

Double Taxation in the East African Community: A Case for Reforms

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ABSTRACT

Ideally, there should be free movement of goods, services and capital across East Africa because this is the main objective of the East African Community (EAC). The EAC Common Market Protocol is premised on the free movement of capital, goods, and services and freedom of establishment. The EAC Treaty stipulates the avoidance of double taxation as an objective of the EAC. In international tax law, double taxation in cross-border trade is avoided through unilateral measures by states or the negotiation of bilateral or multilateral tax treaties. In 2010 the EAC member states signed a multilateral tax treaty aimed at providing a regional framework against double taxation; however, the same is yet to enter into force ten years later.

This study demonstrates how double taxation is a barrier to the process of integration in EAC. The thesis analyses the domestic laws of member states, the provisions of the EAC Treaty and EAC multilateral tax treaty. Through an analysis of existing legislative and treaty provisions for the elimination of double taxation in the bloc, the author argues that unilateral measures are not always adequate to effectively relieve double taxation. Second, the author demonstrates that the EAC multilateral tax treaty is outdated and is not fit for purpose as it would result in double taxation through gross based final withholding tax and double non-taxation through indirect share sales.

Based on the foregoing findings, the thesis makes recommendations on how to effectively deal with double taxation in the Community. First the EAC Multilateral tax treaty should be updated and supplemented before it enters into force because, in its current form, its application would result in double taxation as well as double non-taxation. Further, based on lessons learnt from the EU and the Caribbean Community, the study recommends a more prominent role for the EAC community institutions in tackling double taxation and furthering the objectives of the EAC.

Table of Contents

DECLARATION.....	ii
ABSTRACT	iii
ACRONYMS AND ABBREVIATIONS	vi
LIST OF STATUTES.....	vii
LIST OF CASES	viii
LIST OF TABLES.....	ix
1.0. Background of the Study	1
1.1. Statement of the Problem	2
1.2. Research Objectives	3
1.4. Research Questions	4
1.5. Justification of the Study	4
1.6. Limitations of the Study	5
1.7. Theoretical Framework	5
1.8. Literature Review.....	9
1.9. Research Methodology.....	19
1.10. Chapter Breakdown.....	19
CHAPTER TWO: THE LEGAL REGIME REGULATING DOUBLE TAXATION IN THE EAST AFRICA COMMUNITY	21
2.1. The Domestic Tax Regimes of Partner States.....	21
2.2. EAC Legal Provisions on Elimination of Double Taxation	32
2.3. Conclusion.....	45
CHAPTER THREE: APPLICATION OF THE CURRENT EAC LEGAL REGIME IN CURBING DOUBLE TAXATION.....	47
3.1. Objectives of the EAC: Common Market	47
3.2. How Double Taxation can result in violation of EAC Community Law.	49
3.3. European Union Approach to Double Taxation	57
3.4. Caribbean Community Approach	60
3.5. EAC Context.....	63
3.6. Conclusion.....	65
CHAPTER FOUR: FINDINGS, RECOMMENDATIONS AND CONCLUSION.....	67

4.1. Introduction	67
4.2. Findings	67
4.3. Proposed Areas for Reforms	69
4.4. Conclusion.....	77
BIBLIOGRAPHY	79
APPENDICES: ETHICAL CERTIFICATE AND ORIGINALITY REPORT.....	84

ACRONYMS AND ABBREVIATIONS

CJEU	Court of Justice of the European Union
DTA	Double Taxation Agreement
EAC	East African Community
EAC 1	East African Community (1967-1977)
EAC 2	East African Community (as re-established in 1999)
EAC	East African Community
EAC-DTA	East African Community Double Taxation Agreement
EACJ	East African Court of Justice
KRA	Kenya Revenue Authority
LOB	Limitation of Benefits
MTC	Model Tax Convention
OECD	Organization for Economic Co-operation and Development,
URA	Uganda Revenue Authority

LIST OF STATUTES

Burundi Income Tax Law No.1/02/2013

Kenya Income Tax Act (Cap 470)

Protocol on the Establishment of the East African Community Common Market

Protocol on the Establishment of the East African Community Customs Union

Rwanda Income Tax Law No.16/2018

Tanzania Income Tax Act (Cap 332)

Treaty for the Establishment of the East African Community

Treaty on the Functioning of the European Union

Uganda Income Tax Act (Cap 370)

LIST OF CASES

Aberdeen Property Finiwest Alpha Oy V Uudenmaan verovirasto and Helsingin kaupunki Case C-303/07

Amurta V SGPS V Inspecteur van de Belastingdienst/Amsterdam ECJ November 8th 2007 Case C-379/05

Centro Equestre da leziria Grade Lda V Bundensarnt fur Finanzen Case C-345/04

Compania General de Tabacos v. Collector, 275 U.S. 87 (1927)

Gilly v. Directeur des services fiscaux du Bas-Rhin E.C.R. 1-2793, Case C-336/96 Judgment delivered on 12 May 1998

Kerckhaert & Morres, Case C-513/04, 2006 E.C.R. I-10967.

Denkavit International BV, C-170/05 CJEU Judgement of 14 December 2006,

Arnoud Gerritse v Finanzamt Neukölln-Nord, C-234/01 CJEU Judgement of 19 January 2006

British American Tobacco (U) Ltd v The Attorney General of Uganda EACJ Judgment delivered on 29 March 2019

Commissioner General Uganda Revenue Authority v Zain International BV (CIVIL APPEAL NO.0011 OF 2012) [2014]

Crane Bank Ltd v Commissioner General Uganda Revenue Authority [2013] eULII

Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Qatar v Bahrain, [1994] ICJ Reports 2001

Royal Bank of Scotland plc. v Greece, 1997 E.C.R. I-2651

Unilever Kenya Ltd v Commissioner of Income Tax [2005] eKLR

LIST OF TABLES

Table 1: Summary EAC States Double Taxation Regimes

Table 2: Primary Adjustment

Table 3: Economic Double Taxation

Table 4: Secondary adjustment

Table 5: Gross Withholding Tax

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CHAPTER ONE

1.0. Background of the Study

Ideally, there should be free movement of goods, services and capital across East Africa because this is the main objective of the Community.¹ The EAC Common Market Protocol is premised on the free movement of capital, goods, and services and freedom of establishment.² The realization of the Common Market would result in increased trade across the East African region, a region which boasts of a combined market of 126 million people.³ However, the current state is far from ideal. Trade between the states is minimal and it is riddled with both tariff and non-tariff barriers.⁴

According to the United Nations Economic Commission for Africa, trade in EAC is tension-filled and strained between the Partner States. Intra-EAC trade fell from US\$3.5 billion in 2013 to US\$ 2.4 billion in 2017 while Kenya's intra-EAC exports slid from US\$ 1.6 billion in 2013 to US\$ 1 billion in 2017.⁵ The East African Business Council has attributed the decline of EAC trade to barriers that have led to the loss of competitiveness of the manufacturers in the region.⁶

Double taxation discourages and threatens regional trade. According to the OECD, double taxation's "harmful effects on the exchange of goods and services and movements of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between two countries."⁷ The challenges posed by double taxation are acknowledged by states and, thus, they unilaterally provide relief against double taxation for their citizens, corporations, and residents through tax exemptions or foreign tax credit provisions in domestic

¹ Article 79, *Treaty for the establishment of the East African Community*, 30 November 1999,

² Article 2, *Protocol on the Establishment of the East African Community Common Market*, 1 July, 2005

³ <https://www.eac.int/investment/press-releases/157-trade/136> on 16 April 2020.

⁴ Aloo LB, 'Free movement of goods in the EAC', in Ugirashabuja E., Ruhangisa J, Ottervanger T, & Cuyvers A, (Eds.), *East African Community law: institutional, substantive and comparative EU aspects*, Brill Nijhoff, Leiden, 2017, 320

⁵ An analysis of the East African Community's trade performance [https:// www.uneca.org/oria/pages/eac--east-african-community](https://www.uneca.org/oria/pages/eac--east-african-community) on 1 July 2019

⁶ <https://www.eabc-online.com/news/225-eabc-ensures-policies-work-on-the-ground-for-businesses> on 4 April 2020

⁷ OECD Committee On Fiscal Affairs, *Model Tax Convention On Income and On Capital*, 28 January 2003

legislation.⁸ However, this thesis argues that unilateral measures are inadequate in the mitigation of double taxation since, unlike double tax treaties, their application is limited. First, unilateral measures are limited in scope since some states do not grant unilateral relief; further unilateral measures do not provide reciprocity which states value tremendously. Secondly, if double taxation arises as a result of an entity or a person being considered a resident of more than one state, double taxation cannot be resolved under domestic law since states may have different concepts of territoriality.⁹ Third, national legislation can easily be changed through subsequent legislation while tax treaties are binding international instruments which cannot be easily changed.¹⁰ Fourth, tax authorities in some states may have considerably more discretion to tax than others meaning that taxpayers do not have legal certainty in their tax affairs.

As a result of these limitations, states usually opt to enter into double tax treaties. In 1997, the founding members of the East African Community (EAC), i.e. Kenya, Tanzania and Uganda, negotiated a multilateral tax treaty, but that tax treaty never entered into force. Subsequently, the tax treaty was updated and signed on 30 November 2010 by the then five EAC member States. The East African Community Multilateral Tax Treaty 2010 (EAC –DTA 2010) has not entered into force, but Kenya, Rwanda and Uganda have ratified the tax treaty.¹¹ The partner states' weak commitment to the elimination of double taxation is evidenced by their failure to ratify the EAC-DTA which was signed in 2010. Furthermore, attempts at harmonization of taxes that would mitigate double taxation have also been slow and largely unsuccessful.¹²

1.1. Statement of the Problem

The Common Market's fundamental freedoms of movement of goods, services and capital across East Africa are at the core of East African Community. The limitation of these freedoms could be caused by a number of factors including double taxation which has been identified as one of

⁸Holmes K, *International tax policy and double tax treaties: an introduction to principles and application*, IBFD, Amsterdam, 2014, 103

⁹Nortcliffe E.B, 'United Kingdom-United States double taxation convention' *Intertax* 4 (1976), 227

¹⁰Hearson M, 'Measuring tax treaty negotiation outcomes: the action aid tax treaties dataset' *Institute of Development Studies* (2016), 9

¹¹ <https://www.pwc.co.tz/press-room/eac-tax-harmonization-remains-a-challenge.html> on 14 April 2020

¹² Bett JK, 'Income Tax in the East African Community: A Case for Harmonization and Consolidation of Policy and Law with a Focus on Corporate Income Taxation' Unpublished PhD Thesis, University of Nairobi, October 2016.

the inhibitors of trade within the EAC.¹³ Double taxation exposes of cross-border economic activities to harsher tax treatment than purely internal activities therefore discouraging cross-border trade and investments. Consequently, unilaterally, in their national legislations, EAC states provide for double taxation tax reliefs. However, questions abound on the effectiveness of unilateral measures in mitigation of cross-border double taxation. The EAC Treaty provides as an objective of the EAC, the avoidance of double taxation.¹⁴The EAC Partner states in 2010 entered into the EAC-DTA (2010) with a view to avoiding double taxation. However, ten years later the agreement is not in force because not all the signatories have ratified the Agreement. In view of the foregoing this study is aimed at analysing the current double taxation legal regime and whether it is fit for purpose in eliminating double taxation within the Community.

