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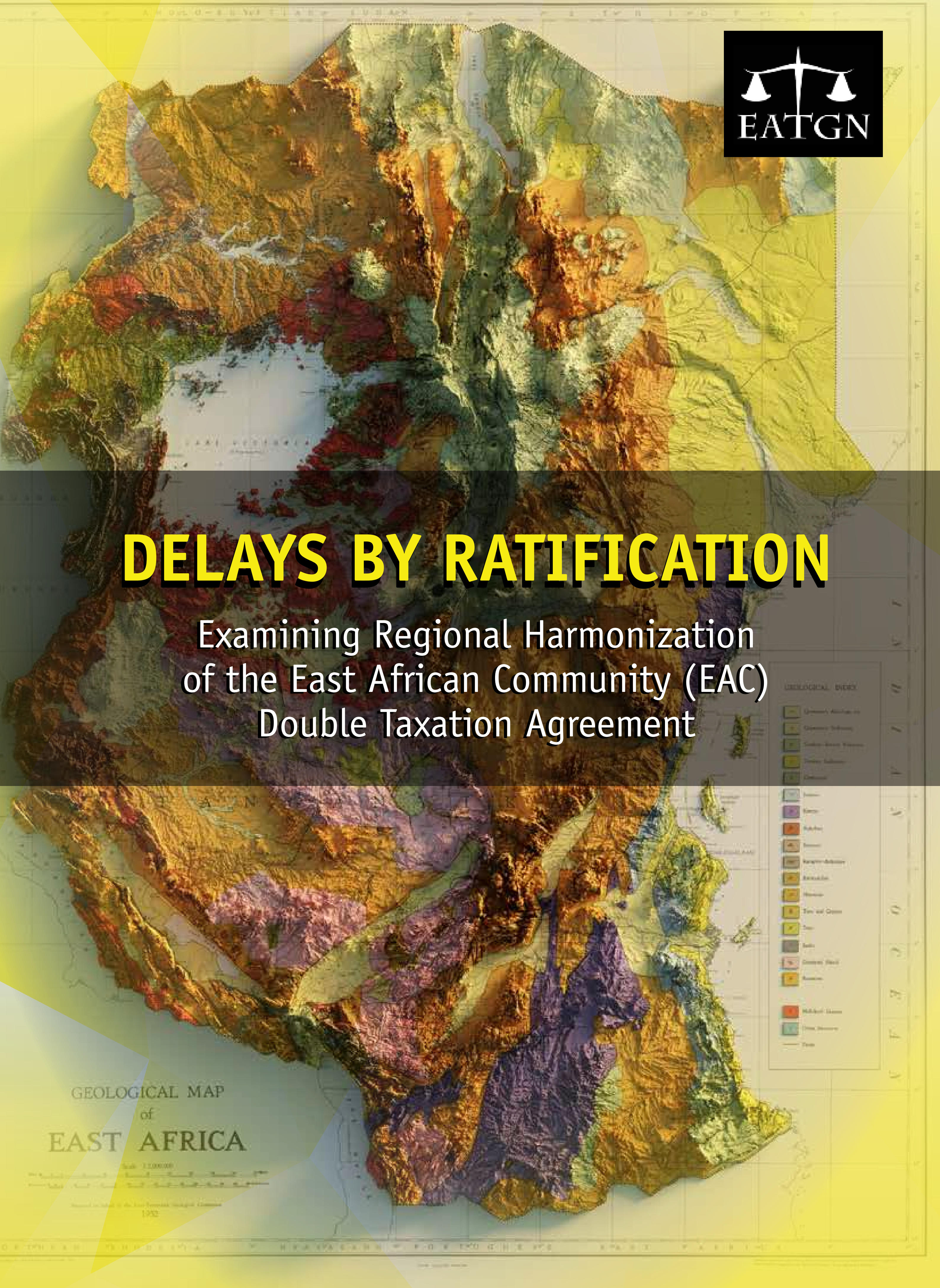
DELAYS BY RATIFICATION

Examining Regional Harmonization of the East African Community (EAC) Double Taxation Agreement



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Jaflo Limited | Block 3 | 106 Brookside Drive | Westlands

CONTACTS
E: info@eataxgovernance.net / coordinator@eataxgovernance.net
T: (+254) 20 24 73373, (+254) 728 279 368
W: www.eataxgovernance.net

WRITTEN BY
Jared Maranga

DESIGNED BY
Evolve Media Ltd

PHOTO CREDIT
Sean Conway

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ABSTRACT

What can we make of regional tax harmonization efforts as captured in the efforts to have a common East African Community (EAC) Double Taxation Agreement (DTA)? The contemporary general view is that tax regimes of different countries need to take global economic integration into consideration especially at the formation stage. As a consequence, countries across the globe have been engaged in different processes to harmonize their tax regimes to match aspects of globalization by signing binding multilateral or bilateral agreements. One of the most commonly used tools used in tax harmonization is signing of DTAs. DTAs are international agreements between two nations to allocate taxing rights between the two countries that have negotiated the specific DTA. The purpose a DTA is to help the two countries minimise instances of double taxation that may arise from existing overlapping tax laws. Double taxation is generally taken as an undesirable element of a tax system, and tax authorities will always endeavour to avoid it whenever possible.

However, DTAs are not without challenges mainly associated to interpretation between tax payers and governments involved, "ratification process" and intentional abuses by tax payers in form of tax treaty shopping. For example, when in 2019 a superior court in Kenya declared a DTA between Kenya and Mauritius to be unconstitutional for failure to follow due process in ratification of the agreement, even if the substance of the agreement was generally considered to be good.This discussion paper attempts to identify some of the key issues that arise out of the ratification process of the EAC double tax agreement and why the EAC member states ought to ratify the tax agreement as one step towards attaining tax harmonization. It also suggests a number of recommendations that can be adopted to make the model DTA an effective tool for tax harmonization tool.

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1.0 INTRODUCTION

Tax Harmonization

Tax harmonization can generally be described as the process of adjusting tax systems of different jurisdictions to achieve a common tax as an economic policy objective. Tax harmonization has been hailed as one of the key adoptions needed in minimization and removal of tax distortions that affect the efficient allocation of resources within an integrated market (George, 1992). As provided in Article 83(c) of the East African Community (EAC) treaty, the desire to attain full integration, tax harmonization within the EAC is critical to enhance easy movement plus allocation of factors of production. The call for tax harmonization across the region has taken centre stage in all regional integration arrangements from inception of the EAC by the founder member states Kenya, Tanzania and Uganda.[1]

The efforts by the member states are evident with the level of achievements that has been realised as regards to the indirect tax harmonization which include the great steps towards the adoption the Common External Tariff (CET) for cross border trade. However, efforts towards the harmonization of income taxes have been slow and full of challenges. One of the major steps that the member states have made towards income tax harmonization agenda was the approval of the EAC double taxation agreement (DTA) by the council of ministers in 2010. Since its approval, all efforts have been directed towards the push for its ratification by all the EAC partner states which has been slow for some members.[2] As a tool of international taxation, a common double tax agreement will bring efficiency in the taxation of income taxes for businesses operating across the East Africa region and subsequently increase trade flows and facilitation of economic development. This multilateral agreement has been hailed as a tool that will enhance efficient movement in factors of production across the EAC region and subsequently foster increase in economic activities of the EAC partners.

