envisaged in Articles 7 and 14 and taxed in that other Contracting State.

Paragraph 3 states that notwithstanding paragraphs 1 and 2, the source State also retains a taxing right in respect of other income.

Article 23

Elimination of Double Taxation

The provisions of this Article are designed to allow for the actual mechanisms required for the elimination of double taxation.

In subparagraph (a) the position with regard to the manner in which Kenya will provide relief in cases of double taxation of its residents is set out while the South African position with regard to its residents is set out in subparagraph (b). Both States use the credit method.

Article 24

Non-discrimination

Paragraph 1 provides that a State may not impose upon nationals of the other State any tax or requirement connected therewith which is other or more burdensome than that which it imposes on its own nationals in the same circumstances. The underlined words above are crucial to understanding the effect of this paragraph. By way of example, if Kenya imposed a withholding tax (NRST) on dividends paid to non-residents, but did not impose a similar tax on residents, NRST would be paid by South African shareholders but not by Kenyan shareholders. Nevertheless, this tax does not contravene the provisions of this paragraph, because the shareholders are not in the same circumstances, as they are resident in different States. A Kenyan national taking up residence in South Africa would also become liable for NRST and the discrimination is thus on the basis of residence and not nationality. This is permitted.

The paragraph also extends the application of these non-discrimination provisions to all nationals of either of the States who are or may be resident in a third State.

Paragraph 2 provides that where an enterprise of one State has a permanent establishment in the other State, that permanent establishment shall not be less favourably taxed than enterprises of the host State which carry on similar activities. An exception is made, however, in the case of personal allowances, reliefs and reductions on account of civil status or family responsibilities. An example of such an allowance or relief would be the child rebates previously granted by South Africa. These reliefs may be withheld from non-residents.

Paragraph 3 provides that interest, royalties and other disbursements paid to non-residents deriving income in a State are to be allowed as a deduction by that State in the same manner as that State grants those deductions to residents. It is provided, however, that this paragraph does not override Articles 9(1), 11(6) and 12(6) which allow a State to make adjustments in cases where excessive payments are made because of a special relationship between payer and recipient.

Paragraph 4 prevents a State from giving less favourable taxation treatment to enterprises owned by non-residents than it gives to enterprises owned by residents. The paragraph deals only with the taxation of the enterprise - it is still permissible, as discussed in relation to paragraph 1 above, to impose a different tax regime on the owners of the enterprise.

Paragraph 5 states that nothing in the Agreement shall prevent South Africa from imposing a tax on the profits attributable to a permanent establishment in South Africa of a company resident in the Kenya, at a rate which does not exceed the rate of normal tax on companies by more than five percentage points.

The Agreement generally applies only to the taxes listed in Article 2 but paragraph 6 provides that the non-discrimination provisions of this Article will apply to taxes of every kind and description.

Article 25

Mutual Agreement Procedure

This Article institutes a mutual agreement procedure for difficulties arising out of the application of the Agreement.

If, due to the actions of one or both of the Contracting States, a resident of one of the Contracting States considers that taxation which is not in accordance with the provisions of the Agreement has been imposed, paragraph 1 enables such resident of a Contracting State to present a case to the competent authority of that State. This may be done irrespective of remedies provided by domestic legislation. The taxpayer must notify the competent authority within 3 years of the notification of the action which results in such incorrect taxation.

Paragraph 2 stipulates that the competent authority, considering the objection to be justified and unable to arrive at a satisfactory solution shall, in an endeavour to avoid incorrect taxation, consult with the competent authority of the other Contracting State. The implementation of any agreement reached is not subject to any time constraints in the domestic law of the Contracting States.

In paragraph 3, the competent authorities of the two States are authorised to resolve by mutual agreement any problems relating to the interpretation and application of the Agreement, and, furthermore, to consult together for the elimination of double taxation in cases not provided for in the Agreement.

Finally, for practical purposes, paragraph 4 authorises the competent authorities to communicate directly with each other for the purpose of reaching mutual agreement in respect of any of these matters. This paragraph also makes clear that the competent authorities may develop bilateral procedures for implementing mutual agreement reached under this Article. It further provides that the competent authorities may devise unilateral procedures, conditions, methods and techniques to facilitate bilateral action and implementation of the mutual agreement procedure.

Article 26

Exchange of Information

Paragraph 1 provides that the States shall exchange such information as is relevant both for carrying out the provisions of the Agreement and for applying the domestic taxation laws concerning any tax imposed on behalf of the Contracting States or of their political subdivisions or local authorities, in particular for the prevention of fraud or evasion of such taxes. .The exchange of information is not restricted by Articles 1 and 2.