1.2. Research Objectives

The main objective of this thesis is to analyze the problem of double taxation in relation to the Common Market, interrogate the efficacy of existing legislative and treaty provisions for the avoidance of double taxation in the bloc, and present a case for reforms aimed at eliminating double taxation in the EAC.

The specific objectives of the study are to:

- a) To analyse effect of double taxation on freedoms of the Common Market.
- b) To assess whether the unilateral double taxation reliefs provided for in national legislations are sufficient to eliminate double taxation in the EAC.
- c) To assess whether the provisions of the EAC Treaty are sufficient to avoid double taxation in the bloc.
- d) To assess whether the provisions of the EAC-DTA are sufficient to avoidance of double taxation in the bloc.

¹³ <https://www.eabc-online.com/news/225-eabc-ensures-policies-work-on-the-ground-for-businesses> on 1 April 2020

¹⁴ Article 80(h), *Treaty for the establishment of the East African Community*.

- e) To determine the necessary reforms that will facilitate the avoidance of double taxation in the EAC

1.3. Research Hypothesis

This thesis proceeds on the presumption that;

- a) Double taxation defeats the objectives of the EAC
- b) Existing national and regional legal regimes are insufficient for the elimination of double taxation.

1.4. Research Questions

This thesis seeks to answer the following questions:

- a) Whether unrelieved double taxation constitutes a violation of the EAC Treaty?
- b) Are the unilateral double taxation reliefs provided for in the domestic legislation of member states sufficient to avoid double taxation?
- c) Are the EAC-DTA provisions sufficient to avoid double taxation in the bloc?
- d) What are the necessary reforms that will enhance the elimination of double taxation in the EAC?

1.5. Justification of the Study

This study dissects how double taxation is a barrier to the process of integration in EAC. The author seeks to analyse the domestic laws in member states, and the weaknesses of the proposed way of avoiding double taxation in the EAC which is the EAC- DTA (2010), including how it violates the EAC Treaty.

Currently there is no research study that has been specifically dedicated to the double taxation regime within the EAC common market therefore this study fills in the gap in existing literature in relation to double taxation in the EAC.

This study also aims at influencing policy and legal reforms within the EAC. This study explains how EAC can tackle the problem of double taxation including reforms necessary for the EAC-DTA to be effective.

1.6. Limitations of the Study

The main limitation for the study was inadequate time and resources to commit to interaction with actual regional traders and investors in the process of gathering qualitative primary data. Furthermore, the limited reliable data and research by East African scholars posed a challenge in conducting this research. There are however sufficient resources to enable the author conduct a conclusive desktop research on the topic.

1.7. Theoretical Framework

This study is based on two main theories, the neoliberalism regime theory and the neorealist regime. The neoliberalism theory takes the view that it is possible through bargaining to arrive at a mutually beneficial regime among states. The neorealist theory on the other hand takes the view that differences in states power are so stark that it is fundamentally impossible to arrive at a mutually beneficial regime; that the stronger economy always wins.

Neoliberalism Regime Theory

The Neoliberalism Regime Theory utilised by Diana Ring helps to explain why countries negotiate double taxation treaties despite the availability of unilateral solutions to double taxation.¹⁵ In general, neoliberalists maintain that the basic challenge of states is to overcome market failure and international regimes are tools for overcoming market failure.¹⁶ The theory posits that if states act cooperatively, they may achieve better outcomes than by acting unilaterally.¹⁷

In the analysis of double taxation, treaties and domestic law reflect a shared understanding of double taxation as harmful and, therefore, the need to eliminate it.¹⁸ The regime is explained as the principles, norms, rules, and decision-making procedures that describe the state of conduct or reaction over an issue.¹⁹ In international taxation, the principle is that double taxation is harmful, the norm is that residence countries should yield primary tax jurisdiction to source countries for

¹⁵ Ring DN, 'International tax relations: theory and implications', 83-154

¹⁶ Chang HJ, 'Breaking the mold: an institutionalist political economy to the neoliberal theory of the market and the state', United Nations Research Institute for Social Development (2001), 6

¹⁷ Ring DN, 'International tax relations: theory and implications' 119

¹⁸ Ring DN, 'International tax relations: theory and implications' 147

¹⁹ Ring DN, 'International tax relations: theory and implications' 105

certain types of income, and the rules include the mechanisms by which residence jurisdiction yields to source jurisdiction.²⁰

Neoliberalism Regime Theory pursues three lines of inquiry: the bargaining game; the regime system and, lastly, underlying issues. Several bargaining games have been identified by neoliberals including; prisoners dilemma, suasion, coordination and assurance.²¹ The most suitable study, of the four games, is the “coordination game” which is described as the pursuit of a common strategy in order to avoid unfavourable results arising from the application of divergent measures.²² As noted above, states can unilaterally offer double taxation relief. This begs the question of why states need to cooperate to eliminate double taxation. Ring argues that there are two levels of cooperation. The first level of cooperation regarding double taxation is the decision by a state to offer unilateral double taxation relief.²³ However, with different states having different applications of source rules and tax definitions, double taxation may persist notwithstanding the unilateral relief.²⁴ Coordination between states is necessary to ensure complete relief, against double taxation.

State X and Y can each respond to the problem of double taxation as follows: assuming that State X and Y both view double taxation as being harmful but only State X grants double taxation relief to its residents, the tax revenue lost is offset by the economic benefits of X residents undertaking more cross-border economic activities. The temporary tax revenue increase received by Y will also result in a decrease of the economic activities undertaken by Y residents. If both states do not afford their residents double taxation relief and there is no DTA in force the overall global economy may suffer.²⁵ Hence for a State affording its residents double taxation relief the most desired outcome would be for joint state coordination on double taxation.²⁶ While the benefits of coordination between developed countries are clear, as states with comparable investment flow cooperation should lead to improved trade and development, Dagan posits that a Double Taxation Agreement (DTA) only benefits developed countries; since DTA are

²⁰ Ring DN, ‘International tax relations: theory and implications’ 116

²¹ Aggarwal V, Dupont C, ‘Collaboration and coordination in the global political economy’ in Ravenhill J(ed) *Global political economy*, Oxford University Press, London, 2017, 34

²² Little R, ‘International regimes, in globalization of world politics’, 314

²³ Ring DN, ‘International tax relations: theory and implications’ 132

²⁴ Ring DN, ‘International tax relations: theory and implications’ 116, 132.

²⁵ Ring DN, ‘International tax relations: theory and implications’ 131

²⁶ Ring DN, ‘International tax relations: theory and implications’, 129

residence-based, they would result in loss of revenue for developing countries.²⁷ This is because developing countries would benefit from source-based taxes on repatriated income as more often than not, they are net importers of capital goods and services while developed countries support residence-based taxation because they want to keep the revenue generated by the foreign investment of their residents.²⁸ Developing countries must determine whether the loss in revenue will be offset by increases in economic investments. A report published by the EAC indicates that the total intra-EAC imports and exports as of 2017 were 7.7% and 18.7 % respectively indicating a small portion of the total trade conducted in the EAC.²⁹ With regard to investments, for instance, intra -EAC investment to Uganda was at US\$ 464 million out of a total foreign direct investment US\$1.3 billion while the total intra EAC investments into Tanzania is at US\$33 million while the total foreign investment is at US\$3.4 billion.³⁰ While the current intra – EAC trade reflects a small portion of the total EAC trade, this thesis argues that the EAC countries will benefit from a tax treaty for several reasons. First as discussed in 1.9.3. below, several authors argue that tax treaties spur economic growth even for developing countries by eliminating distortions to trade and encouraging cross border trade.³¹ Second, while the volume of investment and trade is currently low, the significance of this trade ought not to be overlooked in light of the continued efforts of the EAC to deepen economic integration.³²

The Neoliberalism Regime theory also explains how developing countries benefit from negotiated tax treaties.³³ While the driving motivation for developing countries is to attract investment as opposed to eliminating double taxation, DTAs will encourage investments as investors generally prefer environments where there is certainty as to the taxation and there is a

²⁷Dagan T, 'Tax treaties Networks', Brooklyn Journal of International Law (2016) ,996

²⁸ Pinto D, 'Exclusive source or residence-based taxation – is a new and simpler world tax order possible?' IBFD Bulletin for international taxation, July 2007, 282

²⁹ EAC Trade and Investment Report 2017: Accelerating market driven Integration available at <https://www.eac.int/eac-history> on 12 November 2019.

³⁰ EAC Trade and Investment Report 2017: Accelerating market driven Integration available at <https://www.eac.int/eac-history> on 12 November 2019.

