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PRESENTS

Managing withholding taxes on cross border transactions in Africa

Module 2: Treaty implications of withholding taxes, accounting and transfer pricing implications

Agenda

- What is a tax treaty and its intended objectives?
- When is a tax treaty in force?
- The Multilateral Instrument and its impact
- Principal purpose test
- Access to treaties: Domestic law restrictions
- Access to treaties: Most Favoured Nation clause
- Tax treaties: definitions and rates
- Accounting for withholding tax
- Transfer pricing implications

What is a tax treaty and its intended objectives?

- "Treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation"

Article 2 (1) (a) of the Vienna Convention on Law of Treaties

"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)"

Article 6 (1) of MLI

Desiring to further develop their economic relationship and to enhance their co-operation in tax matters"

Article 6 (3) of MLI

When is a tax treaty in force?

Discussion

Consultation

Formal exchange of letters

Signing

Ratification

Gazetted

IN FORCE

Not the end!!

not the end!!

→ need exchange of instruments

eg. Senegal – SA

· Kenya – MU

The Multilateral Instrument and its impact

Art 1-2 : scope & interpretation
3-17 : Beps related measures
18-26 : mandatory prov
27-39 : Administration
+ explanatory note

- BEPS Action 15: Multilateral Instrument
- Implementation of tax treaty related measures without the need to renegotiate each double taxation treaty
- As at 30 September 2021, 96 countries signed the MLI

MU
SA

- MLI structure: Minimum standards and optional provisions

requirement
considering tax treaty

- Each party to the MLI must $\boxed{\text{notify}}$ which treaties to which MLI provisions will apply (Covered Tax Agreements)

implications

- MLI sits alongside a tax treaty and modify treaties to the extent of BEPS minimum standards

Principal purpose test

- Most African states has chosen the Principal Purpose Test (PPT) as a measure to prevent treaty abuse
- PPT: If one of the principal purposes is to obtain a tax benefit, treaty benefit can be denied
- PPT: Source of much uncertainty and dispute between taxpayers and tax authorities

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Access to treaties: Domestic law restriction

Ghana

DTA

Tax treaty

(5) Where an international arrangement requires Ghana to exempt an amount from tax or subject an amount to reduced taxation, the exemption from or reduction of tax is not available to an entity that

(a) for the purpose of the arrangement, is a resident of the other contracting State; and

(b) fifty percent or more of whose underlying ownership is held by persons who, for the purpose of the arrangement, are not residents of the other contracting State or Ghana.

(6) For the purpose of this section, "underlying ownership"

(a) in relation to an entity, means membership interest owned in the entity, directly or indirectly through one or more interposed entities, by individuals or by entities in which no person has a membership interest; or

(b) in relation to an asset owned by an entity, is determined as though the asset is owned by the persons having underlying ownership of the entity in proportion to that ownership of the entity.

(7) For the purpose of this section, "competent authority of another country" means the person designated by that country as the competent authority for tax purposes.

Access to treaties: Domestic law restriction

Kenya

41. Special arrangements for relief from double taxation

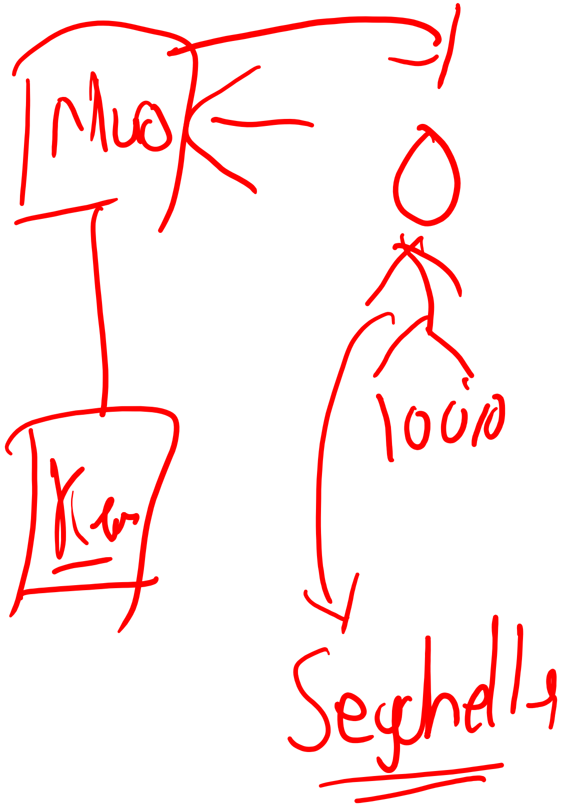
(1) Every special arrangement for relief from double taxation made with the Government of any country outside of the Republic of Kenya with a view of affording relief from double taxation in relation to income tax and any taxes of similar character imposed by the laws of that country shall, subject to subsection (2) but notwithstanding any other provision to the contrary in this Act or in any other written law, have effect in relation to income tax, and every such agreement shall be subject to the provisions of the Treaty Making and Ratification Act, 2012.