As in the case of the European Community where tax harmonization of corporate and capital income taxes was considered urgent since they are levied on gains or profits which are easily moved from one jurisdiction to the other, the EAC has followed suit in pushing for income tax harmonization (International Monetary Fund, 1990). Harmonization of direct taxes helps to prevent instances of tax competition, especially in investment decision-making (Sasho, Natasha & Jana, 2015). Further, harmonization has been championed as a great avenue for improving transparency plus exchange of information so that countries can fully and fairly enforce their tax laws (Petersen, 2010). Exchange of information between trading partners is important towards the efforts of curbing tax evasion or avoidance as well as all other forms of illicit financial flows and subsequently promoting domestic resource mobilization.

This study provides an analysis of the EAC double tax agreement (EAC-DTA) its role towards promoting tax harmonization in EAC, and subsequently its role in promoting investment

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1. East African Community, History of the EAC, https://www.eac.int/eac-history#:~:text=The%20Treaty%20for%20the%20Establishment,all%20the%20three%20Partner%20States. Note the region has since expanded to include Burundi, the Democratic Republic of Congo (DRC), Rwanda, and South Sudan.
2. Peterson Tumwebaze, 'EABC urges member states to expedite ratification of double taxation agreement, The New Times [Italics], 19 June 2017, http://repository.eac.int/bitstream/handle/11671/1854/double%20taXation%20agreement.pdf?sequence=1&isAllowed=y

within the region. Further, an analysis of the EAC-DTA is carried out, identifying potential areas of improvement and the need to align it to the latest best practices particularly under Africa Tax Administration Forum (ATAF) model. The analysis seeks to point out why it has taken long for the some EAC members to ratify the DTA and subsequently delay in its application.

Double Tax Agreement

Double taxation arises where there is no clear coordination in the taxation of income between source and recipient countries; i.e. double taxation arises where the same income or capital is taxed in both countries (United Nations, 2014). This brings about cases of increased tax burden on taxpayers. These instances arise where both the source and recipient countries claim the right to tax the income. Source countries, on one end, argue that the activities giving rise to the income occurred there, while the recipient's country claims the right to tax the income on the basis of the recipient's residence (John & Perry, 1976).

Double tax treaties (DTAs) or Double Tax Avoidance Agreements (DTAAs) can be described as international tax tools used by states to align and bring about coordination between tax systems of the trading countries. This is necessary because countries exercise tax sovereignty by putting in place independent tax regimes. These differences in taxation regimes bring about instances of double taxation of incomes realised by businesses and individuals operating in more than one country (Sasho, Natasha & Jana, 2015).

Incidences of double taxation are often a limitation on the exchange of goods, services, movements of capital, persons, and subsequently trade. Double taxation brings about unnecessary additional costs towards doing business especially with increased globalization. As a safeguard measure to the increased tax burden and cost of doing business, there are increased international calls for coordination and alignment of the income taxation regimes between trading partners (John & Perry, 1976). This has witnessed increased negotiation and signing of DTAs between many countries. Tax treaties help in distribution of taxation rights between trading countries and subsequently the determination of the amount of tax that a country can apply to a taxpayer's income, capital, estate or wealth.

However, lack of tax coordination between trading partners may grant income realised from foreign trade or investment unintended tax benefits through cases of double non taxation. Double non taxation is not as obvious as double taxation, however, it is as undesirable as double taxation (Eva & Lilla, 2019). Double non taxation arises where a certain item of income, a transaction or an activity remains untaxed. Double non taxation leads to a reduction of the overall tax paid by all parties involved as a whole, which harms competition, economic efficiency, transparency and fairness (OECD, 2013). Coordination of income taxation between two countries contributes greatly to transparency and efficient allocation resources and tax efficiency.

Apart from avoidance of double taxation, such agreements help in ensuring that treaty benefits flow only to the intended recipients. Tax treaties are negotiated with the objectives of encouraging cross-border trade, investment, transfer of skills and technology and enhancement of tax co-operation between contracting states to minimize instances of international tax avoidance or evasion.

Further, tax treaties provide predictable and stable taxation of cross border incomes, curbs tax discrimination practices, standardization of the taxation systems thereby facilitating easy exchange of tax information as well as offering reliable avenues of tax dispute resolutions. Equally, countries may negotiate tax treaties as a mechanism of positioning themselves politically, like an expression of conforming with international tax standards and or enhance their economic relationship. Additionally, countries may be asked to enter into a tax treaty for other non-tax reasons, such as a condition for obtaining economic assistance or implementation of specific projects (United Nations, 2014).

Taxation of Income Across Economic Blocs

Income is subjected to direct taxes at both national and international level. Direct tax is imposed on the net income realised by a person. One of the distinguishing features of direct tax is that a taxpayer is unable to pass it on to his customer because he is unable to predict the precise amount of tax at the time of the transaction (John & Perry, 1976). Direct taxes are mainly associated to factors of production put into use by businesses.

Countries across the world, including the members of the EAC, tax income differently. These differences sometimes confer unfair tax competition and unequal treatment of taxpayers, goods, or services (Mutsotso, 2010). These differences have been portrayed to create barriers to movement in factors of production across countries. This is further challenging since international tax law is not uniformly codified (Petersen, 2010).

Differences in taxation of income across the EAC partner states has remained a hindrance to the efficient allocation and movement of resources across the region, hence the increased calls for tax harmonization. Calls for tax harmonization have been prompted recognition of how the competitive advantage of multinational enterprises capitalizes on the differences in taxation rules as a result of inadequate coordination in taxation policy (Picciotto, 2018). Moreover, when capital is free to flow to countries with a favourable tax regime or where it can escape taxation altogether, the gains on such capital will not necessarily be used to finance the most efficient investments in the country.

The table below provides a summary of taxes applicable on the select incomes accrued from the EAC partners:

Table 1. Summary of Taxes in the EAC Region

Country	CIT	Dividends	Interests	Royalties	Management & Professional fees
Burundi	30%	15%	15%	15%	15%
Kenya	30%*	10%	25%	20%	20%
Rwanda	30%	15%	15%	15%	15%
Tanzania	30%	10%	10%	15%	15%
Uganda	30%	15%	15%	15%	15%
DTA	-	10%	10%	10%	10%

**Income from permanent establishments/ non-resident corporations is taxed on a higher rate of 37.5%.*

From the Table 1, it is evident there is no coordinated taxation of the various income streams between the EAC partners states. This implies that without harmonization, partners may continue lowering the applicable tax rates to attract more investment at the expense of the other partner states. However, these adjustments of tax rates may not be productive and efficient since they plunge countries into a race to the bottom phenomena.