³¹ Owens E, 'United States income tax treaties: their role in relieving double taxation', 17 RUTGERS Law Review (1963), 428; Neumayer E, 'Do double taxation treaties increase foreign direct investment to developing countries?', The Journal of Development Studies 43 (2007), 1501-1519; Avi-YR. 'Double tax treaties: an introduction', in K. Sauvart and L. Sachs (eds), *The effect of treaties on foreign direct investment*, Oxford University Press, New York: (2009)106

³²Mwasha NO, 'The benefits of regional economic integration for developing countries in Africa: a case of East African Community (EAC)',74

³³ Ring DN, 'International tax relations: theory and implications'128

guarantee of a mode of elimination of double taxation.³⁴ As will be further discussed in 1.9.3 below, tax treaties eliminate uncertainty in international taxation as they eliminate ambiguity in the application of different legislation and rule overlap. This signifies that States act against set out rules in the international arena.³⁵

Regimes are formed by conflict. In international taxation, the main conflict is over tax revenue. The neoliberalism theory argues that conflicts over tax revenue are easier resolved between states that have comparable or reciprocal economies and harder to do between non- reciprocal economies.³⁶ Background factors can influence the success or failure of a regime formation. The background factors include frequency of interaction, availability of leadership, number of actors, distribution of resources in the issue area to mention a few. In double taxation, for instance, multilateral treaties are not common due to the difficulty in reaching an agreement.³⁷ The other background factor that greatly influences the creation of a regime is the distribution of investment flows as discussed above.³⁸

Neorealist Regime Theory

The neorealist regime theory, a contrast to the neoliberal regime theory, argues that the double tax regime is driven by the power of one state over another.³⁹ The theory asserts that tax treaties are distributional in nature; that is, the treaty allocates taxing rights to one state at the expense of another.⁴⁰ As a result, the more powerful states get to tax at the expense of the weaker states.⁴¹ Ring demonstrates that where countries have an approximately equal amount of investment flows then the countries are likely to get an equal amount of tax.⁴² EAC country economies are not homogeneous. Some are economically more advanced, and in light of the neorealist regime theory there would be winners and losers with the tax treaty benefitting some countries more than others.

³⁴ Ring DN, 'International tax relations: theory and implications' 128-129. However, see Section 1.8.3 for discussion on studies challenging the idea that double tax treaties lead to increased investment.

³⁵ Allison C., 'Sovereignty, taxation and the Social Contract', 8

³⁶ Ring DN, 'International tax relations: theory and implications,' 123.

³⁷ Ring DN, 'International tax relations: theory and implications,' 127.

³⁸ Ring DN, 'International tax relations: theory and implications,' 142.

³⁹ Ring DN, 'International tax relations: theory and implications,' 91.

⁴⁰ Arnold BJ, *International tax primer*, Kluwer Law International B.V, Amsterdam, 2016, 46.

⁴¹ Dagan T, 'Tax treaties networks', 996.

⁴² Ring DN, 'International tax relations': theory and implications,' 123.

The neo-realist's argument that the distributional nature of DTAs tends to favour powerful states as at the expense of weaker states is valid.⁴³ Developing and developed countries engage in tax treaty negotiation irrespective of the levels of power within the international scene,⁴⁴ However more developed countries due to their high investment enjoy the upper hand in practice. However, neo-realist's argument does not account for the fact that 'weaker states', recognizing that the Organization for Economic Co-operation and Development (OECD) model DTA supports residence-based taxation, and also noting that they are not members of the OECD and cannot influence the OECD model treaty, worked through the United Nations (UN) to develop a more favourable model treaty for developing countries.⁴⁵ Based on the foregoing, the neorealist regime theory does not adequately explain the double taxation regime.

In conclusion, Allison Christians states that due to the high interdependence of states economically, a nation's local tax policies can affect other states.⁴⁶ She goes on to mention that states are parties to a global social contract; therefore, instead of focusing on national tax policy, states should strive to come up with policies that consider the needs of the larger global community.⁴⁷ This article lends its voice to the neoliberalism and neorealist regime theories dichotomy by emphasizing the importance of coordination and cooperation in the development of tax policies and resolving double taxation.

As discussed above, neo-realists focus on economic power helps the study in explaining why some EAC states are reluctant to enter a multilateral treaty. The neoliberalist regime theory, which looks beyond power, helps explain why the EAC member states negotiated the EAC-DTA despite the availability of a unilateral solution to double taxation. Consequently, the author taps into both the neoliberalist regime theory and the neorealist regime theory.

1.8. Literature Review

1.8.1. Double Taxation

⁴³ Dagan T, 'Tax treaties myth,'1996.

⁴⁴ Holmes K, '*International tax policy and double tax treaties: an introduction to principles and application*',64.

⁴⁵ Holmes K, '*International tax policy and double tax treaties: an introduction to principles and application*',64.

⁴⁶ Allison Christians, '*Sovereignty, taxation and the Social Contract*' Minnesota Journal of International Law (2008),36

⁴⁷ Allison C., '*Sovereignty, taxation and the Social Contract*'34

Justice Oliver Wendell Holmes Jr. advanced the idea that taxes and civilization are inseparable concepts and proposed that taxation is key to the existence of a civilized society.⁴⁸ States assert their sovereignty by levying taxes upon their citizens according to their national tax legislation. However, due to recent developments in the field of science and technology, the rise of multinational enterprises, and an increase in cross-border trade and investments, the world has become a global village. Put differently, globalization has led to an increase in the volume of cross-border transactions and migration, all of which are subject to taxation.⁴⁹

It is in the assertion of national governments' sovereignty of their tax policies coupled with a lack of harmonization in global tax systems that instances of double taxation arise. These instances are often detrimental to trade and investments among countries. Double taxation is defined as the taxation of the same income more than once.⁵⁰ Double taxation arises due to the overlaps in and diverse interpretations and application of taxation principles. There are two forms of double taxation: juridical double taxation and economic double taxation; there exists a clear distinction between the two.⁵¹ In order to draw out the distinction, it is necessary to define what both forms of double taxation entail. The preamble to the OECD Model Taxation Convention defines juridical double taxation as, "the imposition of comparable taxes in two (or more states) on the same taxpayer in respect of the same subject matter and for identical periods."⁵² Double taxation is international in nature in that it involves the imposition of tax in more than one country. It occurs because states establish tax liability based on different taxation principles, i.e., source, residence and citizenship.⁵³

As discussed in 1.0 above, residence based taxation is where, a state levies tax upon an individual or legal entity based on the fact that the state is his or her or place of residence. Under the source based taxation is where a country will levy taxes on income generated within its territory.⁵⁴ The differences in the application of the above principles by states give rise to conflicts that often result in double taxation. These conflicts may be classified as: source-source

⁴⁸ *Compania General de Tabacos v. Collector*, 275 U.S. 87 (1927).

⁴⁹ Root F R, '*International trade and investment*', south-Western Publishing Company, Cincinnati, 1978, 19-20.

⁵⁰ Klaus Vogel, '*Double tax treaties and their interpretations*' www.scholarship.law.berkeley.edu on 18 May 2019.

⁵¹ Barenfeld J, 'Taxation of cross-border partnerships: double tax relief in hybrid and reverse hybrid situations', IBFD Publications (2007), 84.

⁵² OECD, *OECD Model Tax Convention*, 2014, 7.

⁵³ Barenfeld J, 'Taxation of cross-border partnerships double tax relief in hybrid and reverse hybrid situations', 84.

⁵⁴ Klaus Vogel, '*Double tax treaties and their interpretations*' 4

conflict, residence-residence conflict and source-residence conflict.⁵⁵ Source-source conflict relates to the assertion of domestic laws as the source of a taxpayer's income by two states.⁵⁶ On the other hand, residence-residence conflict refers to the assertion of domestic laws based on being the taxpayer's country of residence.⁵⁷ Lastly, source-residence conflict, which is most common, arises when one country claims tax based on the residence principle and the other based on the source principle.⁵⁸

The second form of double taxation, economic double taxation, refers to, 'the imposition of tax on the same income in the hands of different taxpayers.'⁵⁹ This means that the same items of income are subject to tax through different taxpayers. Although economic double taxation more often occurs in the domestic setting, it may also occur internationally in instances such as when a company and its owner are residents of different states.⁶⁰

From the above, it then suffices that the principle difference between juridical double taxation and economic double taxation is that the former occurs when income is subject to tax by two different states in the hands of the same taxpayer. The latter, however, occurs when income is subject to tax by two states but in the hands of different taxpayers.⁶¹

Usually, double taxation arises because states tax assets and transactions located and conducted within their territory and in other countries. Whichever form that double taxation takes, the result is the inhibition of economic activity.⁶² Therefore, states enter into treaties to curb and reduce double taxation. Nonetheless, the implementation and efficacy of a treaty largely depend on state cooperation and workable interpretation of the same.⁶³

Klaus Vogel states that unlike conflict rules in private international law, tax treaties recognize that each contracting state applies its law.⁶⁴ Double tax treaties only limit the application of the laws of the contracting states. He further notes that treaty provisions do not give countries the

⁵⁵ Holmes K, *International tax policy and double tax treaties*, 23.

⁵⁶ Holmes K, *International tax policy and double tax treaties*, 23.

⁵⁷ Holmes K, *International tax policy and double tax treaties*, 23.

⁵⁸ Holmes K, *International tax policy and double tax treaties*, 24.

⁵⁹ Klaus Vogel, 'Double Tax Treaties and their Interpretations', 11.

⁶⁰ Barenfeld J, 'Taxation of cross-border partnerships', 86.

⁶¹ Barenfeld J, 'Taxation of cross-border partnerships', 86.

⁶² Holmes K, *International tax policy and double tax treaties*, 19.

⁶³ Klaus Vogel, 'Double tax treaties and their interpretations' 4-5.

⁶⁴ Klaus Vogel, 'Double tax treaties and their interpretations', 9.

jurisdiction to tax; rather states have original jurisdiction to tax and by assenting to and ratifying treaties, they simply limit their substantive laws based on reciprocity.⁶⁵ He goes on to point out that in the event of overlap between local tax laws and treaty laws on taxation, parties agree which of them shall withdraw its tax claim.⁶⁶ He, therefore, concludes that tax treaties are not only a source of international law but they also establish a mechanism of avoiding double taxation through the division of tax claims.⁶⁷ Vogel's arguments are vital to this study because they shall aid the author in shedding light on how partner states interpret the EAC-DTA and how interpretations may impact double taxation in the region.

1.8.2. Double Taxation Relief

There are two main ways of relieving international double taxation: unilaterally or through tax treaties. In both instances, there are three methods of relief. In cases of concurrent taxation (most of the cases) double taxation will only be eliminated or mitigated by the application of certain methods by the residence state.⁶⁸ Under the *Credit Method*, the residence state (for example Kenya), calculates its tax based on the taxpayer's total income including the income from the other Contracting State, (for instance, Rwanda) which, according to the EAC DTA, may be taxed in the other Contracting State but not including income which is only taxable in that other State. Kenya then allows a deduction from its tax for the tax paid in Rwanda by a Kenyan resident receiving income from Rwanda. The principle of credit applies by either the full credit method or the ordinary credit method.