Thus, should South Africa obtain tax information relating to a resident of a third State who is liable for Kenyan tax, it may make that information available to the Kenya. The exchange extends to taxes of every kind and description.

Paragraph 2 stipulates that information obtained by a State under this provision must be treated with the same degree of secrecy as applies to information obtained under the domestic laws of that State. In addition to this general stipulation on secrecy, it is specifically provided that it may be disclosed only to persons or authorities involved in the administration of the taxes imposed on behalf of a Contracting State or its political subdivisions or local authorities, and that those persons and authorities shall use the information only for the purposes of such administration.

In terms of paragraph 3, the provisions of paragraphs 1 and 2 will not impose on a State the obligation:

(a) to do anything which is contrary to the laws and administrative practice of either State;
(b) to supply information which is not obtainable under the laws of either State or in the normal course of the administration of either State;
(c) to supply information which discloses any business secret, or information the disclosure of which is contrary to public policy.

In terms of paragraph 4 a Contracting State is obliged to exchange information even in cases where the requested information is not needed by that State for domestic tax purposes. Paragraph 4 further makes it clear that the obligation to exchange information is subject to the limitations of paragraph 3 provided that the said limitations cannot be construed to form the basis for declining to supply the requested information where the requested State's laws or practices include a domestic interest requirement.

Paragraph 5 provides that the requested Contracting State shall not decline to supply information to the requesting Contracting State solely because the requested information is held by a bank or other financial institution. Paragraph 5 therefore overrides the provisions of paragraph 3 to the extent that paragraph 3 would otherwise permit the requested State to decline to supply the requested information on grounds of bank secrecy. Paragraph 5 further provides that the requested State shall not refuse to supply the requested information on grounds that the information is held by persons acting in an agency or fiduciary capacity or because the information relates to an ownership interest in a person, including companies and partnerships, foundations or similar organisational structures.

Article 27

Assistance in collection of taxes

Paragraph 1 stipulates that the Contracting States will lend each other assistance in the collection of revenue claims and will not be restricted by Articles 1 and 2. The mode of application may be settled by the competent authorities of the Contracting States.

Paragraph 2 defines the term "revenue claim."

Paragraph 3 provides for the competent authority of a Contracting State to arrange for a revenue claim, proved to be payable in that Contracting State, to be collected by that other State in terms of its domestic law.

Paragraph 4 stipulates that a Contracting State shall take measures to collect taxes if approached to do so by the competent authority of the other Contracting State even if at the time such measures are applied the revenue claim is not enforceable in the other Contracting State or the person by whom it is owed has a right to prevent its collection.

Paragraph 5 states that the Contracting State collecting the revenue claim, in terms of paragraphs 3 and 4, shall not be subjected to time limits or given any priority under the laws of that State, due to its nature. If the other Contracting State has domestic law giving such priority, this will not be taken into account.

Paragraph 6 stipulates that no legal or court action concerning the revenue claim of a Contracting State will be instigated in the State of collection.

Paragraph 7 provides that when a Revenue claim has been made by a Contracting State to the other Contracting State in terms of paragraph 3 or 4, and such claim is rescinded in the first mentioned State, the competent authority of this State shall promptly notify the competent authority of the other State of this fact. At the option of the State of collection, the State of request shall either suspend or withdraw its request.

Paragraph 8 stipulates that this Article must not be construed as imposing an obligation on the State of Collection:

(a) to carry out administrative measures at variance with the laws or administrative practice of either State;
(b) contrary to public policy;
(c) to provide assistance if the other State has not pursued all reasonable measures under its own domestic law for collection;
(d) if the administrative burden is clearly disproportionate to the benefit derived by the other Contracting State.

Article 28

Members of Diplomatic Missions and Consular Posts

The Article ensures that members of diplomatic missions and consular posts are not deprived of any right which is accorded to them under international law or special agreements between Contracting States. In effect this normally means that the remuneration which they receive from their State of residence while they are stationed in the other Contracting State is not subjected to tax in that other State.

Article 29

Entry into Force

Paragraph 1 stipulates that the Contracting States will notify each other, through the diplomatic channel, once the legal procedures required in each country for completion of their domestic requirements for entry into force of the Agreement have been fulfilled. . The Agreement will then enter into force on the date of receipt of the later of these notifications.

Paragraph 2 specifies the date on which the provisions will begin to operate in both States, with regard to taxes withheld at source and with regard to all other taxes, being on or after the first day of January next following the date of entry into force of the Agreement.

Article 30

Termination

The Article provides that the Agreement shall remain in force for a minimum period of five years after which it may be terminated by giving written notice prior to 30 June of any calendar year. It will then cease to operate from 1 January in the calendar year following such notice of termination on the basis set out in paragraph 2.