Slowed progress in tax harmonization challenges is mainly associated with issues of tax sovereignty, diversity of jurisdictional interests or preferences, countries' divergent and at time conflicting obligations under various regional arrangements as well as the inadequate institutional framework of the EAC (Mwok-Handa, 2008). The harmonization of tax law in the EAC has been a slow affair as partner states are not willing to take risks with policy and promulgation of laws that may change or influence their political, economic, or social positions. Lack of tax harmonization contributes to increased tax competition. Increased tax competition, in the long run, may drive tax rates down to suboptimal levels or create tax systems that are less efficient than if they had been the result of coordinated efforts (George, 1992). Increased tax competition often leads to countries plunging into the race to the bottom phenomenon, where countries deliberately lower or scrap their taxes or tax rates to outdo each other by attracting or retaining economic investment in their jurisdictions at the expense of the other. The reduction or adjustment of taxes is poised as a mechanism of reducing the cost of investment or doing business in that country. A move by countries towards a set of common rules may in fact help countries to make their sovereign tax policy choices (OECD, 2013).

International efforts on income tax harmonization is further complicated by unilateral tax incentives and disincentives adopted by independent countries. These unilateral measures bear little or no impact to the sound economic performance of multinational enterprises and instead reflect unilateral moral standards or sociological goals (John & Perry, 1976). This is evident by the sovereign tax practices adopted by the EAC members states to increase levels of investments through the use of export processing zones or the special economic zones. These zones present special and favourable tax regimes to investors operating within the zones. Tax exemptions awarded or reduced taxation rates for investors in these zones creates unnecessary competition between foreign (beneficiaries of the favorable tax terms) and domestic investors. The zone often provides false hope towards catalyzing economies since in most case business in the zones report perennial losses then end up relocating without paying any tax or creating any substantive employments.

Existing tax treaties in the EAC, present significant inconsistencies in tax provisions and taxation mechanisms agreed between different the various EAC members plus other contracting states. Tax abuse often happens on passive income associated to movement of resources across countries i.e. dividends, royalties, interests, capital gains among others. Articles associated to passive income in DTAs are often subject to abuse leading to high incidences of tax base erosion and profit shifting (East Africa Tax and Governance Network, 2020).

2.0 DOUBLE TAX TREATY FRAMEWORK

DTA as a Tool of Tax Harmonization

Tax harmonization is mainly aimed at the elimination of distortion between tax systems to ensure coordination that leads to adoption of identical or similar tax systems, tax bases and tax rates within an integrated community (Keuschnigg, Loretz, & Winner, 2014). The question, therefore, is how to effectively reduce or even eliminate tax barriers to facilitate regional integration.[3] Tax harmonization is a prerequisite for the creation of an effective functioning single market (Gheorghe & Daniela, 2011). This is true for the fully integration and functioning of the EAC.

Tax harmonization is a process of convergence in tax systems based on a mutual set of rules and, in general, it means the existence of identical or similar tax rates between trading economies (Sasho, Natasha & Jana, 2015). Tax harmonization should, however, not be taken to mean having identical tax across the EAC but, rather the process of putting in place efforts geared towards removal of barriers that affect the free movement of goods and services, "people" and capital that impedes investment across the EAC.

The signing and ratification of a model DTA will help states in the harmonization process of nationally administered taxes by eliminating instances of double taxation and instances of tax avoidance practices. DTAs by their very nature do not create new taxes; they merely allocate the right to tax income rather than impose new taxes. This is true to the fact that different partner states have different forms of taxes which, if not well coordinated, may lead to distortion and subsequently create a barrier to the efficient movement of resources across the region.

Tax harmonization is necessary, to facilitate the attraction of investment in the context of globalization (Mintz, 2004). Lack of coordination in taxation systems across trading economies brings about instances of unnecessary tax competition. This is because states are at liberty to independently set the applicable domestic rates. This sovereign independence portends the risks of lowering tax rates or extending unprecedented tax incentives to attract investment compared to their trading counterpart, at the expense of revenue generation.

Harmonization will help minimise the instances of unnecessary tax competition and subsequently boost efforts of domestic resources mobilization through increased tax revenues. Incidences of tax competition mainly present challenges associated to shifting away capital from what is perceived as high tax jurisdictions to lower tax jurisdictions (Dan Mitchell, 2004). This negative movement impacts highly on the affected tax jurisdictions from a revenue mobilization or development perspective as a result interfering with free movement of capital plus labour. A double tax agreement, especially for the region, will play a major role in minimising instances of unnecessary tax competition by streamlining the taxation regime across the EAC.

The East Africa Community Double Tax Agreement

The EAC double tax agreement (EAC-DTA) is anchored under Art. 5 of the EAC treaty which provides that one of the key objectives of the community shall be to develop policies and

3. Oscar Kambona, 'Regional integration and tax harmonisation: A critical analysis of the East African Double Taxation Agreement', MA diss, Makerere University, (2009), http://makir.mak.ac.ug/handle/10570/3902

programmes aimed at widening and deepening co-operation among the partner states in political, economic, social and cultural fields, research and technology, defence, security and legal and judicial affairs, for their mutual benefit (East Africa Community, 2006).

The EAC-DTA is one of the key protocols that partner states have signed with the aim of deepening and widening the efficient movement of resources across the region. The DTA was signed by; Burundi, Kenya, Rwanda, Uganda and the United Republic of Tanzania on the 30 November 2010, with a view of affording relief from instances of double taxation in relation to income tax and any rates of similar character imposed by tax laws of the partner states. Since its sign off, only Kenya, Rwanda and Uganda have ratified the agreement. Burundi and Tanzania are yet to ratify the agreement; this has consequently delayed the DTA's entry into force. Art. 30 of the DTA, provides that the agreement shall only enter into force when the last notification for ratification is received.

The EAC-DTA recognizes the tax sovereignty of partner states by encouraging source taxation of business profits, pension, and capital gains to the states where the amounts arise (Barata & Birungyi, 2014). The agreement mainly puts in place anti-tax abuse measures which aim at avoiding the improper use of the treaty. For instance, the requirement on beneficial ownership provisions regarding dividends and interest have the effect of limiting the reduction of tax on the said passive income to beneficial owners of the said income. Table 2 provides an overview of the structure of the EAC-DTA and the potential areas of concern where applicable.

Table 2. Overview of the EAC-DTA vis a vis ATAF Model

Article	EAC-DTA	ATAF Model
Art. 1: Scope	- The article covers persons who are residents of the trading partners. - The EAC-DTA has not made any provision on taxation of fiscally transparent entities	- Similar to the EAC-DTA, the model proposes that the agreement shall apply to persons who are residents of one or both of the contracting states. - It further includes a paragraph on taxation for fiscal transparency – this often presents challenges on where the incomes derived by such entities ought to be taxed.
Art. 2: Taxes covered	- The treaty mainly covers taxes which are of income in nature and any other taxes of similar nature. The DTA makes reference to all taxes covered under the Income Tax Act of the member states. - It is a requirement that competent authorities of the contracting states shall notify each other of any substantial changes on income tax laws which have been made in their respective taxation laws.	- The ATAF model provides that a standard DTA should cover income taxes and taxes of similar nature.