Under the full credit method, Rwanda allows the deduction of the total amount of tax paid in the other Contracting State i.e. Kenya on income which may be taxed in Kenya or Rwanda. Under ordinary credit method the deduction given by Rwanda for the tax paid in another Contracting State(Kenya) is limited to the average rate of Rwanda income tax of the person for the year of income applied to the person's taxable foreign income. Whereas Article 24 (1) of the EAC DTA prescribes the Full Credit method by allowing a deduction from the tax on the income of a resident deriving such income from another Contracting State which is equal to the income tax paid in the other Contracting State, section 77, Kenya Income Tax Act, Cap 470 is inclined

⁶⁵ Klaus Vogel, 'Double tax treaties and their interpretations',73.

⁶⁶ Klaus Vogel, 'Double tax treaties and their interpretations',22.

⁶⁷ Klaus Vogel, 'Double tax treaties and their interpretations'7

⁶⁸ Arnold BJ, *International tax primer*, 46

towards the application of the ordinary credit method. However, in the event of conflict of laws, the Kenya Income Tax Act, Cap 470 provides that the provisions of the EAC DTA take precedence over the provisions of the Act.⁶⁹

The credit method is employed whenever source state taxation is limited to a maximum rate⁷⁰, when the Treaty aims at distributing the tax revenue between the contracting states, and when an exemption is considered to create a pathway for tax evasion.⁷¹

Under the exemption method, the state of residence does not tax foreign-source income which according to the EAC DTA is taxed in another Contracting State where it is derived, nor tax income which is only taxable in that other Contracting State. The exemption method is applicable to pensions and payments in respect of services rendered in the discharge of governmental functions which are only taxable in the paying state.⁷²

Under the deduction method foreign source income is added to its total taxable income of the resident but foreign taxes are deductible to arrive at the net income.⁷³

Attempts have been made by EAC states to provide unilateral relief against double taxation through domestic laws. EAC states have adopted the tax credit method to avoid double taxation. Under this method, the total income of a resident, irrespective of origin, is calculated and credit is allowed for the tax paid in the source country provided that the tax credit does not exceed the domestic tax applicable.⁷⁴ For example, in Uganda, a credit for the foreign tax paid is allowed provided that the tax credit does not exceed the amount of income tax payable in Uganda.⁷⁵ Tanzania⁷⁶ and Rwanda⁷⁷ have a more or less similar provisions to that of Uganda where a

⁶⁹ Section 41, *Income Tax Act (Kenya)*.

⁷⁰ Articles 10 -13, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

⁷¹ Article 24, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

⁷² Articles 5, 20 *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

⁷³ Holmes K, *International tax policy and double tax treaties: an introduction to principles and application*,103

⁷⁴ Holmes K, *International tax policy and double tax treaties: an introduction to principles and application*,103

⁷⁵ Section 81, *Income Tax Act (Uganda)*.

⁷⁶ Section 77, *Income Tax Act (Tanzania)*.

⁷⁷ Article 7, *Income Tax Law No.16/2018 (Rwanda)*.

resident taxpayer may claim a foreign tax credit for any foreign income tax paid on foreign income which should not exceed the average rate of tax in those countries. The Tanzanian Income Tax Act also provides a taxpayer with the option of claiming a deduction for foreign income tax⁷⁸. Kenya does not have a unilateral relief provision except for citizens.⁷⁹ It allows for deduction of foreign tax as an expense. The Act only provides for a credit where there is a DTA.⁸⁰

As mentioned above, double taxation can be eliminated either unilaterally or through DTAs. There is no consensus on which is more appropriate to relieve international double taxation. Tsilly Dagan strongly argues against the necessity of DTAs and contends that unilateral policies reduce double taxation and treaties often simply replicate unilateral measures.⁸¹ Dagan further states that policymakers have a false assumption that double taxation would occur in the absence of treaties arguing that treaties play a relatively small role in relieving double taxation.⁸² Allison Christians, in conducting a case study of the tax treaty between the US and Ghana, argues that tax treaties between developing and developed countries are largely symbolic as tax treaties do not impact the flow of investments to developing countries.⁸³

It is noteworthy that the aforementioned studies focused on tax treaties between developed and developing countries and not between developing countries themselves. Ring briefly analysed the benefits of tax treaties between developing countries generally; however, her analysis did not contextualize the benefits of tax treaties in a regional economic bloc and more specifically with a focus on the EAC. It is possible that in the context of a regional bloc, if states act cooperatively through a DTA, they may achieve better outcomes than by acting unilaterally.⁸⁴ As previously mentioned tax treaties provide the benefit of certainty and stability. Pickering argues that between developing countries, especially members of a regional economic community, tax treaties can provide the benefits of increased certainty with respect to taxation, and may facilitate resolution of problems between countries. Pickering acknowledges that treaties between developing countries will not attract significant additional foreign investment, but its existence

⁷⁸ Section 77(4), *Income Tax Act (Tanzania)*.

⁷⁹ Section 39, *Income Tax Act (Kenya)*.

⁸⁰ Section 42, *Income Tax Act (Kenya)*.

⁸¹ Dagan T, 'Tax treaties myth', 996.

⁸² Dagan, 'Tax treaties myth', 996.

⁸³ Christians DA, 'Tax treaties for investment and aid to sub-Saharan Africa: a case study', 644.

⁸⁴ Ring DN, 'International tax relations: theory and implications', 119.

will facilitate and encourage cross-border trade and improve and economic activity between developing countries. As will be discussed in Chapter 3, in order to avoid inequality occasioned by residence-based DTA on net capital importing countries, developing countries should consider source based DTA.

Other authors have supported the relevance of treaties in eliminating double taxation and highlighted the limitations of unilateral measures. Nortcliffe E.B argues that unilateral measures of avoiding double taxation are confined to domestic law as opposed to the tax treaties which will affect tax conditions of more than one state.⁸⁵ Secondly, if double taxation arises as a result of an entity or a person being considered a resident of more than one state, double taxation in this instance cannot be resolved by unilateral law.⁸⁶ Martin Hearson states that national legislations can be easily changed through subsequent legislation while tax treaties are binding international instruments which cannot be easily changed.⁸⁷

These studies taking different positions will be critical in the analysis of the need for a regional treaty to eliminate double taxation within the EAC.

1.8.3. Effect of Elimination of Double Taxation on Trade and Investments

Tax treaties are viewed as a means of curbing trade barriers and this creates an expectation that these treaties will increase trade and investment. Treaties are supposed to increase investments and trade by offsetting double taxation of foreign earned business profits and reducing tax uncertainty.⁸⁸ Entering into DTA and giving up some taxation rights only pays off if a country can expect to receive more foreign direct investment (FDI) and greater access to foreign markets in return.

Several studies have been conducted on the effect of double tax treaties in increasing foreign investments with mixed results. Barther, Fabian and Neumayer (2010) carried out a study on the correlation between Double Tax Agreements and increased FDI and their results indicated that

⁸⁵ Nortcliffe E.B, 'United Kingdom-United States double taxation convention', 227.

⁸⁶ Nortcliffe E.B, 'United Kingdom-United States double taxation convention', 227-228.

⁸⁷ Hearson M, 'Measuring tax treaty negotiation outcomes: the action aid tax treaties dataset', 9.

⁸⁸ Allison C., 'Sovereignty, taxation and the Social Contract', 8.

DTAs do lead to higher foreign stocks.⁸⁹ Further, Eric Neumayer conducted an empirical study to provide evidence that developing countries that have a higher number of DTAs with important capital exporters do receive more FDI in total.⁹⁰ The study by Neumayer is critical since although there are other studies on the effects of DTA to FDI, it is the first one that focuses on developing countries. This study is critical in providing evidence that the elimination of double taxation through international agreements has a positive correlation with the increase of trade and FDI.

Despite the positive results in the studies above, there are other studies countering the argument that DTAs have a positive effect on trade and FDI. Avi Yonah argues that empirical economic studies have failed to show the existence of a DTA materially affecting investment and trade.⁹¹ In support of this view, Christian argues that tax treaties offer incidental benefits which are insufficient to significantly impact Least Developed Countries.⁹² Indeed, Avi Yonah admits that DTAs work well where the trade flow is reciprocal, that is between equally yoked countries.⁹³ Dagan argues that DTAs work to redistribute income from poorer signatories to rich signatories.⁹⁴

From the literature, it is evident that developing countries get the short end of the stick when it comes to DTAs with developed countries. However, there is insufficient evidence on the effect of DTAs on trade and economic activity between developing countries in a regional economic bloc and this study seeks to add its voice in the debate.

1.8.4. Elimination of Double taxation and tax barriers in the EAC

A lot of the research conducted on the effect of double taxation on the common market have been focused on the EU. Kolfer and Mason reviewed the link between fundamental freedoms of the EC Treaty and the requirement for the Member States to mitigate juridical double taxation.

⁸⁹ Owens E, 'United States income tax treaties: their role in relieving double taxation', 17 RUTGERS Law Review (1963), 428.

⁹⁰ Neumayer E, 'Do double taxation treaties increase foreign direct investment to developing countries?', The Journal of Development Studies 43 (2007), 1501-1519.

⁹¹ Avi-YR. 'Double tax treaties: an introduction', in K. Sauvant and L. Sachs (eds), *The effect of treaties on foreign direct investment*, Oxford University Press, New York: (2009), 106.

⁹² Allison Christians, 'Sovereignty, taxation and the Social Contract', 69.

⁹³ Avi-Yonah RS, 'Tax competition, tax arbitrage, and the international tax regime' University of Michigan Law and Economics working papers, (2007), 20.

⁹⁴ DaganT, 'Tax treaties myth', 940.

They conclude that such a requirement could reasonably be inferred from the goals of the fundamental freedoms and the European Court of Justice's jurisprudence. The study also notes that despite the reasonableness of the link between fundamental freedoms and the requirement to mitigate double taxation the European Court of justice has produced contradicting jurisprudence on the issue and therefore even in the EU the matter is not settled. While their study does not address itself to the EAC, lessons can be drawn from the EU approach which will be canvassed in chapter three.

