TAX DRAINAGE

Kenya/Mauritius DTA and its potential impact on tax base erosion in Kenya

Acknowledgement

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Our vision is a new Africa in which tax justice prevails and ensures an equitable, inclusive and sustainable development which enables all its citizens to lead a dignified and fulfilled life.

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1.0 Introduction

In May 2012, Kenya's then Minister of Finance, Njeru Githae, and his Mauritian counterpart Xavier-Luc Duval signed a Double Taxation Avoidance Agreement (DTAA) and an Investment Promotion and Protection Agreement (IPPA) between Kenya and Mauritius. According to the island state's Prime Minister's Office, the objective of this agreement was to place the competitiveness of Kenyan companies at par with that of other African countries already having tax treaties with Mauritius and to streamline tax effectiveness. Duvall stressed that Mauritius, being an emerging economy and due to its strategic location, had a central role in facilitating trade and investment in the region. He stated that Africa is an emerging market and is growing at a fast pace, registering a growth rate of over six per cent. Mauritius, it was stated, is positioning itself as a financial centre of substance in the region in the investment and trade sectors and investors are encouraged to tap the African market.

International tax law allows the taxation of foreign economic transactions when a sufficient connection exists between the taxpayer and the taxing state. Such may include residence, habitual abode, establishment, citizenship, or location of assets. Taxation under the foregoing situation is usually effected through Double Taxation Treaties (DTTs)[1]. The phenomenon of double taxation is understood to be the levying of taxes on the same income (or capital) of the same taxpayer in the same period across two jurisdictions. This, it is argued, has a harmful effect on the movement of capital and inter-country economic relations in general. While international tax law provides a mechanism for cooperation in tackling tax evasion, there are instances where it is abused through "treaty shopping" which is using other favourable tax treaties as a conduit to channel investments into third countries. This enables corporations to avoid their tax obligations.

To address the foregoing challenges, countries usually negotiate DTTs supposedly to eliminate double taxation and therefore encourage Foreign Direct Investments (FDI) while preventing tax evasion. DTTs have been stated to be useful in promoting FDI through resolving tax problems which are impediments to trade and investment between countries. However, they can also be used (or rather abused) by multinational companies and individuals who exploit inherent loopholes in their (DTTs) design resulting in the loss of huge revenues for governments struggling to provide public goods. In fact, some studies have argued that DTTs have no effect on FDI from developed to less developed countries because developed countries unilaterally provide for the relief of double taxation and the prevention of fiscal evasion regardless of the treaty status of a host country[2] This, it has been argued, eliminates the key economic benefit and risk that the treaties would otherwise create for multinational enterprises when making FDI location decisions.

Perhaps the clearest illustration of how DTTs could be abused is to be seen in the case of the DTT between India and Mauritius. About 47 per cent of India's FDI is rerouted through Mauritius. India, it is estimated, loses about US$600 million annually because of the DTT with Mauritius. In 2011, the Government of India signalled its intention to renegotiate its DTT with Mauritius. Upon this announcement, the capital markets responded and the SENSEX went Red. Within a span of ten minutes, the BSE slipped down over 450 points (nearly three percent) on the information that the Indian Government proposed to rework India-Mauritius double tax avoidance treaty to plug revenue leakages. These events were a reaction to the announcement and an indicator that a revision would have had significantly had financial implications on the markets as companies were abusing the Indian treaty with Mauritius.

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[1] Klaus Vogel, Double Tax Treaties and Their Interpretation (1986) 4:1 Berkeley Journal of International Law

[2] See for example Baker, L.P., An Analysis of Double Taxation Treaties and their Effect on Foreign Direct Investment. Draft Version 23 May 2012

1.1 Revisiting the "International Financial Services Centre" Status of Mauritius

The World Investment Report 2010 identified Mauritius as a favourable and tax efficient platform for African investments. The country is also on the "white list" which entails jurisdictions that have implemented the internationally agreed tax standard and are therefore not considered tax havens by the Organisation for Economic Co-operation and Development (OECD) through its Global Forum on Transparency and Exchange of Information. The country was ranked among the top ten countries globally on the Economic Freedom Index (EFI) and the Environmental Performance Index (EPI) in 2010.

Being the choice country for many cross-border investments into Africa has to do with, among other factors[3], the country's incentive for companies to reduce their tax burden in countries they invest in within the continent. Mauritius currently has DTTs with 13 African states (Botswana, Lesotho, Madagascar, Mozambique, Namibia, Rwanda, Senegal, Seychelles, Swaziland, South Africa, Tunisia, Uganda and Zimbabwe) and has signed DTTs with four other states (Kenya, Congo, Zambia and Nigeria) which are awaiting ratification. The country is also in the process of negotiating DTTs with Burkina Faso, Algeria, Tanzania, Egypt, Gabon, Malawi and Ghana. The DTTs that Mauritius has signed with these countries confers a number of benefits to companies that are resident in the country. These include:

- **Exemption From Capital Gains Tax (CGT)**: Most jurisdictions on the African continent (including Kenya) levy CGT at a rate ranging from 30-35 percent. However, in jurisdictions where Mauritius has concluded DTTs, there is usually restriction on taxation rights on capital gains to the country of residence of the seller's assets. However, Mauritius itself does not impose CGT to its companies. This therefore means that companies investing through Mauritius completely avoid paying CGT and are able to keep huge profits from monies due as tax. The Mauritian DTT model also guarantees the maximum effective withholding tax rate should changes occur in the fiscal policy in the countries of investment.
- **Limitation of Withholding Tax on Dividends:** In many African countries, dividends paid out to non-residents attract withholding tax ranging from between 10 and 20 per cent. For countries with DTTs with Mauritius, however, there is a limit on the extent of withholding tax payable. The treaty rates are generally zero per cent (0%), five per cent (5%) and 10 per cent. This, therefore, enables companies using Mauritius as an intermediate jurisdiction to make savings ranging from 5% to 20% depending on the country they are investing in.

1.1.1 Reforms on Mauritian Financial Services Sector Laws and Regulations: From "Offshore Haven" to "International Financial Services Centre."

The Mauritian laws and regulations on the financial services sector were significantly altered on December 1, 2001. In this case, the Mauritius Companies Act of 1984 was replaced by the Companies Act of 2000. Further laws to regulate the sector included the Financial Services Development Act 2001 (FSD Act) and the Trust Act 2001. Among the significant changes made was the replacement of the Mauritius Offshore Business Activities Authority (MOBAA) with a modernized regulatory body, the Financial Services Commission (FSC).

These changes saw the replacement of nomenclature from "Offshore" to "Global Business", "Offshore Company" to "Category 1 Global Business License Company", "International Company" (which basically is the Mauritius version of international business companies found in jurisdictions such as Jersey, Guernsey and Isle of Man) to "Category 2 Global Business License Company" and "Offshore Trust" being referred simply as a trust.

