

# Tax Alert

5 November 2014

## Ratification of Tax Treaty between South Africa and Kenya

*The Tax Treaty between Kenya and South Africa was concluded in 2010 and ratified by South Africa in 2011. Kenya ratified the treaty in October 2014. South Africa is awaiting official diplomatic notification before the treaty comes into effect.*

The treaty represents a significant development between two of the economic powerhouses in Africa. South Africa represents the largest African investor in Kenya and this treaty also promotes South Africa as a possible intermediate holding company location for investments into Kenya. We highlight some of the notable clauses in the treaty.

### Summary of withholding tax rates

We provide below a summary of the domestic withholding tax rates and the reduced rates under the treaty.

	Kenya	South Africa	Treaty rates
<b>Royalties</b>	20%	12% (15% from 1 Jan 2015)	10
<b>Services and management fees</b>	20%	0% (15% from 1 Jan 2016)	0
<b>Interest</b>	15%	0% (15 from 1 Jan 2015)	10
<b>Dividends</b>	10%	15%	10

There is, however, a limitation in respect of the application of the treaty benefits under the Kenya Income Tax Act. Further detail in relation to this limitation is provided below.

### Permanent Establishment

#### Services PE

While there is no withholding tax on services / management fees, the definition of a permanent establishment ("PE") has been extended beyond the traditional OECD definition to include a services PE – that is a PE by reason of the furnishing of services through employees of an enterprise (or other personnel engaged by the enterprises) within the source state in relation to a project for a period or periods exceeding in aggregate 183 days in any twelve month period. In addition, a building site or construction, assembly or installation projects



## ***Ratification of Tax Treaty between South Africa and Kenya***

or any supervisory projects in connection with such site or projects will be deemed to be a PE if the project or activity lasts for more than six months.

### ***Force of attraction***

Article 7(1) contains a force of attraction rule in respect of business profits – that is, the source state may tax other profits in addition to the profits that are attributable to the PE. The additional profits that may be taxed are profits that are attributable to either:

- Sales in the source state of goods or merchandise of the same or similar kind as those sold through that PE;  
or
- Other business activities carried on in the source state of the same or similar kind as those effected through the PE.

This force of attraction rule will not apply if the enterprise demonstrates that the sales or activities have been carried out for reasons other than obtaining a benefit under the treaty (i.e. there are legitimate commercial reasons for such sales or activities not taking place through the PE).

### **Capital Gains on property investments**

The treaty includes the property rich company clause in Article 13. The source country will now have full taxing rights on capital gains derived from the sale of shares in companies that derive more than 50% of their value from immovable property situated in the source state.

This article is now relevant for Kenya which recently re-introduced Capital Gains Tax into its Income Tax Act (effective date 1 January 2015).

### **Tax rate reduction**

The treaty will offer a number of tax rate reductions which are considered to be favorable compared to the treaties that Kenya has with European countries.

The treaty applies a maximum tax rate of 10% on dividends, interest and royalties where the beneficial owner of the income stream is a resident of the other state. There is no minimum participation threshold to qualify for the dividend rate. However, see comments below on unilateral limitation on benefits.

There is no management or professional services article in the treaty, and accordingly fees for such services will be exempted from taxes at source unless the source state has taxing rights in accordance with Article 7. Kenya has a withholding tax on management fees of 20% and South Africa will introduce a withholding tax of 15% on management fees in 2016.

## ***Ratification of Tax Treaty between South Africa and Kenya***

### ***Unilateral Limitation on Benefits***

Kenya has introduced a unilateral limitation on benefits (“LoB”) in its Income Tax Act, with effect from 1 January 2015. The effect of the LoB clause is to prevent access to the benefits under a treaty if the underlying ownership in a resident of a contracting state that is claiming a reduced rate under a treaty is more than 50% held by individuals that are not resident in that same contracting state. Underlying ownership is defined to include direct and indirect ownership by individuals through interposed companies.

### ***Entry into Force***

The treaty will come into force after each state has notified the other in writing, through the proper diplomatic channels, of the completion of the procedures required by its law (i.e. ratification). Although ratification has been completed by both countries the official diplomatic notification is still outstanding. Should the notification be received by 31 December 2014 then the provisions of the treaty will apply from January 2015 - from 1 January 2015 for amounts held at source, and for years of assessment (South Africa) or years of income (Kenya) beginning on or after 1 January 2015.

PwC will send an alert once South Africa receives official diplomatic notification from Kenya.

---

For more information please contact one of the following or your usual PwC contact:

#### ***South Africa***

David Lermer: +27 21 529 2364 david.lermer@za.pwc.com  
Osman Mollagee: +27 11 797 4153 osman.mollagee@za.pwc.com

#### ***Kenya***

Steve Okello: +254 20 2855116 steve.x.okello@ke.pwc.com  
Titus Mukora: +254 20 2855 395 titus.mukora@ke.pwc.com

This Tax Alert is provided by PricewaterhouseCoopers Tax Services (Pty) Ltd for information only, and does not constitute the provision of professional advice of any kind. The information provided herein should not be used as a substitute for consultation with professional advisers. Before making any decision or taking any action, you should consult a professional adviser who has been provided with all the pertinent facts relevant to your particular situation. No responsibility for loss occasioned to any person acting or refraining from acting as a result of using the information in the VAT Alert can be accepted by PricewaterhouseCoopers Tax Services (Pty) Ltd, PricewaterhouseCoopers Inc or any of the directors, partners, employees, sub-contractors or agents of PricewaterhouseCoopers Tax Services (Pty) Ltd, PricewaterhouseCoopers Inc or any other PwC entity.

© 2014 PricewaterhouseCoopers (“PwC”), a South African firm, PwC is part of the PricewaterhouseCoopers International Limited (“PwCIL”) network that consists of separate and independent legal entities that do not act as agents of PwCIL or any other member firm, nor is PwCIL or the separate firms responsible or liable for the acts or omissions of each other in any way. No portion of this document may be reproduced by any process without the written permission of PwC.