Art. 3: Definitions	- Provides definitions of key terms used in the agreements. This is mainly geared towards minimising conflicts associated with interpretation of terms adopted. - The DTA has not defined what should be considered as business income for the taxation purposes.	- The model provides some of the general definitions that should be included in a DTA, including what could be considered as business. - Failure to include clear definitions of key terms like what should be considered as business income provides challenges for administration of the agreement.
Art. 4: Residence	- The agreement will apply where one is a resident by reason of his domicile, residence, place of effective management, place of incorporation or any other criterion of a similar nature. - The agreement provides that taxation of persons with dual residence should be handled between the partners states through mutual agreement.	- The tie-breaker rule applied in a case where an entity may be resident in two different jurisdictions. - The model proposes the use of mutual agreement while considering the place of effective management[4] as basis of determining place taxation in cases of dual residence.
Art. 5: Permanent Establishment (PE)	- Provides a definition of what should be considered as a PE - PE includes deemed services, which are rendered in contracting state for an aggregate of 6 months within a period of 12 months. - Provides a business case that shows exemption from being considered as PE, popularly referred to as activities or services that are preparatory or auxiliary nature.	- The artificial mechanism adopted by exclusion of business from creating taxable presence (PE) has often been room for tax avoidance. For example, contractors may split off a contract into small implementable phases in order to avoid meeting the time threshold that may lead to creation of PE.
Art. 6: Taxation of immovable properties	- The treaty provides for exclusive source taxation rights on gains realised from property based on where the property is situated/ located. - No provision has been made on taxation of alienation of company shares.	- The model provides for exclusive source taxation rights on gains realised from property where the property is situated/located.

4. Place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the enterprise's business are in substance made. The place of effective management will ordinarily be where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the enterprise as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. An enterprise may have more than one place of management, but it can have only one place of effective management at any one time."

Art. 7: Taxation of business profits	- The article provides for source taxation rights on a portion of profits that is directly attributable to the permanent establishment. - The taxable profits are allocated to the PE as if it was a separate entity from the Home Office (HO). - There is always a challenge in drawing a clear line for one-time incomes which are not specifically provided for in the agreement. - As part of the BEPs project proposals, it is expected that profits will be reported where the economic activities that generate them are carried out and where value is created.	- The model proposes the use of source taxation of profits of an enterprise where it carries on business in the other contracting state through a permanent establishment.
Art. 8: Shipping, Inland Waterways, Railway and Air Transport	- Exclusive source taxation rights are granted to the contracting state where the effective place of management of the enterprise is situated. - There is need to define what qualifies to be the place of effective management within the context of the DTA.	- The model provides for source taxation of profits of an enterprise of a contracting state from the operation of ships or aircrafts in international traffic.
Art. 9: Associated enterprises	- Calls for application of arm's length principle in attribution of profits between related enterprises.	- Calls for application of arm's length principle in attribution of profits between related enterprises.

Art. 10: Dividends	- Provides for taxation of dividends paid by a resident of one contracting state to a resident of another contracting state. - Source taxation of 5%, on gross dividends, will apply to the owner of dividends if he is the beneficial owner. - Lack of clear definition of beneficial ownership threshold within the context of DTA. - Kenya and Rwanda have introduced requirements for beneficial owner[5] disclosures through a review of their respective companies act.	- The model proposes limited source taxation of dividends paid by a company that is a resident of a contracting state to the beneficial owner of who is a resident of the other contracting state. - The model proposes a threshold for any person controlling about 25% in any period of 365 days.
Art. 11: Taxation of interest	- Provides a source taxation of 10% of the gross amount of the interest if the recipient is the beneficial owner of the interest.	- The model proposes that interest may be taxed in that state according to the laws of that state. - However, if the beneficial owner of the interest is a resident of the other contracting state, a limited source taxation will be applied. - The model proposes that royalties be taxed exclusively in the state of residence of the beneficial owner thereof. - It proposes a limited right of taxation to the source state if the beneficial owner of the royalties is a resident of the other contracting state.
Art. 12: Taxation of royalties	- Provides for the taxation of royalty income earned by residents of the other contracting state. - The DTA provides source taxation at a rate of 10% of the gross royalties where the beneficial owner is a resident of the other contracting state.	- The model proposes that royalties be taxed exclusively in the state of residence of the beneficial owner thereof. - It proposes a limited right of taxation to the source state if the beneficial owner of the royalties is a resident of the other contracting state.

5. Beneficial owner is a natural person who ultimately owns or controls a legal person or arrangements or a natural person on whose behalf transactions are conducted and include persons who exercise ultimate effective control over a legal person or arrangement.

Art. 13: Taxation of management or professional fees	- Provides a clear definition of what should be considered management or professional services: *payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of a technical, managerial, professional or consultancy nature not covered under any other Article of this Agreement.* - The treaty provides for limited source taxation of 10% on the gross amount will be applied on the gross management fees where the recipient is the beneficial owner in the contracting states. - This will not apply where beneficial owner of the management or professional fee is a resident of a contracting state, carries on business in the other contracting state in which the management or professional fees arise through a PE situated therein. - Where a DTA does not provide explicitly for the taxation of management or professional fees, and there have been conflicting interpretations between the contracting states.	- The model proposes an unlimited taxation right to the state of residence, with a limited taxing right being extended to the state of source. - To minimise the ambiguities the model defines when fees will have have been considered paid or payment could have been done.
Art. 14: Capital gains	- Provides for taxation of gains realized from alienation of immovable properties	- Proposes source taxation of gains realised by resident from alienation of immovable property situated in the other contracting state.
Art. 23: Other incomes	- Provides for taxation of other incomes that have not dealt with in the DTA. Rights to taxation are granted to the source country, in line with the domestic laws.	- Art. 21 proposes for taxation of income of a resident of a contracting state, wherever arising, not dealt with in the foregoing treaty shall be taxed in line with existing domestic laws.

Art. 24: Elimination of double taxation	- The DTA encourages the use of credit method to minimise instances of double taxation. - Nationals of a contracting state shall not be subjected in any other contracting state to any taxation or requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the other states in the same circumstance are or may be subjected.	- Art. 23 proposes the use of either credit method or exemption method in managing instance of double taxation.
Art. 25: Non discrimination	- Nationals of a contracting state shall not be subjected in any other contracting state to any taxation or requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the other states in the same circumstance are or may be subjected.	- Art. 24 of the model makes a proposal on how the nationals of the contracting states should be treated.
Art. 26: Mutual agreement procedures	- Provides guidelines on dispute resolution between taxpayers and their governments on who may be having the rights to tax given income.	- Art. 25 of the model proposes adoption of the mutual agreement procedures in resolving of any conflicts. - This cushions taxpayers where actions of one or both contracting states will result in such taxation, and that this taxation appears as a risk which is not merely possible but probable.
Art. 27: Exchange of information	- Competent authorities of contracting state commit to exchange of information concerning the taxes covered in the agreement to avoid instances of double taxation or non-taxation.	- Art. 26 proposes that competent authorities should commit to exchange of information that will be considered relevant.

Art. 28: Assistance of collection of taxes	- Commitments between contracting states to support one another in collection of taxes	- Art. 27 proposes that there is need for contracting states to support one another in collection of taxes.
Art. 29: Diplomatic Agents and Consular officers	- Provides for taxation of members of diplomatic missions. Provision of the treaty do not affect any fiscal privileges conferred.	- Art. 28 provides that nothing in the treaty should affect the fiscal privileges of members of diplomatic missions or consular posts under the general rules of international law or under the provisions of special agreements.
Art. 30: Entry into force	- For the agreement to enter into force, contracting states must notify each other of the completion of the ratification procedures. - The agreement shall enter into force when the last notification is received.	- Art. 29 proposes that the treaty will enter into force when the contracting states notifies each other through diplomatic channels.
Art. 31: Termination	- The agreement shall remain in force indefinitely but contracting state may terminate the agreement through diplomatic channel. - Giving a written notice to the other states not later than 30 June of the calendar year starting 5 years after the year of entry into force.	- Art. 30 proposes how the treaty should be terminated through diplomatic channels.