A Category 1 Global Business License Company offers investors a chance to benefit from the 36 existing DTAs and future ones; low tax rates; generous tax

[3] These include political stability, liberal exchange controls and a headquarters tax regime.

credits; no withholding tax on dividends, interest and royalties paid; no Capital Gains Tax; free repatriation of profits, capital and interest; no estate duty, inheritance, wealth or gift tax as well as full protection of assets. Such a company is liable to corporate tax at 15 per cent but may claim a foreign tax credit in respect of the actual foreign tax suffered or 80 per cent presumed foreign tax credit, whichever is higher. This effectively means that a Category 1 Global Business License Company is taxed at a maximum effective rate of three (3) per cent.

The net effect of the changes brought by the Companies Act of 2001 was bringing domestic companies within the same ambit as companies in the previously ring-fenced offshore sector as they were essentially regulated by the same statutory regime save for certain special provisions in recognition of the peculiarities of Global Business Companies. Business activities that qualify under the FSD Act as global business activities are given below.

Category 1 Global Business License Companies	
Aircraft Financing and Leasing	Consultancy services
Employment services	Financial services
Assets management	ICT Services
Funds management	Operational headquarters
Insurance	Pension funds
Logistics, Licensing and franchising of marketing	Shipping trading and ship management

Category 2 Global Business License Companies	
Passive Investment Holding	Marketing
Trading: non-financial	Shipping
Non-financial consultancy	Logistics
ICT Services	Others, as approved by the FSC

Source: Kamal Hawabhay, *Revisiting the Mauritius/South Africa Double Tax Treaty. Tax.* **Planning International Review**

1.1.2 Disclosure of Information Under Mauritian Law

The FSD Act places severe restrictions on the disclosure of information relating to Category 1 and 2 companies. The Act gives powers to the FSC to request any information and also be shown all records and documents deemed necessary to ensure compliance with the FSD Act and any other relevant laws. The Chief Executive of the FSC has powers to make any inquiries and inspection in relation to the conduct of business in the financial services sector.

Personnel of the FSC (including the Chief Executive and the Board) are required under the Act to maintain confidentiality on any information which comes to them with regard to Category 1 and 2 companies, their shareholders and beneficial owners. Consequently, any disclosure of information to any court, tribunal, and commission of inquiry or authority within Mauritius or elsewhere is prohibited except with the leave of the court through a court order.

However, Section 33(6) of the FSD Act does not include tax matters within the ambit of information

that can be disclosed. In fact, a Mauritian court can only make orders for the disclosure or production of information in relation to Category 1 or 2 companies strictly upon the application of the Mauritius Director of Public Prosecutions. Such application must prove beyond reasonable doubt that the confidential information is ***bona fide*** required for the purpose of any inquiry or trial relating to the trafficking of narcotics and dangerous drugs, arms trafficking or money laundering under the Financial Intelligence and Anti-Money Laundering Act of 2002. The Registrar of Companies also has a duty to report to the FSC such matter if it becomes known to him or her.

Furthermore, disclosure of information to foreign tax authorities is severely constrained under Mauritian law. Whereas the FSD Act provides that its provisions are without prejudice to the obligations of Mauritius under any international treaty, convention or agreement, disclosure of information under the Act is limited to supervisory functions. An amendment to Section 33(7) of the FSD Act through the Finance Act of 2002 enabled information disclosure by the FSC on condition of confidentiality for the sole purpose of exercising its supervisory functions in relation to a financial institution carrying out a service under the Act. This disclosure can only be made to the Bank of Mauritius and to an FSC-like institution in a foreign country. The disclosure, therefore, is not linked in any way to income tax authorities of any country as its nature is limited to supervisory functions.

Foreign tax authorities have faced challenges invoking that tax information exchange provisions in the DTAs signed by Mauritius. The Securities and Exchange Board of India (SEBI), for example, was denied access to books of some Global Business (offshore) companies suspected of being involved in major stock exchange scams in India. The FSC disallowed the numerous applications on the grounds that SEBI's requests lacked solid, persuasive and tangible evidence. Public access to records of Category 1 and 2 companies maintained by the appointed management company and the Registrar of Companies is limited to shareholders, directors, agents, appointed management companies or their authorised officers. The net effect of this law is to make Mauritius rather opaque in instances where disclosure of information is needed to arrest financial misconduct of multinationals investing in Africa resulting to illicit financial flows. While the Global Forum on Transparency provides a mechanism for possible disclosure, ownership information on global business companies is severely restricted especially for those that enjoy treaty benefits.

1.1.3 Investment Promotion and Protection Agreements

Mauritius has also entered into IPPAs with 20 African countries.[4] The structure of IPPAs largely follows the design in Bilateral Investment Treaties (BITs) with guarantees for the protection of investments. The Mauritian model of the IPPA includes measures such as:

- Free repatriation of investment capital and returns
- A guarantee against expropriation (both direct and regulatory)
- The Most Favoured Nation (MFN) rule with respect to the treatment of investment, compensation for losses in case of war or armed conflict or riots
- Dispute settlement mechanisms which largely focus on investor-state arbitration.

1.1.4 Membership to Regional Economic Communities and Free Trade Zones

Mauritius has also taken advantage of Regional Economic Communities (RECs) to establish "semi-tax havens" which are basically locations that produce goods for sale primarily outside of their territorial boundaries and have flexible regulations to encourage job growth, such as Free Trade Zones, territorial-only taxation, and related inducements. The country is a member of the South African Development Community (SADC), the Common Market for Eastern

[4] These include Madagascar, Mozambique, South Africa, Benin, Botswana, Zimbabwe, Tanzania, Ghana, Guinea Republic, Mauritania, Rwanda, Senegal, Chad, Nigeria, Burundi, Cameroon, Comoros, Swaziland, Kenya and the Democratic Republic of Congo.

and Southern Africa (COMESA) and the Indian Ocean Rim – Association Regional Cooperation (IOR-ARC). The country is also a signatory to more than 15 multilateral conventions relating to Africa. Membership in SADC and COMESA provides leverage for Mauritius to request other African countries for conclusion of DTTs.

COMESA membership affords the country access to a Free Trade Area (FTA) with 18 other African countries[5] with customs duties from COMESA imports within Member States being eliminated. The REC has a population of about 430 million, an annual import bill of about US$ 152 billion and exports worth US$157 billion. SADC, on the other hand, comprises of 15 Member States, a population of 258 million inhabitants and a Gross Domestic Product (GDP) of US$ 472 billion.

The membership to these RECs and the benefits conferred therefrom have made the country attractive for countries or private equity funds to establish any Africa Fund, holding companies or trading companies. The fastest growing economies today see Mauritius as a gateway to tapping the African continent. China, for example, is making a wave of strategic investments to take advantage of the COMESA and SADC FTAs. The country recently invested US$ 700 million in a Special Economic Zone (SEZ) in Mauritius to service its expansion in Africa. Mauritius also has significance to India with regard to its maritime dominance of the continent. India plans to build a logistics and services hub in the SEZ within the country. The incentives for establishment of Freeport companies in Mauritius' SEZ for export to African countries include:

- Zero tax rate on corporate profits. The country had exempted such entities from income tax payable for income years up to and including the income year ending 31 December 2013. The corporate tax rate applicable to processing and transformation activities is 15 per cent.
- Exemption from Customs duties and Value Added Tax (VAT) on all goods and equipment imported into the Freeport zone.
- A reduction in fees related to port handling charges for all goods destined for re-export
- Free repatriation of profits from the Freeport operations.
- Full ownership (100 per cent) where no immoveable property is to be held in Mauritius.
- An allowance to sell a quota of 20 per cent of total goods re-exported into the local market where normal tax rates will apply.