There is little research on the problem of double taxation in the EAC. However, some work has been undertaken on the need to harmonize the diverse tax systems and policies in the EAC. Khadka Rup in his book *'The East African Tax System'* reviews the individual taxation regimes of five of the six partner states.⁹⁵ His book focuses on various aspects of business profit tax, customs duties, excise duties, personal income tax and value-added tax of the EAC member states and their tax administration systems. His work is vital to understanding each partner state's national tax laws and policies and the unilateral measures employed in relieving double taxation.⁹⁶

Jackson Kiprotich Bett argues that the policy and legal differentiation of income tax between partner states results in double taxation.⁹⁷ He advocates for a harmonized policy regime of corporate income tax to solve the problem of double taxation.⁹⁸ Bett's work corroborates the hypothesis of this study by identifying double taxation as one of the threats to integration.⁹⁹ The focus of the study, however, is on harmonization and only refers to double taxation as a result of heterogeneous tax laws and policies in the EAC. Other researchers who have focused on harmonization of EAC tax laws with cursory mention of the problem of double taxation in the EAC include Clyde Mutsotso.¹⁰⁰

⁹⁵ Khadka R, *The East African tax system*, 9.

⁹⁶ Khadka R, *The East African tax system*, 67.

⁹⁷ Bett JK, 'Income Tax in the East African Community: A Case for Harmonisation and Consolidation of Policy and Law with a Focus on Corporate Income Taxation', 172.

⁹⁸ Bett JK, 'Income Tax in the East African Community: A Case for Harmonisation and Consolidation of Policy and Law with a Focus on Corporate Income Taxation' ,338.

⁹⁹ Bett JK, 'Income Tax in the East African Community: A Case for Harmonisation and Consolidation of Policy and Law with a Focus on Corporate Income Taxation', 172.

¹⁰⁰ Mutsotso C, 'Harmonisation of EAC tax policies and laws, proposal for EAC tax policies and laws,' www.cuts-geneva.org on 21 May 2019.

A. Trindade and C. Ngina Mutava focus their research on income tax and recommend the adoption of a code of conduct for investment incentives and company income taxation to aid in harmonization of income tax as used in the European Union. They further suggest that this code will cure the distortions caused by the different tax bases and incentives offered by the partner states of the EAC.¹⁰¹ They further affirm that lack of an integrated and harmonized tax system hampers the economic and regional integration of the EAC.¹⁰² Their research shall be relevant in aiding the author's attempt to propose ways to regulate the conduct of member states to ensure adherence to the EAC-DTA.

Despite the focus on harmonization of tax laws in the EAC, Kolfer and Mason argue that the double taxation problem cannot be cured by harmonization of domestic tax laws as it would persist even if all Member States had the same tax laws. This is because double taxation arises from the simultaneous assertion of source taxing rights by the source country and residence taxing rights by the residence country,¹⁰³ furthermore similar laws would inevitably be interpreted differently by different courts, tax authorities, and in different cultures.

Hattingh J, reviews the appropriateness of the provisions of the EAC-DTA. He recognizes the importance of linking the objectives of the EAC Treaty and the EAC-DTA. Hattingh also highlight the European approach to the problem of double taxation. His work will be useful in the review of the EAC- DTA provisions in the next chapter. Hattingh however does not propose reforms necessary to activate the EAC-DTA as well as tackle the problem of double taxation in the community.

1.8.5. Research Gaps

The studies reviewed above mainly focused on the harmonization within the EAC and the effect of tax harmonization and cooperation on regional integration in the EAC. To date, there is very

¹⁰¹ A. Trindade, C. Ngina Mutava, *Tax integration within the East African Community: A partial model for regional integration in Africa* <https://www.afdb.org/uploads/tx_lafdbpapers/DEF - EAC PAPER - A. Trindade and C. Ngina Mutava.pdf>on 21 May 2019.

¹⁰²A. Trindade, C. Ngina Mutava, *Tax integration within the East African Community: A partial model for regional integration in Africa* <https://www.afdb.org/uploads/tx_lafdbpapers/DEF - EAC PAPER - A. Trindade and C. Ngina Mutava.pdf>on 21 May 2019.

¹⁰³ Kolfer GW, Mason R, Double taxation: a European "switch in time?" 68

little research on the elimination of double taxation as a means of enhancing harmonisation and regional integration in the bloc. The focus of this study is on the problem of double taxation as an impediment to the growth and development of the EAC Common Market by looking at the provisions of EAC treaty and EAC-DTA and their implementation.

1.9. Research Methodology

The study adopts the doctrinal research methodology. The study relied on secondary data including relevant statutes from the EAC Partner States, EAC Treaty and its Protocols, international conventions, textbooks, scholarly journals and articles, theses, reports, newspaper articles and several internet sources.

The data collection from various sources were analysed for relevance taking into account the objectives as set out in 1.3 above and the scope of the study.

In the process of analysing data from various jurisdiction, the author compared and contrasted the relevant literature, statutes, international conventions and case law. Specifically, the study reviewed how double taxation is addressed in the European Union and the Caribbean Community. The European Union is used in this study as an example from which EAC can learn as the two organization are on a similar path of realizing a successful Common Market /internal market aimed at lifting economic prospects of Partner States. Similarly, it also operates without a DTA. The review of the Caribbean Community is to draw lessons from a regional community that is successfully implementing a regional tax treaty while the EAC is in the process of actualizing a DTA.

1.10. Chapter Breakdown

This thesis will be structured as follows:

Chapter One This chapter lays out the foundational basis of the study, by introducing what the study is about.

Chapter Two presents the legal regime governing double taxation within the EAC. First, the author gives an overview of the tax system in the individual member states and highlights the

extent to which existing unilateral measures adequately alleviate instances of double taxation using secondary adjustment in transfer pricing as a case study. Second, the author analyses the provisions of the EAC Treaty (insofar as they touch on double taxation) and finally the EAC-DTA.

Chapter Three This chapter analyses the problem of double taxation vis a vis the objectives of the common market. The chapter also analyses the efficacy of the EAC regime in its current form in eliminating double taxation and furthering the objectives of the EAC Common Market through the illustration of gross-based final withholding tax. The chapter will then review how double taxation is eliminated in the European Union and the Caribbean Community.

Chapter Four The author summarizes the findings of the study and offers recommendations of reforms that may be adopted in curing double taxation in the EAC. The reforms proposed shall be based on the current challenges arising from double taxation. The author draws from and contextualises methods adopted by other regional blocs, such as the European Union, to reduce double taxation.

CHAPTER TWO: THE LEGAL REGIME REGULATING DOUBLE TAXATION IN THE EAST AFRICA COMMUNITY

This chapter begins with a discussion on the legal regime governing the elimination of double taxation within the EAC, i.e., the provisions in the individual member states' tax systems that grant unilateral relief from double taxation. In the second section, the author will critically analyse the provisions of the EAC Treaty (insofar as they touch on double taxation), the analysis will also include a review of the CJEU case law interpreting similar provisions under the EU Treaty. The Third section will critically analyse the provisions of EAC-DTA.

2.1. The Domestic Tax Regimes of Partner States

The heterogeneity of EAC member states' tax laws has been identified as a major cause of double taxation in the EAC and it is important to examine the individual legal regimes of member states to understand the salient features of each that lead to heterogeneity within the Community.¹⁰⁴

2.1.1 Uganda

Income tax in Uganda is levied under the Income Tax Act of 1997 Cap 340. Section 4 of the Act provides that income tax is charged for each year of income upon all the income of a person whether resident or non-resident which accrued in or was derived from Uganda.¹⁰⁵ Under the Act, the chargeable income of a person for a year of income is the gross income of the person for the year less total deductions allowed under the Act for the year.¹⁰⁶ The gross income of a resident person includes the income derived from all geographical sources.¹⁰⁷

The chargeable income under the Act includes employment income, profits from business or profession, profits from the use of property, dividends and interest, pensions, management or professional fees and royalties, trust income and income of non-residents deemed to be derived

¹⁰⁴ Bett JK, 'Income Tax in the East African Community: A Case for Harmonisation and Consolidation of Policy and Law with a Focus on Corporate Income Taxation' 172.

¹⁰⁵ Section 4, *Income Tax Act* (Uganda).

¹⁰⁶ Section 15, *Income Tax Act* (Uganda).

¹⁰⁷ Section 17, *Income Tax Act* (Uganda).

in Uganda.¹⁰⁸ Foreign income of a resident employed by a foreign entity is exempt from Ugandan income tax if the individual has paid tax in respect of the income.¹⁰⁹

A credit for the foreign tax paid is allowed provided that the tax credit does not exceed the amount of income tax payable in Uganda and it is calculated by applying the average Ugandan tax rate to the taxpayer's net foreign income.¹¹⁰

All non-resident companies with branches in Uganda pay 15% tax on repatriated income for the year of income.¹¹¹ The tax payable is in addition to any corporation tax charged on the income of the branch.¹¹² Non-resident persons who derive income in the form of dividends, interest, royalty, rent, management and professional fees or natural source payments are subject to withholding tax at 15% (subject to DTAs) on the gross amounts received.¹¹³

2.1.2 Tanzania

In Tanzania income tax is charged on the income of a resident person from employment, business and investment for the year of income irrespective of the source of income.¹¹⁴ Non-residents on the other hand, are taxed only on their income sourced in Tanzania.¹¹⁵ If an individual has been resident in Tanzania for a period of two years or less they are taxed as non-residents.¹¹⁶

A resident taxpayer is entitled to a foreign tax credit for any foreign tax paid by the taxpayer.¹¹⁷ Foreign tax credits claimed are calculated separately for each year of income and shall not exceed the average rate of Tanzanian income tax of the person for the year of income applied to the person's taxable foreign income.¹¹⁸

¹⁰⁸ Section 17-20, *Income Tax Act* (Uganda).

¹⁰⁹ Section 80(1), *Income Tax Act* (Uganda.)

¹¹⁰ Section 81(1), *Income Tax Act* (Uganda).

¹¹¹ Section 82(1), *Income Tax Act* (Uganda).

¹¹² Section 82(5), *Income Tax Act* (Uganda).

¹¹³ Section 83,84,87, *Income Tax Act* (Uganda).

¹¹⁴ Section 6, Cap 332, *Income Tax Act (Tanzania)*.