(2) Subject to subsection (3), where an arrangement made under this section provides that income derived from Kenya is exempt or excluded from tax, or the application of the arrangement results in a reduction in the rate of Kenyan tax, the benefit of that exemption, exclusion, or reduction shall not be available to a person who, for the purposes of the arrangement, is a resident of the other contracting state if fifty per cent or more of the underlying ownership of that person is held by a person or persons who are not residents of that other contracting state for the purposes of the agreement.

(3) Subsection (2) shall not apply if the resident of the other contracting state is a company listed in a stock exchange in that other contracting state.

(4) In this section, the terms "person" and "underlying ownership" have the respective meanings assigned to them in the Ninth Schedule.

"underlying ownership", in relation to a person, means an interest in the person held directly, or indirectly through an interposed person or persons, by an individual or by a person not ultimately owned by the individuals.



Access to treaties: Most Favoured Nation clause: South Africa

Cl 10

"(10) If under any convention for the avoidance of double taxation concluded after the date of conclusion of this Convention between the Republic of South Africa and a third country, South Africa limits its taxation on dividends as contemplated in subparagraph (a) of paragraph 2 of this Article to a rate lower, including exemption from taxation or taxation on a reduced taxable base, than the rate provided for in subparagraph (a) of paragraph 2 of this Article, the same rate, the same exemption or the same reduced taxable base as provided for in the convention with that third State shall automatically apply in both Contracting States under this Convention as from the date of the entry into force of the convention with that third State."

SA/Netherlands Treaty

"(6) If any agreement or convention between South Africa and a third state provides that South Africa shall exempt from tax dividends (either generally or in respect of specific categories of dividends) arising in South Africa, or limit the tax charged in South Africa on such dividends (either generally or in respect of specific categories of dividends) to a rate lower than that provided for in subparagraph (a) of paragraph 2, such exemption or lower rate shall automatically apply to dividends (either generally or in respect of those specific categories of dividends) arising in South Africa and beneficially owned by a resident of Sweden and dividends (either generally or in respect of those specific categories of dividends) arising in Sweden and beneficially owned by a resident of South Africa, under the same conditions as if such exemption or lower rate had been specified in that subparagraph."

SA/Sweden

"Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State who is the beneficial owner of such dividends shall be taxable only in that other Contracting State."

SA/Kuwait treaty

The SA/Sweden DTA was concluded on 24 May 1995;
The SA/Netherlands DTA was concluded on 10 October 2005;
The SA/Kuwait DTA was concluded on 17 February 2004 and entered into force on 25 April 2006;

The protocol to the SA/Netherlands DTA was concluded on 8 July 2008 and entered into force on 28 December 2008; and

The protocol to the SA/Sweden DTA was concluded on 7 July 2010 and entered into force on 18 March 2012.

Tax treaties: definitions and rates

ARTICLE 10

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged on the beneficial owner shall not exceed:

(a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which owns at least 25 per cent of the capital in the company paying the dividends;

(b) 10 per cent of the gross amount of the dividends in all other cases.

This paragraph shall not affect taxation of the company in respect of the profits out of which the dividends were distributed.

3. The term "dividends" as used in this Article means income from shares or other rights not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Tax treaties: definitions and rates

Article 11

Interest

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, subject to the provisions of paragraph 3, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 8 per cent of the gross amount of the interest.

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

   (a) the Government, a political subdivision or a local authority of the other Contracting State;

   (b) any board, body or institution which is wholly owned by the Government, a political subdivision or a local authority of the other Contracting State; or

   (c) any bank which is a resident of the other Contracting State.

4. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purposes of this Article.

Both have taxing rights

8%

Interest

Moz

Bank

SA

Not Subject in Moz

Service fees

Tax treaties: definitions and rates

Article 14 Technical Fees

1. Technical fees arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such technical fees may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but if the beneficial owner of the technical fees is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the technical fees.

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

3. The term "technical fees" as used in this Article means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any service of a technical, managerial or consultancy nature, unless the payment is limited to the reimbursement of actual expenses incurred by that person with respect to the service.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the technical fees, being a resident of a Contracting State, carries on business in the other Contracting State in which the technical fees arise, through a permanent establishment situated therein and the technical fees are effectively connected with such permanent establishment. In such case, the provisions of Article 7 shall apply.

5. Technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the technical fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to pay the technical fees was incurred, and such technical fees are borne by the permanent establishment, then such technical fees shall be deemed to arise in the State in which the permanent establishment is situated.

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the technical fees paid exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement.

Tax treaties: definitions and rates

ARTICLE 12

ROYALTIES

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State the tax so charged shall not exceed 12 per cent of the gross amount of the royalties.

3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph and video films, or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, computer software, plan, secret formula or process, or for the use of, or the right to use industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience. It also includes payments for technical assistance performed in a Contracting State by a resident of the other Contracting State where it is related to the application of any such rights, property or information.

Mauritius / Egypt

taxing rights

12%

IM

lease

Tech

Egypt

Equipment

Case study 1

A Ltd is a company holding a GBL and incorporated after 16th October 2017. Its year end is 30 June.

The Company received dividend income from its Ugandan subsidiary amounting to USD 10,000 during the income year ended 30 June 2020.

You are advised that this was the sole source of income of A Ltd. The Company incurred allowable expenses of USD 2,000.

You are required to compute that tax payable of A ltd and prepare a note (in bullet form) to the Director of A Ltd which will summarise your observation on the tax position of A Ltd.

Case study 2

A Ltd is a company holding a GBL and incorporated on 1 April 2004. Its year end is 30 June.

The Company received interest from loan receivable from a group company in Ghana amounting to USD 10,000 during the income year ended 30 June 2020.

You are advised that this was the sole source of income of A Ltd. The Company incurred allowable expenses of USD 2,000.

You are required to compute that tax payable of A ltd and prepare a note (in bullet form) to the Director of A Ltd which will summarise your observation on the tax position of A Ltd.

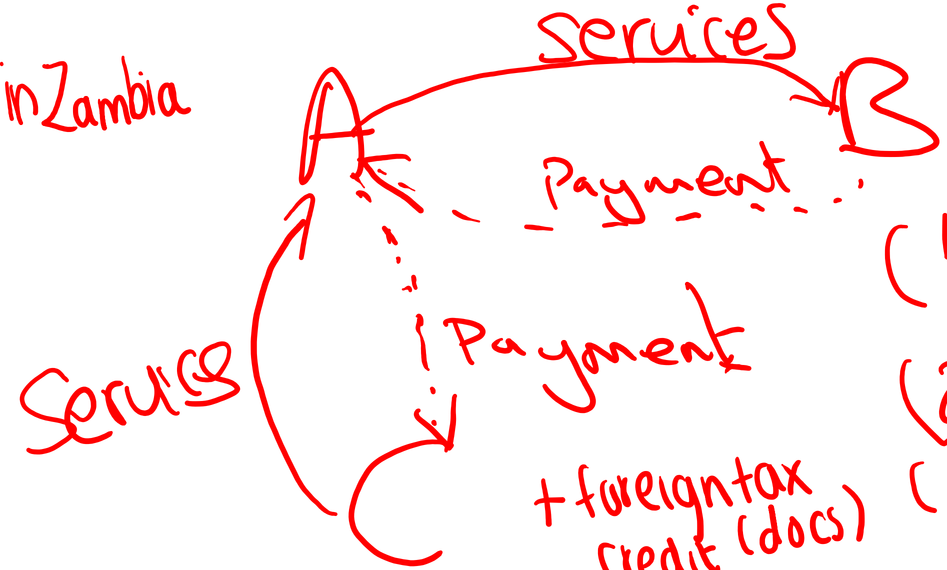
Case study 3

A Ltd, Mauritian company, has been engaged by B Ltd, a company based in Zambia for the provision of services.