The requirement for the operation in the Mauritius Freeport is the obligation to undertake substantive value addition for eligibility for issuance of the COMESA Certificate of Origin. The REC's tariff reduction programme requires all goods satisfying the value addition criteria of 35% to be eligible for COMESA duty-free tariff treatment and allows re-export in all COMESA Member States.

[5] These include Djibouti, Eritrea, Ethiopia, Egypt, Libya, Sudan, Comoros, Madagascar, Seychelles, Burundi, Kenya, Malawi, Rwanda, Uganda, Swaziland, Zambia, Zimbabwe, Democratic Republic of Congo and South Sudan.

2.0 Foreign Direct Investment Flows in Kenya and Mauritius

Between 2006 and 2007, Kenya's net investment inflows increased over fourteen-fold. The World Bank's World Development Indicators Report observes that investment increased from US$51 million (0.2 percent of GDP) in 2006 to a record US$729 million (2.7%) in 2007 mainly because of large privatizations in telecommunications and investment in railways infrastructure. There was a sharp drop in 2008 with FDI inflows being US$96 million (0.3%) before rebounding to US$116 million (0.4%) in 2009, US$178 million (0.6%) in 2010, and US$335 million (1.0%) in 2011. UNCTAD estimates Kenya's 2011 FDI stock at approximately US$ 2.6 billion.

Kenya is today ranked among top FDI destinations in Africa. According to the FDI Intelligence's FDI Report of 2012, Kenya ranked 10th in infrastructure systems in Africa and 8th in human resource capacity attributes in Africa. The report indicates that Kenya attracted 55 projects in 2011 compared with 154 projects in South Africa and 70 projects in Morocco. The biggest FDI inflows by sectoral projects were in coal, oil and gas, real estate, hotels and tourism, software, ICT services as well as communications sub-sectors. There was an increase in the number of projects that attracted FDI with Kenya attracting 77 per cent more projects which placed the country ahead of Nigeria and Egypt. The other East African Community (EAC) countries did not feature in the ranking.

The country has also divested from its traditional FDI sources such as Europe with an increasing profile of FDI flows from emerging markets. Kenya has seen FDI flows from China (roads, manufacturing and agriculture), India (ICTs such as Airtel and Yu), and the Middle East (hotel and property development such as Fairmont). Large government infrastructure projects such as the Standard Gauge Railway and the LAPPSET infrastructure corridor are likely to see an increase in FDI flows in the coming years. The government has passed a law on Public Private Partnerships (PPP) which may leverage the entry of major players.

Increasingly, most of these investments are flowing through Mauritius which has become the third major source of FDI for Kenya. This trend indicates a preference by multinationals to reroute their investments through Mauritius to benefit from its fiscal structures and reduce their exposure to taxation. Furthermore, Kenyan companies are increasingly using the jurisdiction as a launching pad for their investments within the region. Companies such as British American Insurance, Jubilee Insurance and Centum Investments are fashioning regional investments through entities established in Mauritius.

With a decreased risk profile for the country's upstream energy sector in 2012 as well as increased energy demand, foreign interest in Kenya's energy sector has grown substantively. Kenya's energy sector has received significant attention with major breakthroughs in oil and geothermal which have staved off the slow development of wind and solar energy sub-sectors. The country now boasts an expanded minerals profile including coal, rare earths, and niobium as well as oil and gas resources. These resources will inevitably result in increased investment flows. With such flows, the attractiveness of low tax jurisdictions will inevitably push investors to redirect their inflows through countries such as Mauritius. The resulting effect is that taxation of income generated from these investments will be substantively insulated from the Kenya Revenue Authority.

2.1 Mauritius and Foreign Direct Investments in Africa

Mauritius has become a key plank for foreign companies investing into Africa because of its investment climate and the fact that it is a low tax jurisdiction that also allows free transfer of profits for multinationals. FDI flows from the country are mainly towards accommodation and food services, financial services real estate activities as well as manufacturing. This investment pattern from Mauritius has had a significant impact on tax policy in

many African countries as will be discussed later. The following figure shows the concentration the FDI flows from Mauritius by sector of activity.

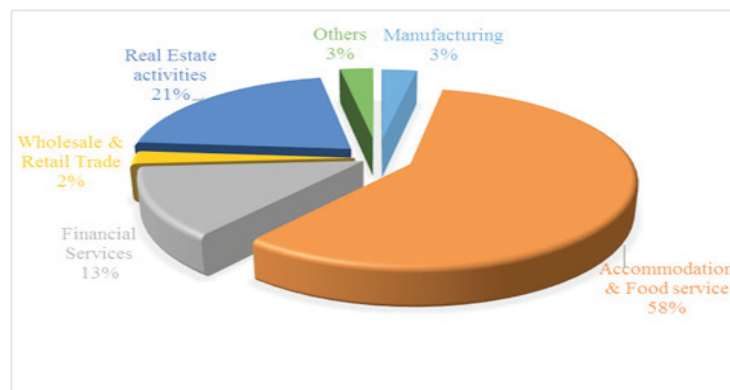

Figure 1: Direct Investment Abroad by Sector of Activity
Source: Bank of Mauritius

The FDI outflows in the accommodation and food services in 2013 was 2.4 billion Mauritian Rupees (MUR) with real estate activities accounting for MUR 862 million with both sectors accounting for 58% and 21% of total FDI respectively. FDI outflows in the financial services sector accounted for MUR 535 million or 13% of total outflows after a rally of MUR 2.4 billion (accounting for 43% of total outward FDI) in 2012. The manufacturing sector saw a decline in FDI outflows to MUR 124 million while wholesale and retail trade FDI outflows were MUR 96 million in 2013. The exchange rate is 1 MUR being equivalent to 0.033 US Dollar.

The biggest FDI flows from Mauritius are into the African continent with total investment outflows into Africa accounting for 72 percent of total outflows or 2,993 million. FDI flows to Europe was MUR 730 million (18%) with France (MUR 212 million) and Switzerland (MUR 107 million) being the main host countries. The US received a total of MUR 85 million while the United Arab Emirates (UAE) received a total of MUR 163 million. The following figure shows the total FDI flows from Mauritius in 2013 by region.