¹¹⁵ Section 6, *Income Tax Act* (Tanzania).

¹¹⁶ Section 6, *Income Tax Act* (Tanzania).

¹¹⁷ Section 77, *Income Tax Act* (Tanzania).

¹¹⁸ Section 77(2), *Income Tax Act* (Tanzania).

The Tanzanian Income Tax Act also provides a taxpayer with the option of claiming a deduction for foreign income tax.¹¹⁹ Under the deduction method, foreign source income is added to its total taxable income of the resident but foreign taxes are deductible to arrive at the chargeable income.¹²⁰

2.1.3 Burundi

The personal income tax and corporate income tax are governed by the Burundi Income Tax Law No.1/02/2013.¹²¹ Income tax is charged on income generated in Burundi and worldwide income of residents of Burundi.¹²² A resident taxpayer is entitled to a foreign tax credit for any foreign tax paid.¹²³ The amount of foreign tax credit shall not exceed the tax payable in Burundi.¹²⁴ Non-resident entities are liable to corporate income tax on business profit for income derived through a permanent establishment in Burundi.¹²⁵ Non-resident persons receiving income from Burundi are taxed at 15% (WHT) of gross income.¹²⁶

2.1.4 Rwanda

Residents are liable to income tax on income and business profit per tax period from domestic and foreign operations.¹²⁷ Non-resident entities are liable to tax on income sourced from Rwanda¹²⁸ or derived through a permanent establishment in Rwanda.¹²⁹ A non-resident individual who earns employment income received from a non-resident employer for services rendered in Rwanda is exempt from income tax unless it relates to a permanent establishment of the employer in Rwanda.¹³⁰ A withholding tax of 15% is imposed on payments made by residents to a person not registered by the Rwandan tax administration or to a registered person who does not have recent income tax declaration.¹³¹ Residents of the EAC who receive dividends

¹¹⁹ Section 77(4), *Income Tax Act* (Tanzania).

¹²⁰ Holmes K, *International tax policy and double tax treaties: an introduction to principles and application*, 68.

¹²¹ Burundi *Income Tax Law, Law No 1/02/2013* of 24 January 2013.

¹²² Article 20, *Income Tax Law, Law No 1/02/2013* (Burundi).

¹²³ Article 14, *Income Tax Law, Law No 1/02/2013* (Burundi).

¹²⁴ Article 15, *Income Tax Law, Law No 1/02/2013* (Burundi).

¹²⁵ Article 85, 100, *Income Tax Law, Law No 1/02/2013* (Burundi).

¹²⁶ Article 113, *Income Tax Law, Law No 1/02/2013* (Burundi).

¹²⁷ Article 5, *Income Tax Law No.16/2018* (Rwanda).

¹²⁸ Article 5, *Income Tax Law No.16/2018* (Rwanda).

¹²⁹ Article 5, *Income Tax Law No.16/2018* (Rwanda).

¹³⁰ Article 16(5), *Income Tax Law No.16/2018* (Rwanda).

¹³¹ Article 60, *Income Tax Law No.16/2018* (Rwanda).

from securities listed on capital markets or interest arising from investments in listed bonds with a maturity of 3 years and above are subject to withholding tax at a reduced rate of 5%.¹³²

A resident taxpayer who generates income from abroad is entitled to a foreign tax credit for any foreign tax paid in respect of that income.¹³³ The amount of foreign tax credit should not exceed the tax payable in Rwanda and should be supported by appropriate documentation.¹³⁴

2.1.5 Kenya

The Act provides that a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.¹³⁵ This, therefore, means that the tax regime is both source-based and residency-based. The former means that all income that was earned from Kenya will be subject to tax in Kenya while the latter means income of a person who is considered to be tax-resident in Kenya will be taxed even though such an income may not have been earned in Kenya.¹³⁶ The worldwide taxation only applies to resident individuals and not corporations.

The chargeable income under the Kenya Income Tax Act (ITA) includes:

- a. gains or profits from a business for whatever period of time carried on;
- b. employment or services rendered;
- c. a right granted to another person for use or occupation of property¹³⁷;
- d. dividends or interest;
- e. a pension, charge or annuity and any withdrawal from, or payments out of, a registered pension fund or a registered provident fund or a registered individual retirement fund;
and
- f. any withdrawals from registered home ownership savings plan and an amount deemed to be the income of a person under the Income Tax Act or by rules made under the same Act.¹³⁸

¹³² Article 60, *Income Tax Law No.16/2018* (Rwanda).

¹³³ Article 7, *Income Tax Law No.16/2018* (Rwanda).

¹³⁴ Article 7, *Income Tax Law No.16/2018* (Rwanda).

¹³⁵ Section 3(1), *Income Tax Act (Cap 470)* (Kenya).

¹³⁶ Lagat C, *The Tax Landscape in Kenya*,

<https://www.dlapiper.com/en/Belgium/insights/publications/2018/11/Africa-connected-doing-business-in-africa/the-kenyan-tax-landscape-an-overview> on 13th January 2020.

¹³⁷ Section 10, *Income Tax Act (Cap 470)* (Kenya).

Tax rates that are set out in the ITA may be varied by a DTA that Kenya is a signatory to and is operational at that time. Pursuant to this, Section 41 and Section 41A of the ITA is committed to providing special relief due to arrangement by the government of Kenya and other governments or international organizations.

Kenya has ratified the EAC-DTA and, with no doubt, the provisions of the Treaty will find their effects through the ITA and thereby mitigate the incidents of double taxation in the spirit of the EAC Treaty. The ITA recognizes and gives full effect to international agreements entered into between the Government of Kenya and a foreign country or countries giving such international tax agreements as the EAC DTA precedence over the ITA.

Section 39 of the ITA provides unilateral relief for citizens by way of credit for the same tax against the tax charged in Kenya on such income.¹³⁹ For non-citizens foreign tax paid is treated as a deductible expense. Therefore, for non-citizens, the foreign taxes are treated as an allowable expense but a tax credit is granted where there is a tax treaty.¹⁴⁰ The amount of foreign tax credit should not exceed the tax payable in Kenya.

Table 1: Summary EAC States Double Taxation Regimes

COUNTRY	STATUTE	BASIS OF TAXATION	UNILATERAL RELIEF	EAC-DTA
Uganda	Income Tax Act of 1997 Cap 340	Source and residence based taxation	Ordinary credit	Ratified
Tanzania	Income Tax Act Cap 332,	Source and residence based taxation	Ordinary credit or Deduction	Not ratified
Rwanda	Income Tax Law No.16/2018	Source and residence based taxation	Ordinary credit	Ratified
Burundi	Burundi Income Tax Law No.1/02/2013	Source and residence based taxation	Ordinary credit	Not Ratified
Kenya	Income Tax Law No.16/2018	Source and residence based taxation	Deduction- (limited to Citizens Tax credit in case of a DTA	Ratified

¹³⁸ Section 11, *Income Tax Act (Cap 470)* (Kenya).

¹³⁹ Section 39(2), *Income Tax Act* (Kenya).

¹⁴⁰ Section 42, *Income Tax Act* (Kenya).

2.1.6. Unilateral Measures and the Problem of Double Taxation

From the foregoing it is clear that there is heterogeneity in the income tax laws of EAC states. heterogeneity may result in double taxation in the following instances: Firstly, **residence** is a central concept for taxation as evidenced in 2.1 above with all the EAC states taxing residents on their worldwide income. Because countries use different tests for residency, there is a great chance of individuals having a dual residence. For instance, Rwanda defines a resident for tax purposes if an individual fulfils one of the following: Has a permanent residence in Rwanda; has a habitual abode in Rwanda; or is a Rwandan representing Rwanda abroad; or a person who stays in Rwanda for more than 183 days in any 12 months, either continuously or intermittently, is resident in Rwanda for the tax period in which the 12 month period ends.¹⁴¹ In contrast, Uganda defines a tax resident as an individual who has a permanent home in Uganda; and is present in Uganda for a period of 183 days or more in any 12 month period which commences or ends in a year of income; or periods averaging more than 122 days during the year of income and in each of the two preceding years of income.¹⁴² For instance, if a Ugandan resident is posted to Rwanda during the year of income, the different test employed by Uganda and Rwanda may result in an individual having dual residency. However, assuming that all the EAC countries adopt the 183-day test for residency, it would still be possible for the same individual to be resident in more than one country under each country's tax law at the same time. An example is the frontier worker who lives in Kenya but works in Uganda and crosses the border between the two countries each workday.¹⁴³ Dual residency creates problems of double taxation as each EAC country taxes the worldwide income of its residents. It is difficult for a country to solve this problem on its own, and so a DTA provides a tiebreaker mechanism to allocate the residence of the individual to one country alone for the purposes of the treaty.¹⁴⁴ This allocation is achieved

¹⁴¹ Article 3, *Income Tax Act* (Rwanda).

¹⁴² Section 9, *Income Tax Act* (Uganda).

¹⁴³ Vann RJ, 'International aspects of income tax' in Thuronyi V(ed), *Tax law design and drafting*, International Monetary Fund, 1998, 14.

¹⁴⁴ Article 4(2), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*

through a hierarchy of tests involving the individual's permanent home, the centre of personal and economic relations, habitual abode, and nationality.¹⁴⁵

Secondly, the concept of source may lead to double taxation. *Source* – Source double taxation is when both countries assert in their domestic law that income is sourced in that country. Like in the case of dual residence it is difficult for any one country to solve this problem unilaterally. This can occur for example Uganda tax law provides that sales income of a non-resident corporation is taxable in that Uganda if the sale was made through an office located in that Uganda.¹⁴⁶ In contrast, Kenya will tax income derived or accrued from Kenya but doesn't specify the instances when income is deemed to have accrued or derived in Kenya therefore allowing the Kenya Revenue Authority a lot of room for interpretation in determining what has accrued or is derived from Kenya.¹⁴⁷ This conflict in the tax rules of Uganda and Kenya may result in double taxation of income derived from a sale made through an office located in Uganda for delivery in Kenya. The inconsistent domestic legislation that result in both States exercising source jurisdiction over the same item of income results in double taxation.¹⁴⁸ Tax treaties are used to solve this problem by providing expressly or impliedly for a single source rule to apply between the parties to the treaty for particular categories of income.