A Ltd will subcontract a substantial part of the work to C Ltd, a company based in the UK.

You have been approached by the Finance Director of A Ltd who requested an advice on the tax implications of the services which A Ltd will ~~be~~ provide~~d~~ to B Ltd.

A-PE? in Zambia



+ foreign tax credit (docs)
+ corp tax 15%.

B – A

(1) Withholding / DTS → 20%

(2) VAT → 16%

(3) Reverse VAT → not allowed as input vat deduction

→ appointment of agent in Z

(4) Foreign/Local income → Place / location

A → C

(1) DTS → PE / location
If UK → NO DTS

(2) No treaty betw MU – Z
WHT 20%
→ But UK – Z treaty
↳ no WHT
↳ (2014)

Accounting for withholding tax

- Withholding tax on cross border transactions should be disclosed as "current tax" in the books of the payee (recipient)
- This is generally viewed as a final tax
- Income should be disclosed as gross in the books of the payee (excl WHT)
- Withholding tax in the books of the payor should be disclosed as a liability until such payment is made to the revenue authorities
- Where withholding tax is not a final tax for the ~~payor~~ payee, the WHT should be disclosed as receivable until such time that the receiveable crystallises

∘ Annual tax due

∘ disclosure is key!

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Accounting for withholding tax

(relief) ghana credit / deduction (choose)

- Most African countries use the "credit method" to mitigate impact of foreign tax on corporate tax payable by the payee
- But some countries do apply the "deduction method" as foreign tax credit relief
- Mauritius applies the credit method such that foreign tax credit is restricted to the corporate tax liability arising on the foreign source income
- Ghana allows taxpayers to choose either the credit method or the expense method

check treaty! → provide for deduction method

allowable exp

MU → credit method → Receive royalty

WHT 20%

gross 100

tax liab 15% . 100 = 15

corp tax 15 - 20 → 15 - 15 = 0

Credit for foreign tax: Mauritian example

- X Ltd is a GBL. The Company received a dividend of USD 20,000 from Z Ltd a company based in Zambia. A withholding tax of 5% has been deducted at source in Zambia. X Ltd incurred allowable expenses of USD 2,000. You are required to compute the Mauritian tax payable by X Ltd (ignore partial income exemption).

MU → credit method

Case study 4

- X Ltd is a GBL. The Company received a dividend of USD 20,000 from Z Ltd a company based in Zimbabwe. A withholding tax of 20% has been deducted at source in Zimbabwe. X Ltd incurred allowable expenses of USD 2,000. You are required to compute the Mauritian tax payable by X Ltd (ignore PFTC and partial income exemption).

Transfer pricing: Withholding tax

- Where transactions are not conducted at arm's length, the revenue authorities may impose WHT on such amounts forfeited → impact tax cost
- The deemed interest provision in Kenya
- Consequences can be dire, no corporate deduction for amounts forfeited by the payor- double taxation
- Transfer pricing documentation must be readily available and choice of methods including benchmarking must be bullet proof

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THE 'CARPUS' WAY

Connecting the forearm to the hand, the carpus is a set of bones that lets us execute crucial tasks with a flick of our wrist. It is from this connection that we derive our mission, vision and corporate culture. Much like a set of bones, our diverse and talented team works together, providing innovative solutions in the field of taxation.

As an independent tax advisory firm, we move away from restrictive environments of accounting/audit/fiduciary firms and provide bespoke tax services to our clients.

THE 'CARPUS' DIFFERENCE

Our team looks at excellence not as an achievement but as a habit. Every member aims to consistently add value to the businesses and states we work with. Our holistic approach to taxation helps clients execute faster and take measured decisions whether it be at an organisational or macroeconomic level.

We extend our ability to deliver in a seamless manner over Africa by working with tax advisers and lawyers carefully selected to meet the needs of our clients.

THE 'CARPUS' PHILOSOPHY

The backbone of Carpus is its people. Our work culture attracts the best and promotes an ecosystem conducive to the growth and wellbeing of our people. Together, Carpus strives to be the most trusted, competent and innovative tax advisory firm in Africa.

We share the values of honesty, integrity, mutual respect, diversity, balance, reliability, adaptability and open-mindedness.