Comparative Analysis of Select Articles on Passive Incomes

Article 12: Royalties

The EAC-DTA provides that royalties should be taxed at 12% of gross where the beneficiary is a resident of the contracting state. The ATAF model has further proposed that the paragraph should include the fact that competent authorities should settle mode of application for this limitation by mutual agreement.

Paragraph 5 provides for the taxation of royalties in relation to permanent establishment, however, there is no clear approach on how such royalties should be taxed. To minimize instances of ambiguities on taxation of royalties, there is need to specify that royalties associated to a PE will be taxed under Article 7, as clearly worded under Paragraph 6 of the ATAF model.

Article 14: Capital Gains

The EAC-DTA has not provided for taxation of gains arising from disposal or movement of shares; this brings about an ambiguity on how business restructuring transactions across the region will be taxed without any instances of double taxation arising.

Paragraph 5 of the ATAF model provides for the taxation of sale in company shares, or comparable interests, such as interests in a partnership or trust, which is a resident of the other contracting state. Such movements of shares or interest may be taxed in the other contracting state if the seller, at any time during the 365 days, preceding such a sale, held directly or indirectly a given percentage of capital investment. There is need to review the EAC-DTA to clearly provide for taxation of gains realised from disposal of shares, as proposed in the ATAF model.

Article 13: Management and Professional Fees
Paragraph 1 provides that management or professional fees arising in a contracting state which are derived by a resident of any of the other contracting states may be taxed in that other contracting state.

Paragraph 2 states that where the beneficial owner of such management or professional fees is a resident of the other contracting state, source tax so charged shall be fixed at 10 percent of the gross amount of the management or professional fees which are considered as services of a technical, managerial, professional, or consultancy nature not covered under any other Article of this Agreement.

Management fees realised through a permanent establishment will be taxed in that contracting state as business income under Article 7 of the DTA. To align the taxation of management fees, the EAC partner state may consider reviewing existing DTAs to include an article on taxation of income from professional and management fees.

Most of the DTAs signed by the EAC partner states do not include the article on taxation of income earned from the provision of management and technical services. This has over time brought challenges on who has the rights to tax the income. Taxpayers have argued that since it is not provided, no tax should be charged; in contrast revenue authority have argued that the income should be considered as other income and should subsequently be taxed. This situation can be explained in the Tax Appeal Tribunal's (TAT) judgment in the case of *Mckinsey and company Inc. Africa proprietary ltd vs. Commissioner of legal services and board coordination Appeal No. 199 of 2020 on taxation of professional fees charged in line with Kenya – South Africa DTA*. See details in Text Box 1.

Meanwhile, contrary to the above, a similar case[6] in Tanzania ruled that professional fee cannot be treated as business income for purposes of the DTA and hence should be tax under Art 21 of the South Africa – Tanzania DTA. See details in Text Box 2.

6. Fautine Kapama, 'Court Dismisses Kilombero Sugar Tax Appeal', *Daily News*, 31 May 2021, https://dailynews.co.tz/news/2021-05-3160b47ed7bc48a.aspx

Text Box 1: Case Review – Taxation of professional fees in line with Kenya – South Africa DTA

Facts

Mckinsey and Company Inc. Africa proprietary Ltd is a limited liability company incorporated in Republic South Africa and operates as a branch in Kenya, registered as a taxpayer. Its principal activity is the provision of consultancy services, including strategy, operations, financial and human resource consulting. The Commissioner of legal services and board coordination is a principal officer appointed under the Kenya Revenue Authority (KRA) Act, Cap 469 of the Laws of Kenya as an agency of the Government for the collection and receipt of all revenue.

In line with Article 22 of the Kenya – South Africa DTA, KRA through the commissioner of taxes issued an initial audit finding where it made a demand for payment of additional corporation tax and withholding tax in relation to services rendered from South Africa to Kenya. The taxpayer objected, asserting that no withholding tax applied pursuant to provisions of Article 7 of the Kenya – South Africa DTA with an appeal to the Tax Appeal Tribunal (TAT).

The key issue of determination by the TAT was whether KRA erred in demanding withholding tax from the A ppellant in respect of professional fees paid to its head office. The appellant argued that the respondent erred in law and fact by failing to acknowledge the provisions of the Kenya-South Africa DTA which came into force on 1st January 2016 by failing to acknowledge and appreciate that professional fees paid by the Appellant are taxable and by concluding that professional fees paid by the Appellant cannot be construed as business profits under Article 7 of the DTA.

Article 7 provides that,

"The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

a. that permanent establishment;

b. sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or

c. other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment."

The KRA responded by counter arguing that Mckinsey South Africa rendered consultancy services to the Appellant. These were booked as borrowed charges in the appellant's financial statements. According to the KRA, the services were governed by the agreement for consulting services. Under the agreement, the supplier of consultancy services invoices for the borrowed charges through Mckinsey & Company Inc. US, one of the Mckinsey group entity which acts as the group's clearing house. KRA argued that professional services are not provided for, under a separate Article of the Kenya-South Africa DTA, such income can only be taxed under the clause on "other income" which is Article 22 of the DTA.

Ruling

The tax tribunal held that the KRA erred in demanding for withholding tax in respect of the payments made by the Appellant to its associate resident in South Africa. This is on the ground that the professional fees should be taxed in line with Article 7 of the DTA. This has raised a fundamental issue about how the provisions of double tax agreements between different countries.

Text Box 2: Case Review – Taxation of service fees in line with Tanzania – South Africa DTA

Facts – Kilombero Suga Company vs TRA

Kilombero Sugar Company Limited (hereinafter referred to as Kilombero) is a company incorporated in Tanzania whose principal activity is sugar cane farming and sugar production. In furtherance of its business, Kilombero entered into an agreement with Illovo Project Services Limited (IPS), a South African Company for provision of operational and technical services. Pursuant to the agreement, IPS was to provide operational and technical services for the management and control of the Kilombero's factories and agricultural land from time to time and in return Kilombero was to pay fixed fees of USD 30,000 per month for the operational and management services provided by IPS.

Tanzania Revenue Authority (TRA) audited the tax affairs of Kilombero for the period between 2009 and 2011. Following the audit, TRA issued a withholding tax demand on Kilombero demanding payment of withholding tax on reimbursements paid to IPS. Kilombero was aggrieved by TRA's decision and thus unsuccessfully filed an appeal to the Tax Revenue Appeals Board (TRAB) which dismissed Kilombero's appeal leading to further appeal to the Tribunal.