Lastly differing definitions may lead to double taxation, the EAC countries have widely differing definitions and classification of income. For example, Rwanda treats payment on the liquidation of a company to its shareholders as, in whole or in part, a dividend¹⁴⁹, whereas Kenya treats it as a disposal of the shares.¹⁵⁰ The differing definition may result in double taxation, where foreign credit available due to the differing classification of income.

As highlighted in the foregoing, there are limitations in the application of unilateral measures to cross-border transactions. It is difficult for a country to solve these problems on its own, and so a DTA provides a mechanism to allocate taxing rights and avoiding double taxation. In the next section, the issue of corresponding adjustment in Transfer Pricing further illustrates how heterogeneous application may result in double taxation that cannot be resolved unilaterally.

¹⁴⁵ Vann RJ, 'International aspects of income tax', 14.

¹⁴⁶ Section 79, *Income Tax Act* (Uganda).

¹⁴⁷ Section 3, *Income Tax Act* (Kenya).

¹⁴⁸ Vann RJ, 'International aspects of income tax', 19

¹⁴⁹ Article 55, *Income Tax Law* (Rwanda).

¹⁵⁰ Section 2, *Income Tax Act* (Kenya).

2.1.6.1. Transfer Pricing and Corresponding Adjustment

Transfer pricing rules aim at avoiding the manipulation of profits levels where goods and services are bought and sold between associated enterprises. The OECD defines it thus “A transfer price is a price, adopted for book keeping purposes, which is used to value transactions between affiliated enterprises integrated under the same management at artificially high or low levels in order to effect an unspecified income payment or capital transfer between those enterprises.”¹⁵¹

The EAC countries, including Kenya, have enacted transfer pricing rules in their domestic law. For instance, Kenya requires business carried on between a non-resident and a related Kenya resident to be conducted at arm’s length and gives KRA power to adjust the profits of the Kenya resident from that business to the profits that would be expected to have accrued had the business been conducted between independent persons.¹⁵² The Income Tax Act requires that arms-length market value applies to similar transactions in similar circumstances between unrelated parties to be adopted in place of the companies’ transfer price.¹⁵³ Hence a transfer price adjustment involves the redistribution of profits between taxpayers, such that an increase in the profits of one taxpayer is balanced by a decrease in profits of a related taxpayer.¹⁵⁴ For international transactions, a transfer pricing adjustment will normally involve legal systems of at least two states therefore a unilateral approach is not sufficient.

Double taxation arises when governments use different transfer pricing rules to allocate income between countries. Without coordination between the two states, the tax burden will be borne by the taxpayer with the other government gaining unwarranted benefit.¹⁵⁵ Consider the example of a Kenyan company which sells a million units of soda to its Ugandan Subsidiary and the Kenyan corporate tax rate is 30% while the Ugandan corporate tax rate is 30%. If the Kenyan administration applies Section 18 of the Income Tax Act and reconstructs the transfer pricing transaction between the Kenyan company and the Ugandan company, without reference to the

¹⁵¹ <https://stats.oecd.org/glossary/detail.asp?ID=2757> on 19 April 2020.

¹⁵² Section 18 (3) *Income Tax Act (Kenya)*.

¹⁵³ Holmes K, *International tax policy and double tax treaties*, 201.

¹⁵⁴ Wittendorff J, ‘Transfer pricing and the arm's length principle in international tax law’, *Kluwer Law International* (2010), 17.

¹⁵⁵ Wittendorff J, ‘Transfer pricing and the arm's length principle in international tax law’, 38

Ugandan Revenue Authority and Ugandan company's deduction for the cost of purchases of the sodas, the tax effect is as shown below:

Table 2: Primary Adjustment

	Transfer Pricing		After KRA Adjustment	
	US\$ (Million)	US\$ (Million)	US\$ (Million)	US\$ (Million)
Kenyan Company				
Sales Income	70		100	
Kenya Tax (30%)		21		30
Ugandan Company				
Purchase price	70		70	
Ugandan tax benefit (30%)		(21)		(21)
Net tax cost to the group		0		9

From the illustration, through unilateral measures, KRA can only adjust the profits of a Kenyan company, the result of which is that the primary adjustment of the transfer price to 100 million does not equate to the price actually paid by the Ugandan company for the goods. Consequently, economic double taxation for the difference of US 30 million arises with both Kenya and Uganda taxing the same income: by Uganda allowing only a deduction of US\$70 million rather than the US\$ 100 million which Kenya is taxing. Thus from the foregoing example the amount of double taxation is:

Table 3: Economic Double Taxation

	US\$ (Millions)
Sales price assessed in Kenya	100
Less: Cost Price deduction allowed in Uganda	(70)
Income subject to double taxation	30
X Uganda tax rate	X30
Economic double taxation	9

When the price charged for goods or services sold between related parties is not in accordance with the arm's length principle, domestic law authorizes the tax authorities of a State to make primary adjustments to the transfer price. This may trigger economic double taxation as the same income may have already been subject to taxation in the hands of the related party in the other State. To mitigate economic double taxation, a DTA enables the other State to carry out a corresponding adjustment so that the allocation of profits between the two jurisdictions is consistent.¹⁵⁶ For international transactions, if one country makes a transfer pricing adjustment under domestic law the other country is not obligated to make a corresponding/compensating adjustment.¹⁵⁷ Article 9(2) of the EAC-DTA provides for a corresponding adjustment/compensating adjustment. This helps avoid economic double taxation in Uganda (in the foregoing example) to adjust the deduction for the cost of purchases allowed to the Ugandan company in determining the tax liability in Uganda. If URA adjusts the cost of the purchase to US\$100 Million to equate to sales price the corresponding adjustment eliminated the economic double taxation of 7.5 as shown below:

Table 4: Secondary adjustment

	After KRAs Primary Transfer Pricing		After Uganda Revenue Authority Corresponding/compensating Adjustment	
	US\$ (Million)	US\$ (Million)	US\$ (Million)	US\$ (Million)
Kenyan Company				
Sales Income	100		100	
Kenya Tax (30%)		30		30
Ugandan Company				
Purchase price	70		100	
Ugandan tax benefit (30%)		(21)		(30)
Net tax cost to the group		9		0
Decrease in tax cost of the group		9		

¹⁵⁶ luwertaxblog.com/2019/05/27/transfer-pricing-policy-should-the-relief-mechanism-dealing-with-corresponding-adjustments-be-reconsidered-under-tax-treaties on 14 April 2020.

¹⁵⁷ Wittendorff J, 'Transfer pricing and the arm's length principle in international tax law', 38.

To illustrate the likelihood of the above scenario arising is the famous transfer pricing case: *Unilever Kenya Ltd v Commissioner of Income Tax*, [2005] eKLR.¹⁵⁸

Unilever Kenya Limited (UKL) a company resident in Kenya and Unilever Uganda Limited (UGL) a company resident in Uganda are two subsidiaries of Unilever Plc., a company resident in the United Kingdom. UKL and UGL are related parties within Kenyan law.¹⁵⁹

In 1995, UKL, a manufacturer, was contracted to produce various household goods on behalf of UGL, a distributor, for their Uganda market. KRA conducted an audit on UKL for the 1995 and 1996 tax periods. The audit revealed that the prices charged by UKL for the goods to UGL at prices which were much lower than their comparable sales, both in the domestic market (Kenya) and in its exports to unrelated parties. KRA made an adjustment under Section 18(3) of the ITA.

UKL challenged the adjustment. The Local Committee ruled in favour of KRA. UKL subsequently appealed against the decision of the Local Committee to the High Court and argued, among others, that Section 18(3) of the ITA was ambiguous as it did not guide on how to determine an arm's length price. UKL further argued that since the Income Tax Act did not give guidance it was up to taxpayer to resort, to the international best practices, in this case, the OECD Transfer Pricing (TP) Guidelines for guidance. In defence KRA, argued that, Section 18(3) of the ITA as it then stood was clear on the subject and there was no need to resort to international best practice as argued by UKL. KRA further argued that the OECD TP Guidelines, on which the UKL sought to rely, did not form part of the Kenyan laws, and therefore could not be applied. The High Court ruled in favour of UKL and held that Section 18(3) was ambiguous and that in the absence of guidelines in the Kenyan law on how to determine an arm's length price, UKL was entitled to rely on the OECD TP Guidelines in establishing the transfer price for its inter-company transactions.

Notwithstanding the Judgement of the Court in the case, of interest to this study is whether Uganda would have recognized the readjustment made on UKL if KRA assessment had been upheld. As mentioned above URA is not obligated to make any corresponding adjustment when

¹⁵⁸ *Unilever Kenya Ltd v Commissioner of Income Tax* [2005] eKLR

¹⁵⁹ Section 18(6) (b)

KRA or any other foreign authority makes a primary adjustment. In the absence of an enforceable EAC-DTA, Unilever group would have been the subject of double taxation.

It is noteworthy that even with a binding treaty the compensating adjustment by a state is not automatic and parties may differ on adjusted profits. The treaty however also gives the States authority to consult each other to determine the extent of the adjustment.¹⁶⁰

2.2.EAC Legal Provisions on Elimination of Double Taxation

2.2.1. Treaty for the Establishment of the East African Community (EAC Treaty)

The EAC as an intergovernmental organisation is bound by a comprehensive legally binding treaty. Consequently, when this arrangement faces difficulty, questions should be raised as to the appropriateness of the treaty provisions.¹⁶¹ One of the key objectives of EAC is the development of a Common Market. Article 76 of the EAC Treaty provides, “*Within the Common Market, and subject to the Protocol provided for in paragraph 4 of this Article, there shall be free movement of labour, goods, services, capital, and the right of establishment.*” Through the EAC Common Market Protocol, Member States have committed to eliminate all restrictions within their jurisdictions that may impede the fundamental freedoms sought in Article 76 of the Treaty.¹⁶² The Common Market Protocol obligates member *States* to progressively harmonize domestic tax policies and laws to remove tax distortions in order to facilitate the free movement of goods, services and capital and to promote investment within the Community.¹⁶³ Member states are further obligated to develop policies that advance the objectives of the community and abstain from undertaking measures that hamper the progress and achievement of the same.¹⁶⁴ Therefore, the EAC law expressly requires application of the fundamental freedoms to national tax regimes and the EAC-DTA as indicated below in 2.2.2. Consequently, any aspect of the domestic tax laws or the tax treaties of EAC Member States that amounts to an “impediment” to or a “distortion” of the fundamental freedoms is liable to be struck down on the basis that it hinders the implementation or operation of the EAC common market.¹⁶⁵ Furthermore, the EAC treaty

¹⁶⁰ Holmes K, *International tax policy and double tax treaties*, 200.