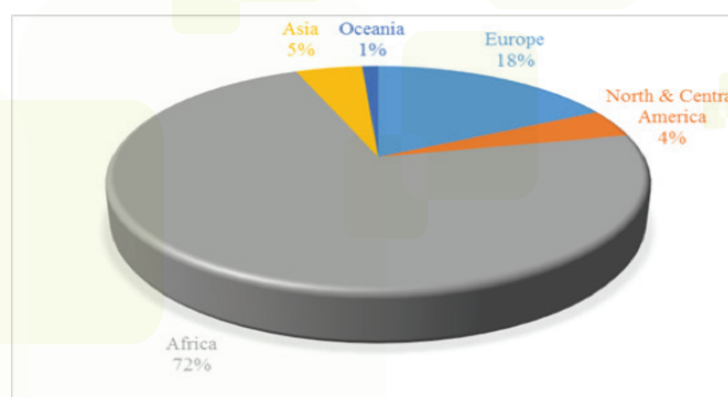

Figure 2: Direct investment abroad by country of origin
Source: Bank of Mauritius

Africa also accounts for 22% of total FDI flows into Mauritius. This is indicated below.

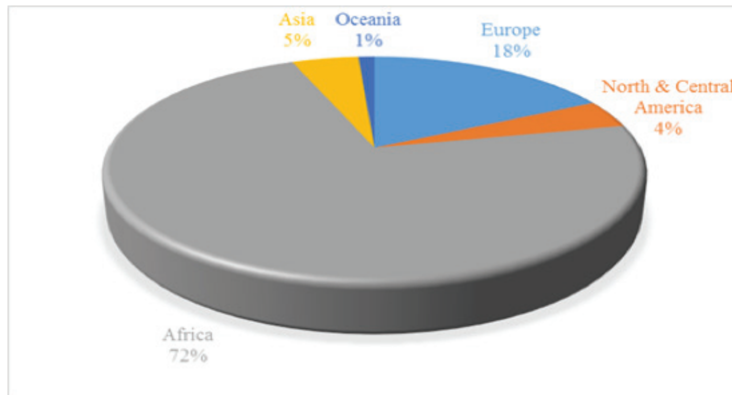

Figure 3: Share of FDI by geographic region
Source: Bank of Mauritius

The pattern of investments into Africa from Mauritius has had significant implications for tax treaty policy in many African countries. In essence, countries have become engaged in competition to make their jurisdictions more attractive to investments by signing treaties with Mauritius. The result has been a situation that limits regional tax policies as countries rush to conclude DTAs with Mauritius. A clear example is the EAC double taxation treaty which has not been ratified to date yet some members have concluded agreements with Mauritius. This has seen losses as most regional companies reroute their investments through Mauritius to avoid double taxation within the region. Furthermore, countries are now competing to lower the tax obligations of investors in the hope that this can translate to increased inflows of investments. This has had a negative impact on the ability of governments to mobilize resources for development through taxation.

With real estate investments accounting for 21 per cent of total FDI outflows from Mauritius, the imposition of CGT could raise significant revenues for governments to be able to provide public goods. The share taken by financial services (13%) as well as accommodation and food service (58%) is also significant with a booming tourism sector as well as a growing financial sector in the continent. The implications for signing up of tax treaties with low tax jurisdictions like Mauritius effectively means that countries have to forego revenues as a trade-off for attracting investments. This severely limits the policy space for governments to undertake measures that promote development through investments in public goods including social services and infrastructure.

The Mauritius/Africa Business Footprint

- Banking ●
- Energy ●
- IT Services ●
- Sugar ●
- Other Agro ●
- Manufacturing ●
- Hotel and Tourism ●
- Export
  - High ●
  - Low ●

Source: Mauritius Africa Club, Strengthening Economic Growth of Mauritius Through a Coherent, Deepened and Effective Mauritius-Africa Strategy. Advocacy Paper

3.0 Analysis of Select Clauses in the Kenya/ Mauritius Agreement

3.1 Article 1: Personal Scope

The first article of the Kenya/Mauritius DTA relates to the personal scope. It states that the Agreement shall apply to persons who are residents of one or both of the Contracting States. However, the UN Model Convention has departed from this definition from "Personal Scope" to "Persons Covered" as the former does not convey the scope of application of the Convention.

The term "person" enjoys wider interpretation under the UN and OECD Models as it includes an individual, a company and any other body of persons. According to the Commentary on Article 3 of the OECD Model Convention, the term also includes "any entity which, although itself not a body of persons, is treated as a body corporate for tax purposes [e.g. a foundation]." This could cover trusts established in both jurisdictions as well. In Mauritius, trusts are increasingly used for tax planning. They are registered as Category 1 Global Business vehicles with income charged at the rate of 15 per cent per annum. Under the Mauritius Income Tax (Foreign Tax Credit) regulations, a credit of up to 80 per cent is allowed effectively making the rate 3 per cent. Non-resident beneficiaries of an offshore trust are exempt from income tax on the income derived from the trust. This means that a Mauritius resident trust can effectively pay no income tax by distributing all its income to non-resident beneficiaries. This leeway has been abused in Kenya by both corporate and individual entities.

3.2 Article 4: The Definition of Resident

The DTA defines a "resident" as being "any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, *place of incorporation*, place of management or any other criterion of a similar nature and also includes that State and any political subdivision or local authority thereof." The inclusion of "place of incorporation" effectively uses the UN Model Convention which is additional to the definition under Article 4 of the OECD Convention.

An exception is made, however, to the effect that "***the term does not include any person who is liable to tax in that State in respect only of income from sources in that State***." The exception has the potential to be abused by excluding foreign-held companies exempted from tax on their foreign income by privileges tailored to attract conduit companies as is the case in Mauritius.

It may be a valuable addition to include a requirement for persons (body corporate and individuals) to file certification by the country's tax authorities on their residency status. The UN Model Convention requires a certificate from the tax authorities of the other country to the effect that the person is a resident of that country as a condition for granting the benefits of the treaty. The use of residence certificates is widespread and can be formalized by an agreement between the competent authorities, as provided for in Articles 10 (2), 11 (2) and 12 (2) of the United Nations Model Convention only.

3.3 Article 5: Permanent Establishment

The definition of this Article is analogous to both the United Nations and OECD Model Conventions. However, Article 5(3) (a) defines permanent establishments as including "***a building site or construction, installation or assembly project, or supervisory activities in connection therewith only if the site, project or activity lasts more than 12 months***." This is beyond the six-month threshold in the UN Model given that construction, assembly and similar activities could, as a result of modern technology, be of very short duration and still result in a considerable profit for the enterprise carrying on those activities. Furthermore, the period during which the foreign

personnel involved in the activities remain in the country is irrelevant to the right of Kenya to tax the income. A commercial warehouse, where space is rented to other concerns, is also not considered a permanent establishment in this scenario.