During the hearing at the Tribunal, Kilombero submitted that TRAB erred in law by considering that costs incurred in course of rendering services (reimbursables) are service fees pursuant to Sections 81, 82 and 83 of the Income Tax Act (ITA). Kilombero argued that service fee is a charge on professional services or skills and has no cost element, therefore, it forms part of a business profit to the South African entity carrying on business in Tanzania. It was Kilombero's argument that, should the Tribunal find that reimbursable expenses are part of service fee, then it should be pleased to hold that payments for service fees to IPS and other South African entities were not subject to tax in Tanzania pursuant to Article 7 of the DTA between South Africa and Tanzania. In respect of the application of Article 21 of the DTA, Kilombero also made a rejoinder that Article 21 can only be used if the other articles in the DTA have been complied with.

In response, TRA submitted that payments made to IPS and other South African entities were incurred in the course of rendering services and hence cannot be excluded from the service fee component. TRA also asserted that service fees and business profits are two distinct terms, service fee is inclusive of costs while business profit is exclusive of cost and, therefore, service fee cannot form part of business profits which are taxable under article 7 of the DTA. TRA underscored its position stating that Article 7 of the DTA is not the relevant article for taxing service fees; but recourse should be to Article 20 of the DTA which deals with other income and that the tax paid in Tanzania in respect of the service fee can be claimed for deduction in South Africa pursuant to Article 21 of the DTA.

Ruling

The Tribunal upheld the decision of TRAB that service fees are included in calculating business income or profits, pursuant to Section 8 of the ITA but do not form part of business profits which are taxable under Article 7 of the DTA. The Tribunal agreed with the TRA that the relevant Article in resolving the dispute was Article 20 and not Article 7(1) and thus there was no violation by the TRA when it demanded withholding tax on the service fee paid to the South African entities.

The court of appeal sustained the ruling of the tribunal that the costs incurred formed part of the service fees and as such should be subjected to withholding tax under Article 20 of the DTA.


Signature
Controller (for Capex items)
approve for the purchase.
For any item not budgeted
Signature 4.

3.0 WHY PARTNERS STATE SHOULD RATIFY THE REGIONAL DTA

Generally, double tax agreements are mainly aimed at promoting investments and trade as well as allocating taxing rights between contracting states, eliminating instances of double taxation plus promoting exchange information between taxing authorities among others.

- **Promotes Investments Within the EAC**
  Reduction of tax barriers to investment will increase the attractiveness of the EAC as a preferred destination for investment. The agreement through the elimination of double taxation and discrimination plus addition to tax certainty will reduce tax barriers to investment. With all other factors remaining constant, investors are likely to invest in a region where incidences of double taxation and discrimination are eliminated based on agreed common rules for the allocation of taxation rights across the region. As capital importing countries, attracting additional inbound investment is a key component of the economic growth strategy of the EAC. Inbound investments bring about positive spill overs, such as transfer of technology, increased employment, increased business to local firms, and increased tax revenues due to growing economic activities. Increased investment boosts levels of integration greatly as it allows for specialization based on comparative advantage, thereby allowing greater economies of scale and it encourages competition among the partner states.

- **Coordinated Dispute Resolution Mechanism**
  The DTA offers mechanisms of dispute resolution in case there is conflict between the taxpayers and governments through the inclusion of an article on Mutual Agreement Procedures (MAP). The MAP provides for a mechanism of dispute resolution between competent authorities where there is conflict on who may be having the rights to tax given income. This is in line with the Base Erosion and Profit Shifting (BEPS) Action Plan 14 which sought to address challenges of dispute resolution between taxpayers and government. BEPs Action plan 14 provides for mandatory binding MAP arbitration as the best way of ensuring that tax treaty disputes are effectively resolved through MAP (OECD, 2015).

  Additionally, tax treaties foster communication and cooperation between tax authorities thereby providing a framework for preventing and solving disputes related to tax treaties through MAP, which mitigates the risk of double taxation. MAP ensures that taxpayers entitled to the benefits of the treaty are not subject to taxation by either or both contracting states that is not in accordance with the terms of the treaty. Inclusion of the MAP within the EAC-DTA ensures that any disputes between taxpayers and partners states will easily be resolved.

- **Combats Tax Avoidance and Evasion among the Partner States**
  The DTA will help EAC partner states in curbing tax avoidance and evasion within the region through assistance with collection of taxes plus the exchange of information between tax authorities. Article 27 of the DTA provides that:

  > "The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Agreement or of the domestic law of the Contracting States concerning taxes covered by this Agreement in so far as the taxation there under is not contrary to the Agreement, for the prevention of fraud or evasion of such taxes."

Similarly, the agreement provides that the contracting states commits to lend each other assistance and support with a view to the collection, in accordance with their respective laws or administrative practice, of the taxes to which this Agreement shall apply and of any administrative penalties, interests and costs pertaining to the said taxes.

- **Elimination of Double Taxation**
  One of the challenges facing international businesses is that of double taxation. Signing a DTA provides relief to businesses on the question of double taxation. DTAs provide relief on double taxation by either the use of exemption method or use of credit method. Exemption method requires that income taxed in one contracting state is exempted from tax in the other contracting states. The credit method on the other hand, allows tax credit for the tax paid in the other contracting state. These approaches provide relief to incidences where same income is likely to be taxed in more than one country, i.e. incidence of double taxation.

  Article 24 of the EAC-DTA provides for deduction of tax paid as a tax credit by residents of the contracting state, an amount equal to the income tax paid in that other state, provided that such deduction shall not exceed that part of the income tax as computed before the deduction is given, which is attributable to the income which may be taxed in that other state.

- **Non-discrimination Against Non-residents of Any Other Partner States**
  Article 25 of the DTA offers relief through commitment by partner states that nationals of a contracting state shall not be subjected, in any other contracting state, to any taxation or requirement connected therewith which is more burdensome than the said taxes and other connected requirements to which nationals of the other states in the same circumstance are or may be subjected.

  This implies that irrespective of nationality, all nationals within the EAC region will be treated in the same way in any partner state without any form of discrimination on taxation for all taxes covered under the DTA. This will boost the free movement of goods and services across the region and will be in line with Art 104 of the EAC treaty where the partner states agreed to adopt measures aimed at achieving the free movement of persons, labour, and services and to ensure the enjoyment of the right of establishment and residence of their citizens within the community.

Challenges Facing the Ratification and subsequent application of the EAC-DTA

The EAC-DTA was drafted in 2005, and signed by the member states in 2010, but the agreement has since not been ratified by all the partner states. Ratification of the DTA will highly contribute to the increased calls for tax harmonization. However, the delays in ratification by Burundi and Tanzania has stalled the desire by the EAC partner states to remove any barriers to efficient movement of resources across the EAC.

This means that even though the realisation of a common market needs a certain degree of tax harmonization or coordination, member states are still highly unwilling to harmonize tax provisions which can cause obstacles to smooth functioning of common market or market deformations (Nerudova, 2004).

The EAC-DTA is an important tool for tax harmonization especially when it is created within a trading block like the EAC. According to Kopits (1992), tax harmonization is largely understood as a process of adjusting tax systems of different jurisdictions in the search of a common tax policy objective. Tax harmonization will involve removal of tax distortions affecting commodity and factor movements to bring about a more efficient allocation of resources within an integrated common market. In the EAC, tax harmonization is anchored on the various protocols especially the Treaty on the Establishment of the East African Community (EAC Treaty), Common Market and Protocol on the establishment of the East African Customs Union.

