Entry into force of the Tax Treaty between South Africa and Kenya

26 November 2015

In brief

The Tax Treaty between South Africa and Kenya was concluded in 2010 and has been ratified by both South Africa and Kenya. In South Africa, the Tax Treaty was published in the Government Gazette on 19 November 2015.

The provisions of the treaty will apply from 1 January 2016 for amounts held at source, and for years of assessment (South Africa) or years of income (Kenya) beginning on or after 1 January 2016.

In detail

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.

Permanent Establishment

Service PE

The definition of a permanent establishment ('PE') extends beyond the traditional OECD definition to include a services PE. Such a PE would arise if an enterprise furnishes services through its employees (or other personnel) within the source state, in relation to a project exceeding in aggregate 183 days in any twelve month period.

In addition, a building site or construction, assembly or installation projects 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

The business profits article (Art 7(1)) contains a force of attraction rule to allow the source state to tax other profits in addition to the profits attributable to the PE, namely:

- 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 placing through the PE).

Attribution rules

The treaty does not follow the latest OEDC method of attribution by way of notional income and expenses, but rather adopts the UN attribution rules.

It is settled in this treaty that profits will not be attributed to a PE merely because it bought goods or merchandise for the enterprise.

Summary of withholding tax rates

The domestic withholding tax rates and the reduced rates under the treaty are as follows:

	Kenya %	SA %	Treaty Rates %
Royalties	20	15	10
Services and management fees	20	0	0
Interest	15	15	10
Dividends	10	15	10

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

Capital Gains on property investments

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

Tax rate reduction

For investors into Kenya, the treaty will offer a number of tax rate reductions which are considered to be favourable compared to the treaties that Kenya has with European countries. For investors into South Africa, this treaty is not significantly more or less beneficial than most of South Africa's other treaties.

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 should be exempt 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 proposes to introduce a withholding tax of 15% on service fees in 2017.

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.

The takeaway

This long-awaited treaty will reduce significantly and/or eliminate the incidence of double taxation on dealings between Kenya and South Africa.

However, whilst the benefits are noteworthy, there are several broad anti-avoidance rules to be considered if and how the treaty will apply. These considerations include the so-called "services PE", the force-of-attraction rule in relation to PE business profits, the treatment of property-rich companies, and Kenya's unilateral limitation on benefits rule.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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