The provision in Article 5(3) (b) relates to the furnishing of services including consultancy services through employees and other personnel. These are not covered specifically in the OECD Model Convention and their addition is a positive thing. However, a limit is put stating that the provision of such services will be considered a permanent establishment provided activities continue for the same or a connected project for a period or periods aggregating to more than 6 months within any 12 month period. Given the significant financial amounts of some of these services, the time-limiting clause may serve to impair the ability of the government to tax activities that are carried out within this time period as it precludes taxation in the case of a continuous number of separate projects, each of four or five months' duration

Article 5(6) states that an enterprise "***shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status***..." This, however, is not adequate to deal with certain aspects of the insurance business. If an insurance agent is independent, the profits would not be taxable in accordance with the provision suggested above. Further, if the agent is dependent, no tax could be imposed because insurance agents normally have no authority to conclude contracts. Such situation would need an evaluation of the said independence through an independence test. This provision may open up future possibilities of entities working through agents in the country.

Finally, Article 5(8) states that the fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise does not make either company a permanent establishment of the other.

However, this exclusion from being a permanent establishment is usually done upon the evaluation against properties of the dependent agent. This is known as the "effectively connected rule."

3.4 Article 7: Business Profits

This provision states that profits of an enterprise of a contracting state are taxable only in that state unless such enterprise carries on business through a permanent establishment established therein. The UN Model Convention uses the "limited force of attraction" rule where if an enterprise has a permanent establishment in the other Contracting State for the purpose of selling goods or merchandise, sales of the same or a similar kind may be taxed in that State even if they are not conducted through the permanent establishment.

A similar rule applies if the permanent establishment is used for other business activities and the same or similar activities are performed without any connection with the permanent establishment. This is important as there may be situations where sales are conducted directly away from the permanent establishment. This could be done through direct dealings with the principal company. The limited force of attraction approach avoids administrative challenges associated with determine whether particular activities are related to the permanent establishment or the income involved attributable to it. This is especially in cases where transactions are directly conducted by the home office within the country and are similar in nature to those conducted by the permanent establishment.

3.5 Article 8: Shipping and Air Transport

This provision closely follows alternative A of the UN Model which reproduces the OECD Model Convention. The implication of the provision is that shipping enterprises should not be exposed to the tax laws of the countries to which their operations extend and would instead have a taxation model that relies on the place of effective management. These profits are wholly exempt from tax at source and are taxed exclusively in the State in which is situated the place of effective management of the enterprise engaged in international traffic. This is based on the argument

that the income of these enterprises is earned on the high seas, and exposure to the tax laws of numerous countries is likely to result in double taxation or at best in difficult allocation problems. Furthermore, it is contended that exemption in places other than the home country ensures that the enterprises will not be taxed in foreign countries if their overall operations turn out to be unprofitable.

Mauritian law permits shipping companies to register as global business under the first category. These companies can own and register ships under the Mauritian flag provided their objects are confined to the registration of the ship under the Mauritian flag and the shipping activities are carried out exclusively outside Mauritius. These vessels are exempted from tax on freight earnings, resultant net revenue or dividends received from the Mauritian shipping companies. With the change of strategy by countries like India to establish a logistics centre, the jurisdiction could be used as a "flags of convenience" jurisdiction.

3.6 Article 10: Dividends

The Kenya/Mauritius DTA has a limited definition of what dividends are. The definition of dividends excludes interest on loans in so far as the lender effectively shares the risks run by the company. The DTA under Article 10 and 11 does not prevent interest on loans from being treated as dividends under domestic thin capitalization rules. This is a weakness that needs clarification that whether the lender shares the risks of the company must be determined in each individual case in the light of all the circumstances.

These circumstances include situations where the loan very heavily outweighs any other contribution to the capital and is substantially unmatched by redeemable assets, the creditor will share in any profits of the company, cases where repayment is subordinated to other creditors or to payments of dividends, where the level of interest is directly related on the profits, situations where here are no fixed provisions in the loan contract for repayment by a definite date and in cases where there are no fixed provisions in the loan contract for repayment by a definite date.

An inclusion of a provision to this effect will clarify the treatment of interest as dividends for tax treaty purposes in the case of hybrid financing and of thin capitalization. The DTA negotiators should be to consider increasing the percentage tax so charged to equal the amount charged to resident companies or 2 per cent less to remove the incentive for avoidance through more favourable terms under the Kenya/Mauritius DTA. Alternatively, they could consider levying tax by allowing the country of residence of the recipient of the income to also fully tax such income, but then it must provide relief, under Article 23 of both the United Nations and OECD Model Conventions, for the tax levied in the source country.

3.7 Article 11: Interest

The provision in Article 11 of the proposed DTA relates to interest. It provides under 11(2) where in cases where the beneficial owner is a resident of the other contracting state, the tax so charged cannot exceed 10 per cent of the gross amount of the interest. This is an OECD Model provision that has been replaced in the UN Model leaves this percentage to be established through bilateral negotiations. Prior to the amendment, it was provided that such interest could also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax was to be charged in the specified manner as has been described above.

In this case, Kenya should have at least the primary right to tax interest. It is therefore incumbent on the residence country to prevent double taxation of that income through exemption, credit or other relief measures. The justification for this reasoning is that interest should be taxed where it was earned, that is, where the capital was put to use. It would therefore serve the country better to raise this rate to 15 per cent as is the rate applicable to non-residents.

3.8 Article 13: Capital Gains Tax

This provision largely adopts the OECD Model and doesn't factor in the changes introduced in the UN Model. While it contains 4 paragraphs, the UN Model Convention consists of the first three paragraphs of Article 13 of the OECD Model Convention, followed

by two new paragraphs (paragraphs 4 and 5) and by the text of Article 13, paragraph 4, of the OECD Model Convention renumbered as paragraph 6 and adjusted to take into account the insertion of the two new paragraphs.

Following the DTA provisions therefore, interpretation would mean that (1) it allows the source country (Kenya) to tax capital gains from the alienation of immovable property; (2) permits gains from the alienation of ships and aircraft to be taxed only in the State of effective management of the relevant enterprises, and (3) reserves to the residence country the right to tax gains on other forms of alienable property. This is a limited scope that limits taxation of gains made from the sale of company shares to Mauritius which has an effective Capital Gains Tax (CGT) of 0%. This can provide an avenue for acquisitions to be done through companies resident in Mauritius and the government can have no right to tax any gains from the subsequent sale of such companies. Further, it provides an environment that can encourage round-tripping where Kenyan companies can avoid taxation of dividends paid to foreign investors through share buy-back plans. Given that parliament has voted to reintroduce CGT, this clause could have far-reaching consequences on the ability to raise revenues. By failing to include Articles 13(4) and 13(5) of the UN Model Convention, has the overall effect of promoting a loophole for tax avoidance through enabling the alienation of immoveable property in Kenya through companies established in Mauritius.

4.0 Double Taxation Treaties and Withholding Tax Rates Between Mauritius and East African Countries

Withholding tax rates between Mauritius and EAC States as well as their (EAC States) treaties with other jurisdictions indicate a trend of lower rates as compared to third countries. This is an incentive for conduit companies to redirect their investments through Mauritius to benefit from its network of treaties.