Initially EAC member states have had some huge differences in their tax systems, including definitions of their tax bases and application of different rates as pointed Table 2. These differences sometimes confer unfair tax competition and unequal treatment of taxpayers, goods, and services in the region, which if not addressed will distort the effective functioning the Common Market (Hans-Georg Petersen et al, 2009).

It has been observed that economic regional integration with the associated consequences such as revenue losses, trade and financial liberalization has had an impact on taxation systems of the integrating countries producing uncoordinated tax laws, which have not been successfully harmonized despite years of cooperation. These challenges often explains why not all partner states have ratified the EAC-DTA for over a decade since the sign off.

The delayed ratification of the EAC-DTA by Burundi can be associated to historical and economic factors which include, differences in political systems of these member states, differences in levels of economic development and perceived negative consequences on tax revenue.

Economically Cautious: The Case of Tanzania
The Republic of Tanzania has generally been slow in its commitment to the aspirations of the EAC, especially the tax harmonization agenda. This is associated with the fact that Tanzania initially adopted and operated a socialist form of economic system which would

explain high levels of economic cautiousness on issues of free market. However, this model was abandoned in the mid-1980s and significant steps plus other measures have since been taken to liberalize the Tanzanian economy along free market lines thereby encouraging both foreign and domestic private investment. The impact of the socialist economic system, to a greater extent, informs some of the decisions that Tanzania makes in relation to EAC integration. This has seen Tanzania remain conservative in its commitment towards some of the proposals aimed at promoting integration in the region.

Equally, Tanzania has been a member of both the Southern Africa Development Cooperation (SADC) and EAC trading blocs. This has had significant effect on how Tanzania handles its commitment to both economic blocs, especially that of the EAC. It is perceived that Tanzania has been more committed to SADC than the EAC. It is due to this very reason that Tanzania had to withdraw from Common Market for Eastern & Southern Africa (COMESA) in the year 2000 after being a member since 1994 (Suleiman, 2019). Tanzania's reasons for leaving further included the fact that COMESA's proposal to reduce customs tariffs for member countries by 90% could have significantly affected Tanzania's revenue. The reduction of tariffs was considered unrealistic by Tanzania since members are at different levels of economic development. The hesitation towards the likely tax revenue loss explains the delayed ratification by Tanzania even after signing the agreement in 2010. Further, as a low-income country Tanzania fears losing its tax revenue by adopting the DTA, which in some cases lowers the applicable tax rates. Based on the COMESA experience, where integration failed to realise benefits as anticipated, Tanzania may be hesitant towards the ratification.

Inequitable distribution of gains, benefits and costs between partners states contributed to the collapse of the EAC in the 1970s. The collapse of the first EAC is attributed to the suspicion of Tanzania against Kenya as regards to unfair sharing of benefits (Mtei, 1984). This has created a culture where Tanzania became overly cautious when dealing with other partner states on any economic aspects. This partially explains some of the grounds why Tanzania has remained non-committal in ratification of the DTA. Tanzania withdrew from COMESA on the basis that committing to free movement of goods without tariff across COMESA will only benefit its trading partners.

Delayed ratification denotes a sign of dissatisfaction and a silent call by partners states to go back to the drawing board to review the current version of the DTA. It is worth noting that the DTA may not meet the test of time since it was drafted in 2005 and signed off by partner states in 2010. It has been over a decade since the DTA was signed off by partners and it is yet to be fully taken up by all members. Without directly pushing for a review of the EAC-DTA, delays in ratification calls the partners to the drawing board for a review and renegotiation of the DTA.

Economic Fragility: The Case of Burundi

The Republic of Burundi has historically been a fragile state making it highly vulnerable to political and economic shocks. From the time when it achieved its independence, it has suffered various chapters of civil strife, two major foiled coup d'états, and five coup d'états that have led to change in political regime (Nkurunziza, 2018). The root cause of the state's fragility is traced back to divisive practices introduced by the colonial power, which have since been perpetuated by post-colonial elites. This political volatility has generated persistent cycles of violence, resulting in the collapse of the country's institutions and economy, even after the negotiation of the peace agreement. This could be contributing towards the delay in the ratification of the DTA. Further, this volatility has affected the way the country relates with its neighbours economically and thus the slowed response even in matters of economic integration.

Historically countries in the EAC were colonised by different colonies. This influenced the language profiles adopted as national languages in the partner states. English is commonly used as the official language of trade in the EAC, however, it is not a national language in any of the partner states in the EAC. The EAC partners states have been pushing for the adoption of Kiswahili as the regional language to foster ease in communication within the community. Burundi and Tanzania have been slow in adopting the use of English, this has been a challenge for the citizens of the two countries to integrate easily with those of other members.

4.0 RECOMMENDATIONS

Harmonization of tax policies and laws on domestic taxes is an important aspect of macroeconomic convergence. It is also one of the yardsticks to be attained for effective functioning of a Common Market. Similar to the European Community, harmonization of income taxation in the EAC is longstanding and one that has become increasingly urgent issues to ensure efficient movement of goods and services across the region (International Monetary Fund, 1990). However, little progress has been made toward the realization of this ambition. Signing and ratification of the DTA presents a key milestone towards the tax harmonization process. Presently, it appears that tax harmonization is urgent due to competitive, downward pressure on tax rates adopted by the partner states.

Article 80 of the EAC Treaty provides that for co-operation in investment and industrial development, the partners should take measures aimed at harmonization and rationalization of investment incentives including those relating to taxation of industries, particularly those that use local materials or labour with a view to promoting the community as a single investment area.

Signing of the regional DTA in 2010 was a mechanism used by countries to deal with the avoidance of double taxation and promotion of tax harmonization. This agreement prevents persons, investors, or companies from being required to pay tax twice for the same taxable income in two different countries. The agreement also assists to promote foreign direct investment, which might otherwise be discouraged if companies were forced to pay tax locally and in their country of fiscal residence for taxable activities. They reduce the tax burdens of foreign investors and provide legal security to investors.

In addition to preventing double taxation disputes, double taxation agreements can also be an effective weapon in the fight against fraud and tax evasion. These agreements establish a series of rules that determine how to declare the incomes obtained based on their origin and thus avoiding double taxation on the same person or company, the same income or possession. For the EAC partner states to enjoy the benefits that can be derived from a double tax agreement, they must negotiate the agreements from a position of knowledge and understanding, taking into consideration the associated costs and benefits of the agreement.

To ensure that that the EAC-DTA meets the expected objective and is acceptable by all member states it is recommended that the parties consider the following:

1. **Adoption of the ATAF model -** The ATAF Model Tax Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income largely follows the Double Taxation Convention model of the United Nations Model between Developing and Developed Countries and the OECD Model Tax Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital. The ATAF Model is a well-researched model that is intended to provide an African approach to tax treaties. It is intended to be revised from time to time and is not a legal instrument as such but rather a guiding instrument.

2. **Inclusion of limitations of benefits clause -** Such a clause seeks to limit the application of DTAs and cushion its abuse through treaty shopping. The act of treaty shopping arises where multinational corporations set up a shell company in a contracting state through

which income/profits will be shifted with a view of taking advantage of tax benefits extended through the DTA. Generally, shell companies have no clear business intention in contracting states other than taking advantage of minimum tax rates. Inclusion of the limitation of benefit clause in the DTA provides a criterion on how to determine the applicability of the treaty with regards to international transactions.

For example, the limitation of treaty benefit provisions in the Kenya Income Tax Act provides that a person can only take advantage of tax benefits under a double tax agreement if:

a. 50% or more of the underlying ownership of that person is held by an individual or individuals who are resident in that country for the purposes of the DTA; or
b. The person is a company listed on the stock exchange in that other contracting state.

Inclusion of limitation of benefits clauses or anti treaty abuse clauses in the DTA will complement the compliance requirements and help to safeguard treaties from abuse associated with treaty shopping by ensuring that the treaty benefits the designated beneficiaries.

3. **The treaty should be precise on all incomes covered -** A major handicap of a DTA can be lack of clarity on what incomes are clearly covered in the arrangement. It is recommended that a DTA must clearly define and specify all the incomes or benefits that are covered by the agreement. Failure to properly specify these incomes will mean that one of the contracting states may end up relinquishing fully their taxation rights to the other, depending on the nature of income. It further leads to unnecessary conflicts and dispute between taxpayers and governments in the contracting states.

   This has been witnessed in the tax appeals tribunal ruling in the case *Mckinsey and company Inc. Africa proprietary ltd Vs commissioner of legal services and board coordination in the tax appeals tribunal appeal no 199 of 2020*. The appeal related to an assessment raised by the KRA for withholding tax on payments made by McKinsey and Company Inc. Africa Proprietary Ltd - Kenya, a company incorporated in South Africa, to its related entity in South Africa for consultancy services received. The appellant's submission was that Article 3 of the Kenya-South Africa DTA does not provide a clear definition of business income and as such professional fees charged for services should be taxed as business income and not under other incomes as argued by the respondent. Even though this position was disputed by the respondent, the tax appeals tribunal ruled in favour of the appellant, that professional fees should be taxed under Article 7 (business income) and not Article 22 (other incomes). This implied that the professional income can only be taxed where the service provider creates a permanent establishment.

   This argument is further supported in the High Court case of *Tax Justice Network-Africa v Cabinet Secretary for National Treasury and 2 others [2019]* where TJNA argued that failure to include an Article on management fees, amounted to the Government of Kenya relinquishing wholly its taxation rights on management fees to Mauritius subsequently denying itself tax revenue where management and professional fees are paid to consultants based in Mauritius.

4. **Need to follow the right procedure in the ratification processes -** Governments across the globe usually have executive authority to enter into negotiation and conclude treaties including DTAs, on behalf of the state. However, this authority is usually accompanied by requirement for a proper procedure to be followed. For example, in Kenya, it is a constitutional requirement that changes in tax laws are subjected to public participation.

Failure to follow these laid down procedures can lead to invalidation of these treaties in a court of law.

This aspect was an issue of determination in the case *Tax Justice Network-Africa (TJNA) v Cabinet Secretary for National Treasury and 2 others [2019]*. TJNA questioned the constitutionality of the DTA signed between Kenya and Mauritius with respect to public participation and observance to the Treaty Making and Ratification Act of 2012 by filing a case in the High Court of Kenya against the government in 2014.

TJNA argued that the failure by the Kenya government to subject the DTA to the due process, as provided for in the Treaty Making and Ratification Act, contravened Articles 10 on the principle of public participation and Article 201 of the Kenyan Constitution that requires standards of transparency and public participation be observed in matters of public finance. The case sought to demonstrate that the government's decision to sign onto this agreement carried both technical risks as well as constitutional shortcomings.

TJNA's main objective was to demonstrate to the court that there are innate risks undermining Kenya's ability to tax both individuals and multinational corporation (MNCs) because of the provision contained in the DTA, therefore, harming current tax revenue collection efforts. The High Court on March 2019 pronounced itself that the DTA between Kenya-Mauritius was null and void in accordance with section 11(4) of the Statutory Instruments Act 2013. The outcome of this case gave emphasis on the need for governments to follow the laid down procedures in development and implementation of statutory instruments.

This is a lesson for the EAC partners states that they adhere to any laid down procedures as regards to ratification of double tax agreements.

5. **Consider reviewing and renegotiating the EAC-DTA and other existing DTAs -** Countries entering into tax agreement negotiations require a great understanding of why they are doing so, and the benefits or costs that emerge so that they can attract foreign investment. In majority of these cases there may be pressing diplomatic reasons. Occasionally they are negotiated because an advisor has suggested that it would be a good thing to do. On the other hand, some developing countries may refuse to have tax treaties, either generally or with particular countries, because of the fear of reduced revenue as a result of the limitations on source taxation that such treaties impose.

   The decision to enter treaty negotiations with another country is not one to be undertaken lightly, especially for developing countries. There are both benefits and potential costs to developing countries from concluding a tax treaty. It is, therefore, so it is desirable to have a comprehensive tax treaty strategy, agreed across the whole of government before embarking on tax treaty negotiations. African countries and specifically members of the EAC, must consider reviewing existing tax agreements and renegotiating these agreements for various reasons such as;

   - *Emergence of new type of business models that are conducted across international borders in form of e-commerce.* The effect of the internet and digital technology is one of the emerging issues of international taxation in the last several years. It is clear that the existing standards of international taxation are totally affected by the advent of electronic commerce and digital technology because it involves state-of-the art technological innovation. There has been a lot of arguments to change the international tax standards in order to capture these impacts.

- *The new African Continental Free Trade Area (AfCFTA)*. The African Continental Free Trade Area has been taunted as having the potential to increase employment opportunities and incomes and helping to expand opportunities for all Africans. Signing of this arrangement has had a significant impact on double tax agreement which require to be reviewed.
- *Consider the inclusion of the proposed Article 12B on taxation of income from digital services as proposed in the revised UN Model.* Review of the regional DTA agreement before it is ratified by all partner states will provide for the mechanisms that should be adopted to allow for source taxation of income realised from digital market place.
- *Consider reviewing the definition of the PE,* in line with the proposals made under BEPS Action Plan 7 to minimize artificial avoidance of Permanent Establishment Status through the use of agency models and building and construction sites.

6. **Create special units for international taxation and tax harmonization:** For ease in of coordination and implementation of the DTA between the EAC member states, there is need for the member states to set up special units focused on international taxation and tax harmonization. The unit will champion the best practices on international taxes and address any issues raised by any state, jointly. Like in the case where each is required to establish a department to coordinate its participation in the EAC integration process pursuant to article 8(3)a of the Treaty for the Establishment of the East African Community, members can follow this approach to promote the tax harmonization process.

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FOR MORE INFORMATION, PLEASE CONTACT:

EATGN/TJNA ADDRESS
Jaflo Limited | Block 3 | 106 Brookside Drive | Westlands

EATGN
E: info@eataxgovernance.net
W: www.eataxgovernance.net

TJNA
E: info@taxjusticeafrica.net
T: (+254) 20 24 73373, (+254) 728 279 368
W: www.taxjusticeafrica.net

Norad

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