4.1 Kenya

	United Kingdom %	Germany and Canada %	Denmark, Norway, Sweden and Zambia %	India %	Mauritius %
Management and professional fees	12½	15	20	17½	20
Royalties	15	15	20	20	10
Rent *- real estate* *- others*	 30 15	 30 15	 30 15	 30 15	 30 15
Dividends	10	10	10	10	5
Interest	15	15	15	15	10
Pension and retirement annuities	5	5	5	5	5
Entertainment sport and promotion	20	20	20	20	20

4.2 Uganda

	United Kingdom %	Italy %	Netherlands %	Denmark, India, Mauritius, Norway, South Africa, Zambia
Dividends	15	15	0-15	10
Interest	15	15	0-10	10
Royalties	15	10	0-10	10
Technical fees	15	10	As business profits	10

4.3 Tanzania

	Denmark %	Canada & Sweden %	India %	Norway & Finland %	South Africa %	Zambia, Italy ** %
Dividends	15	25*	15*	20	20*	-
Interest	12½	15	12½	15	10	-
Royalties	20	20	20	20	10	-
Technical	20	20	20	20	-	-

* - These rates are further reduced for certain percentages of ownership.

** No withholding tax applicable subject to certain conditions.

[5] If paid to a company directly holding more than 10% of the paying company's shares. In all other cases, the WHT rate is 10 percent.

5.0 The Ratification Process of the Kenya/ Mauritius Agreement

The Treaty Making and Ratification Act was enacted by Parliament to give effect to Article 2(6) of the Constitution which requires ratification of any treaties entered into by Kenya through Parliament. The Act was further enacted to provide for the procedure of making and ratification of treaties. Section 3(2) of the Act states that the Act applies to:

a) Multilateral treaties;

b) Bilateral treaties which deal with:

vi) the security of Kenya, its sovereignty, independence, unity;

viii) the status of Kenya under international law and maintenance or support of such status;

ix) the relationship between Kenya and any international body or similar body; and

x) the environment and natural resources

Section 3(4) of the Act further provides that notwithstanding subsection 2(b), the Government may enter into bilateral agreements: (c) necessary for matters relating to government business; and (d) relating to technical, administrative or executive matters. Sections 3(1) – (4) of the Act make provision for the applicability and non-applicability of the Act. Section 2(a) and (b) (i) – (iv) provide more particularly the type of treaties which require ratification as provided under Part III of the Act. The reading of Section 3(4) of the Act provides for an exception to the operation of Section 2(b) by way of the use of the word "**notwithstanding.**" A distinction is also made between **bilateral treaties** and **bilateral agreements** which the drafters of the law clearly intended to demarcate a dichotomy that distinguishes them.

The Attorney General's (AG) office correctly argues that treaties referred to under Section 2(b) relate to specific bilateral treaties that must be ratified by parliament as they have an impact on the Constitution which is the sovereign law as well as domestic laws. Ratification is mandatory in this respect since these agreements form part of Kenyan law given that Kenya is now a Monist state where treaties entered into by the country automatically form part of laws applicable in Kenya. However, the government through Section 3(4) may enter into bilateral agreements relating to specific issues that are not covered by Section 2 (b). These arguments led the AG to conclude that Agreements on Avoidance of Double Taxation, Investment Promotion and Protection and Exchange of Tax Information are not subject to part III of the Act which relates to the ratification process. This position, however, uses a dichotomy between the words "**treaties**" and "**agreements**" to essentially differentiate synonymous agreements in the face of international law.

5.1 The Legal Nature of DTAs and why the Kenya/Mauritius DTA Requires Ratification

There is general consensus in international law that a Double Tax Treaty ("DTT") is a treaty within the meaning of Article 2 of the Vienna Convention on the Law of Treaties. The United States, while not being a signatory to the Convention nevertheless acknowledges that it is bound by the convention to the extent that the convention embodies customary international law.

Perhaps the clearest demonstration that DTAs are not mere agreements is to be seen in the way countries treat them and their relation to domestic laws. The legal status of tax agreements as treaties has been made trite through the Supreme Court case of ***Head Money Cases*** where the court stated:

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> A treaty is primarily a compact between independent nations. It depends for the enforcement of its provisions on the interest and the honor of the governments which are parties of it.[6]

Tax treaties in the US have the legal effect of any other treaty. This is laid out in the Supremacy Clause of Article VI of the US Constitution which provides that all treaties shall be the supreme law of the land. The ratification process of treaties signed by the US is done through the Senate Foreign Relations Committee which acts as a restraint of executive power to make treaties. The status of tax treaties in relation to domestic law varies from country to country. In countries such as Netherlands and Belgium, international law and tax treaties are considered to be the highest source of law in the hierarchy of legal rules. On the other hand, Australia, Canada and the United Kingdom place tax treaties on the same pedestal as domestic laws.

The Treaty Making and Ratification Act adopts the same definition contained in the Vienna Convention in section 2. The implication of this definition in Kenyan law means that DTAs are by their very nature international treaties and are generally interpreted under Articles 31 and 32 of the Vienna Convention on the Law of Treaties. This reality therefore vitiates any argument that creates a dubious dichotomy between agreements and treaties as contained in the AG's opinion on the ratification process of DTAs.

This reality therefore demands the process of ratification a carefully balanced approach in determining the kind of international instruments to be ratified by the country. It is posited that taxation is a sovereign matter that can only be determined by a country itself. This position has been well enunciated in arbitral decisions as well as national-level decisions. In ***Heritage Oil v. Uganda***, an arbitral panel ruled that the question of taxation was a sovereign question well within the province of the Government of Uganda. To significantly reduce taxes as is being done under the DTA fails to take into account the Constitutional principle that the public finance system shall promote an equitable society, and in particular requires that the burden of taxation be shared equally. The DTA therefore significantly alters the Income Tax Act. If the AG's argument that bilateral treaties which impact on domestic laws and the Constitution is to be considered, then the Kenya/Mauritius DTA by virtue of re-writing the Income Tax Act and affecting Constitutional principles needs parliamentary ratification.

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[6] Edye v. Robertson, 112 U.S. 580, 598 (1884)

6.0 Comparative Analysis of Mauritius Agreements With Other Jurisdictions

6.1 The South Africa/Mauritius Double Taxation Treaty

Mauritius concluded, on July 5, 1996, a comprehensive Double Tax Avoidance Treaty with South Africa which covered the Mauritius Income Tax and South Africa's Normal and Secondary Tax on companies. The Treaty was ratified on June 20, 1997. By 2003, the treaty was prone to abuse by South African companies. In the 2003-2004 Budget, South Africa's Finance Minister proposed an amnesty for South African resident taxpayers with illegal money offshore. The amnesty was to cover all income tax and exchange control taxes, penalties, interest charges and civil convictions in exchange for the small fine of 5 percent for all foreign assets that are repatriated to South Africa and a one-time exchange control levy of 10 percent for all foreign assets remaining offshore.

By 2013, however, the practice of tax evasion and avoidance still cost South Africa significantly. As a result, South Africa renegotiated its DTA with Mauritius with the aim of arresting tax evasion by South African residents. The revised agreement is to come into force in 2015 and has made significant changes relating to withholding tax provisions. The following part briefly captures issues that have been included in the agreement.

Dual Residency for Persons Other Than Individuals

Under the 1996 Treaty, where a person other than an individual (e.g. a company) was tax resident in both Mauritius and South Africa, the person was deemed to be a resident of the state in which its *place of effective management* is situated. A South African incorporated company which was effectively managed in Mauritius, would, thus, be deemed to be tax resident in Mauritius and not in South Africa. This made South Africa lose its taxing rights.

In the new Treaty, authorities of the two states must "by mutual agreement endeavour to settle the question" and determine how the DTA will apply to such person. This means that the Treaty eliminates the use of the "place of effective management" test as the final determinant of primary residency and replaces it with a discretionary process in which the two countries' tax authorities must come to agreement on which is the primary residency. Should they fail to come to an agreement, both countries could apply their tax laws.

Withholding Taxes

In the 1996 Treaty, the country of residence of the recipient of interest has the taxing rights if such recipient is the beneficial owner of the interest. A Mauritian lender would thus not be subject to South African withholding tax on interest if the Mauritian lender is the beneficial owner of the interest. In the new DTA, no provision for an exemption is made. Instead, the new DTA instead caps the tax on interest which may be imposed by the source country to 10 percent of the gross amount of the interest. South Africa would thus be entitled to impose a 10 per cent withholding tax on interest paid to the Mauritian lender.

Regarding the imposition of withholding taxes on dividends, the 1996 Treaty provides that the South African withholding tax on dividends will be reduced to 5% if the beneficial owner is a Mauritian company which holds at least 10% of the capital of the company paying the dividends, while in all other instances, the dividends tax may not exceed 15%. The new position is that the country has amended the maximum dividends tax rate to a maximum of 10% that will also be applicable to Mauritian companies. Finally, the exemption of royalties from withholding taxes has been replaced with a 5% maximum rate.

Capital Gains Tax

The biggest change in the DTA relates to changes to Capital Gains Tax ("CGT") regime. The 1996 DTA provides protection against South African CGT for a Mauritian company owning shares in a South African company holding immovable property. However, the capital gains article of the new DTA now specifically provides that a country may tax gains derived from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in such country.

6.2 The India/Mauritius Double Taxation Treaty

The India/Mauritius DTAA was enacted to avoid double taxation, prevent fiscal evasion regarding taxes on income and capital gains, and encourage mutual trade and investment. However, it has come under criticism for encouraging round-tripping of investments, resulting in loss to the exchequer in India. In a bid to avoid tax liability, companies route their investments in Indian securities through Mauritius to gain exemption from capital gains tax. Furthermore, foreign companies are rerouting their investments through Mauritius to benefit from its provisions. This situation has prompted calls for revision of the agreement to prevent revenue leakage given that the country is estimated to lose about $600 million annually through Mauritius. Some of the provisions are stated below.

Article 7 of the DTAA, which deals with the taxability of business profits, provides that the profits of an enterprise of a contracting state are to be taxed only in that state, unless the enterprise carries on business in the other contracting state through a permanent establishment situated there. If a permanent establishment has been created, the profit may be taxed in the other state only to the extent that is attributable to that establishment. Article 5 defines permanent establishment as a fixed place of business through which the business of the enterprise is wholly or partly carried out. Article 6 specifies that the income from immovable property will be taxed in the contracting state in which the property is situated. The DTAA defines immovable property according to the laws and usage of the contracting state in which the property is situated.

Taxation of Capital Gains

Article 13 of the DTAA deals with capital gains and provides that gains from the alienation of immovable property may be taxed in the contracting state in which the property is situated. Article 13(2) further provides that gains from the alienation of moveable property forming part of the business property of the permanent establishment that an enterprise of a contracting state has in the other contracting state, or of moveable property pertaining to a fixed base available to a resident of a contracting state in the other contracting state for purposes of performing independent personal services, including such gains from the alienation of such a permanent establishment or fixed base, may be taxed in that other state. Finally, Article 13 (4) provides that ***gains derived by a resident of a contracting state from the alienation of any property will be taxable only in that state***. Therefore, if a Mauritian company earns capital gains in India, then such income from capital gains is not eligible to be taxed in India. Also, capital gains arising from the sale of securities in India by a Mauritian resident are taxable only in Mauritius. This has prompted the Indian Government to propose amendments to the Treaty to include a limitation of benefits clause akin to one it has with Singapore.

Taxation of Dividends

Under Article 10 of the DTAA, dividend income of a Mauritian resident derived from India is liable to be taxed in Mauritius. However, as far as the Indian position is concerned, under section 10(34) of the ITA, dividends received by a shareholder from an Indian company are exempt from income tax. Many venture-capital entities have structured investments in India through Mauritius, taking advantage of the beneficial provisions of the DTAA.

Section 90 of Income Tax Act deals with agreements with foreign countries and states that the Indian government may enter into an agreement with any foreign country for the purpose of granting relief on income tax payable in India and in the foreign country.

It may also provide for avoidance of double taxation of income under the ITA and the corresponding law of the foreign country. In the case of a conflict between the ITA and the provisions of a DTAA, the latter will prevail over the ITA provisions.

Proposed Amendment to India/Mauritius Double Tax Agreement

India has signalled the intention to renegotiate the DTA with Mauritius numerous times. In 2013, significant progress had been made. This was however hampered by a "limitation of benefits" (LoB) clause that was proposed by India. Under the proposal, India wants an LoB clause similar to the one it has in its DTA with Singapore. The LoB clause in the India-Singapore tax treaty requires investors coming into India through Singapore to incur a minimum expenditure of $200,000 and have a track record of two years to get treaty benefits. Mauritius, on the other hand, suggests an LoB where expenditure is on an annual basis. These issues are also being addressed under the Base Erosion and Profit Shifting (BEPS) project with various proposals suggested. Both countries concluded a Tax Information Exchange Agreement (TIEA) outside the DTAA. It is unclear as to what time these countries will eventually agree on the modification of the DTA to address India's interests.

6.3 Lessons for Kenya

Kenya has recently introduced CGT in amendments in the Finance Act. This situation places the country in a similar situation with South Africa before reintroduction of CGT in the DTA with Mauritius. It will be important to take lessons from South Africa as well as India and include a clause on the limitation of benefits. The recent amendments in the Finance Act relating to DTAs limit the extent to which companies in other contracting states can rely on the DTAs between Kenya and those contracting states. To enjoy treaty benefits, a company in the other contracting state must be listed on the stock exchange. Furthermore, if 50 per cent or more of shareholding is held by non-residents, such company cannot enjoy DTA benefits. While these changes are no doubt laudable, there are procedures set for the amendment of treaties which may expose the process to a challenge as it has not been done through mutual consultations. The argument that an amendment of such nature cannot be done unilaterally has been advanced with proposals that such amendments should only be done bilaterally.

7.0 Conclusions and Recommendations

This study set out to investigate the Kenya/Mauritius Double Taxation Agreement and its potential impact on tax base erosion. It set to analyze the laws and regulations in Mauritius including business laws and disclosure limitation. The study further investigated the tax incentives available in Mauritius and how that has impacts on the flow of FDI into the country. Analysis of the DTA was benchmarked against the United Nations Model Convention on Double Taxation between Developed and Developing Nations.

What conclusions and recommendations can we draw from the study? The next part sets out what emerges as a summary of the conclusions drawn from the entire study together with the recommendations that will contribute towards addressing the pitfalls that come with signing the Agreement with Mauritius.

7.1 Summary and Conclusion

This study adduces evidence that clearly demonstrates that the Kenya/Mauritius DTA will significantly affect Kenya's revenue base. First, the definition of the term resident which excludes persons who are liable to tax in the second State in respect only of income from sources in that State. The exclusion may be abused foreign-held companies exempted from tax on their foreign income by privileges tailored to attract conduit companies. The incentives given by Mauritius hold the potential for such abuse.

The study notes that the Kenya/Mauritius DTA has included a number of clauses on permanent establishments, business profits, dividends, interest and capital gains tax that may negate the country's ability to collect taxes as these clauses have qualifying measures that are inconsistent with the UN Model Convention which is a benchmark for DTA negotiations conducted by developing countries.

Regarding the issue of permanent establishment, the study establishes that the DTA puts a time limit beyond the UN Model on building sites or construction, installation or assembly projects, or supervisory activities in connection therewith. It further limits taxation of consultancy services through employees or other personnel in the case of a continuous number of separate projects, each of four or five months' duration which, however, may involve significant amounts of money which effectively goes untaxed. In cases where an entity carries out business through a broker, general commission agent or any other agent of independent status, the DTA does not deal with the peculiarities of the insurance business which require an independence test to determine taxation obligations. Finally, the DTA limits taxation by excluding some companies from being considered permanent establishments without evaluating against properties of the dependent agents which may be considered as being permanent establishments under the "effectively connected rule."

The Kenya/Mauritius DTA further limits the taxation of profits in the source country unless the enterprise carries on such business through a permanent establishment. This provision is, however, limited under the UN Model Convention which deploys the "force of attraction" rule which taxes sales made outside an existing permanent establishment created for the purpose of selling goods or merchandise even if they are conducted through the parent company. This clause therefore limits Kenya's ability to tax sales made directly by the parent companies with permanent establishments in the country as they will be able to avoid taxation.

The taxation of dividends is limited by the definition of dividends by not including the clause that considers interest on loans in so far as the lender effectively shares the risks run by the company. This is because Kenya's domestic thin capitalization rules treat such interest as dividends. On the issue of interest, the DTA limits taxation in cases where the beneficial owner is a resident of the other contracting state to 10 per cent of the gross amount of the interest. This is an OECD Model provision that has been replaced

in the UN Model which leaves this percentage to be established through bilateral negotiations.

Finally, the provision on Capital Gains Tax limits taxation of gains made from the sale of company shares to Mauritius which has an effective Capital Gains Tax (CGT) of 0%. This is a loophole that can encourage acquisitions to be done through entities that are resident in Mauritius. Any subsequent sale would avoid CGT. It can further encourage round-tripping where taxation of dividends earned by Kenyan companies can be avoided through share buy-back plans.

The study provides a comparative outlook of agreements that Mauritius has made with India and South Africa which are undergoing review. It is noted that one of the most novel provisions being proposed is the limitation of benefits clause that can arrest treaty shopping and round-tripping as is the case with the India/Singapore DTA whose clause is being proposed in the Mauritius agreement.

7.2 Recommendations

In light of the foregoing conclusions on the Kenya/Mauritius DTA, the following specific recommendations are suggested;

1. The process of ratification of the Kenya/Mauritius DTA should follow the right procedure and be subjected to parliamentary ratification. This should provide an avenue for effective dialogue on the need to sign a DTA with Mauritius and if so, the nature of agreement that should be developed to better secure the country's ability to tax business entities.
2. If the agreement is adopted, then the scope under Article 1 should be expanded to include "Persons Covered" which enjoys a wider interpretation to include an individual, a company and any other body of person. This will make the scope extend to any entity which, although itself not a body of persons, is treated as a body corporate for tax purposes such as a foundation. Trusts established for tax purposes will therefore be covered.
3. In the definition of who is a resident, there is need to include a requirement for persons (body corporate and individuals) to file certification by the country's tax authorities on their residency status. The UN Model Convention requires a certificate from the tax authorities of the other country to the effect that the person is a resident of that country as a condition for granting the benefits of the treaty.
4. The clause on permanent establishment should be adjusted to reflect the UN Model Convention. First, Article 5(3) (a) should limit the time to a six month threshold. The time-limiting clauses in Article 5(3) (b) should be adjusted to cover projects that are four to five months. Furthermore, Article 5(6) should be adjusted to accommodate the need for an independence test for agents. Finally, Article 5(8) should be adjusted to only provide for exclusion of entities from being a permanent establishment upon the evaluation against properties of the dependent agent under the "effectively connected rule."
5. The taxation of business profits under Article 7 should be made subject to the "force of attraction" rule as is the case under the UN Model. This will mean that if a Mauritian enterprise has a permanent establishment in the Kenya for the purpose of selling goods or merchandise, sales of the same or a similar kind may be taxed in Kenya even if they are not conducted through the permanent establishment. Furthermore, if the permanent establishment of a Mauritian entity is used for other business activities and the same or similar activities are performed without any connection with the permanent establishment, taxation in Kenya will apply.
6. The definition of dividends as envisaged under Article 10 should be extended to include interest on loans in so far as the lender effectively shares the risks run by the company. This is because the DTA provisions do not prevent such interest from being treated as dividends under domestic thin capitalization rules. The DTA negotiators should also consider

increasing the percentage tax so charged to equal the amount charged to resident companies or 2 per cent less. Alternatively, they could consider levying tax by allowing the country of residence of the recipient of the income to also fully tax such income, but then it must provide relief, under Article 23 of both the United Nations and OECD Model Conventions, for the tax levied in the source country.

7. The provision on taxation of interest under Article 11 should adjust the rate applicable to be 15 per cent as is the case with non-residents. Double taxation can be addressed through exemption, credit or other relief measures without lowering the rate applicable in a preferential manner for Mauritian residents.

8. The taxation of capital gains as envisaged under Article 13 should be amended to include transactions for the sale of company shares by companies resident in Mauritius. This will seal the loophole that can give leeway for treaty-shopping and round-tripping vices.

9. Kenya can follow the example from countries like South Africa and India by introducing a limitation of benefits clause in the DTA with Mauritius. Furthermore, it will be important to review cases of dual residence through mutual agreement. The country should also consider taxing gains derived from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property as is the case in South Africa.

10. In the final analysis, Kenya should carefully consider whether signing the DTA will be synonymous with an increase in investment flows from Mauritius. In this regard, attention should not be paid only to the quantities of volumes of investment but also to the quality of investment regarding the impact it has on the country's economy.

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