¹⁶¹ Ghai YP, ‘Reflections of the law and economic Integration’, Nordsika afrikainstitutet, Sweden, 1976,2.

¹⁶² Article 32, *Treaty for the Establishment of the East African Community*.

¹⁶³ Article 32, *Treaty for the Establishment of the East African Community*.

¹⁶⁴ Article 8, *Treaty for the Establishment of the East African Community*.

¹⁶⁵ Hattingh J, ‘East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?’.

specifically provides for avoidance of double taxation as an objective of the EAC.¹⁶⁶ This study identifies the tax discrimination resulting from the application of domestic tax regimes in the EAC, which breach EAC community law and violates Common Market objectives. The EAC Common Market envisages free movement of goods, services, labour, capital and freedom of establishment.¹⁶⁷ In 1998, the first attempt at signing a multilateral treaty for the avoidance of double taxation was made by the parties signing the Tripartite Agreement on Avoidance of Double Taxation. This agreement was acknowledged by the EAC Treaty¹⁶⁸ but was never ratified.

In the context of the EU single internal market, similar freedoms have provided the bedrock for integration and the harmonization of national tax regimes of the EU Member States.¹⁶⁹ The progress in the interpretation of whether double taxation, like any other tax hindrance, constitutes a violation of the fundamental freedoms of the EU, largely resulted from decisions of the European Court of Justice.¹⁷⁰

Regional courts play an important role in the interpretation of Community law and furthering economic integration.¹⁷¹ Currently, the question as to whether states have an obligation to avoid double taxation has not been adjudicated upon in either the domestic court or the EACJ. Whether the unilateral double taxation relief granted by the partner states is sufficient to fulfil the Treaty obligation to avoid double taxation is a question that is of great interest in this study.

The EU on the other hand, through the Court of Justice of the European Union (CJEU), has adjudicated several cases regarding double taxation within the EU single market. The CJEU has considered case law on the compatibility of double taxation with the free movement rule. The free trade provisions in the European Commission Treaty and EAC Treaty have broadly similar aims to the EAC that is: to remove legal disincentives to investment across state borders. *Article 293 EC Treaty* provides that Member States, “so far as is necessary, [to] enter into negotiations

¹⁶⁶ Article 80(h), *Treaty for the Establishment of the East African Community*.

¹⁶⁷ Article 80(h), *Treaty for the Establishment of the East African Community*.

¹⁶⁸ Article 142, *Treaty for the Establishment of the East African Community*.

¹⁶⁹ Hattingh J, ‘East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?’7.

¹⁷⁰ Kolfer GW, Mason R, ‘Double taxation: a European “switch in time?”’64.

¹⁷¹ Horsely T, ‘Reflections on the role of the court of justice as the “motor” of European integration: legal limits to judicial lawmaking’, *Common market law review* 50(4) (2013), 931.

with each other with a view to securing for the benefit of their nationals... the abolition of double taxation within the Community.”

Article 293 EC Treaty was adjudicated in *Gilly v. Directeur des services fiscaux du Bas-Rhin*,¹⁷² where the Court reiterated that the abolition of double taxation is an objective of the EC Treaty. In view of the lack of harmonization of direct taxes and other unifying measures such as multilateral treaties based on Article 220 of the EC Treaty, however, the Member States were adjudged to be competent to determine the criteria to eliminate such double taxation. The CJEU held that although the abolition of double taxation is an objective of the Treaty, the wording of Article 293 does not confer on individuals any rights on which they might be able to rely before their national courts. The CJEU also held that member states are competent to determine the criteria for taxation on income and wealth with a view to eliminating double taxation.¹⁷³ The court did not address itself to what would happen if double taxation is not eliminated.¹⁷⁴

A more recent case determined in relation to double taxation is the *Kerckhaert & Morres case*.¹⁷⁵ A married couple, Mr. Kerckhaert and Ms. Morres, both Belgian taxpayers, received dividends in 1995 and 1996 from a company resident in France. France assessed a 15% withholding tax on the dividends before they were remitted to Belgium. The Belgian court referred the matter to the CJEU to determine whether juridical double taxation is inconsistent with the fundamental freedoms of the EU. The Court acknowledged that EU law does not lay down any general criteria for the attribution of areas of competence between the Member States.”¹⁷⁶ The CJEU acknowledged that the tax disadvantage to *Kerckhaert and Morres* resulted from the parallel exercise of fiscal sovereignty by two Member States, and it noted the importance of tax treaties to eliminate or mitigate the negative effects of the coexistence of national tax systems on the functioning of the Internal Market.¹⁷⁷

From the foregoing cases, it is clear even in the EU there are limitations in the EU law in resolving the problem of double taxation and the CJEU is only willing to go so far to achieve

¹⁷² Case C-336/96 *Gilly v. Directeur des services fiscaux du Bas-Rhin* [1998] E.C.R. I-2793, [16].

¹⁷³ Case C-336/96, *Gilly v. Directeur des Services Fiscaux du Bas-Rhin*, 1998 E.C.R. I-2793, 26.

¹⁷⁴ Kolfer GW, Mason R, ‘Double taxation: a European “switch in time?”’68.

¹⁷⁵ Case C-513/04, *Kerckhaert & Morres*, 2006 E.C.R. I-10967.

¹⁷⁶ Case C-513/04, *Kerckhaert & Morres*, 2006 E.C.R. I-10967, 22–23.

¹⁷⁷ Case C-513/04, *Kerckhaert & Morres*, 2006 E.C.R. I-10967.

judicial tax integration.¹⁷⁸ One could argue that applying similar arguments in the EAC, with limited focus placed on the elimination of double taxation and the literal interpretation of Article 80(h), the EAC Treaty does not confer to individuals any rights that may be relied on in a court of law but it does highlight the objectives of the EAC. Furthermore, due to the variable jurisprudence in the EU on the question of double taxation,¹⁷⁹ the determination of whether unrelieved double taxation infringes the fundamental freedoms of the EAC is less certain.

2.2.2. The Salient provisions of the East African Community Double Taxation Agreement, 2010

Introduction

This section analyses the EAC's proposed legal instrument for avoiding double taxation: the EAC-DTA 2010. In particular, this section entails a comparative analysis between the current national legislations *vis a vis* the salient provisions of the EAC-DTA.

In 2010 the then five EAC member States (Burundi, Rwanda, Tanzania, Uganda and Kenya) signed the EAC-DTA. However, the EAC-DTA has not entered into force, because out of the 5 states, only Kenya, Uganda, and Rwanda have ratified the EAC-DTA in accordance with Article 30 of the Agreement. The EAC-DTA, however, did not set a target date by which all EAC Member States are expected to ratify it.¹⁸⁰

The question of legal effect of signed but unratified treaties has been inconclusively canvassed by several authors, international courts and tribunals. For instance in the International Court of Justice (ICJ) case *Qatar v. Bahrain*¹⁸¹, Bahrain filed an application at the ICJ in 1991 concerning maritime delimitation and territorial questions between Qatar and Bahrain relating to sovereignty over the Hawar Islands, sovereign rights over the shoals of Dibal and Qit'at Jaradah and the delimitation of their maritime areas.¹⁸² Qatar's position was that its control of the entire peninsula had been recognized in the "Convention relating to the Persian Gulf and Surrounding Territories," concluded between the United Kingdom and the Ottoman Empire in 1913. Both

¹⁷⁸ *Case C-513/04, Kerckhaert & Morres, 2006 E.C.R. I-10967, 22–23.*

¹⁷⁹ Kolfer GW, Mason R, 'Double taxation: a European "switch in time?"'96.

¹⁸⁰ Hattings J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?'1.

¹⁸¹ *Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Qatar v Bahrain*, [1994] ICJ Reports 2001

¹⁸² *Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Qatar v Bahrain*, [1994] ICJ Reports 2001

parties agreed that the 1913 Anglo Ottoman Convention was never ratified.¹⁸³ Qatar advanced the argument that the signed treaty evidenced Qatar's sovereignty over the peninsula. The Court observed that signed but unratified treaties may constitute an accurate expression of the understanding of the parties at the time of signature.¹⁸⁴ Article 18 of the Vienna Convention on the Law of Treaties ("Vienna Convention") imposes on the signatories to an unratified treaty the obligation not to defeat the object and purpose of that treaty prior to its entry into force.¹⁸⁵ It is also acknowledged that the signature imposes no legal duty on a signatory state to actually ratify a treaty.¹⁸⁶ Rogoff cautions that the legal effect of unratified treaty should be determined on a case by case basis.¹⁸⁷ However, the debate on the legal effect of unratified treaties is beyond the scope of this research.

Riesman M W argues that unratified treaties are worth the attention of legal scholars as international law is not just a body of rules but a set of expectations shared by politically relevant actors.¹⁸⁸ Unratified treaties therefore, are useful in determining what those expectations are.¹⁸⁹ In the case of the EAC, the EAC-DTA is the Community's expectation in addressing double taxation in the EAC. Riesman advocates for legal scholars to analyze unratified treaties in terms of impact they may have on the most important goals of the international system¹⁹⁰ Despite the considerable delays in its ratification, the EAC-DTA, may eventually come into force. It is in this context that this paper will seek to analyze the comprehensive proposal behind EAC-DTA and provide recommendations for improvement. A casual perusal of the EAC-DTA reveals several gaps in its content and implementation framework which will be discussed below.

¹⁸³ *Qatar v Bahrain*, 88

¹⁸⁴ *Qatar v Bahrain*, 89,

¹⁸⁵ Article 18, Vienna Convention on the Law of Treaties, 23 May 1969, 1155 UNTS 331

¹⁸⁶ Bradley CA, 'Unratified treaties, domestic politics and the US constitution, 48 *Harvard International Law Journal* (2007) 313

¹⁸⁷ Rogoff MA, 'The international legal obligations of signatories to unratified treaty' *Maine Law Review* (1980) 267

¹⁸⁸ Riesman MW, 'Unratified treaties and other unperfected acts of International Law: constitutional functions' 35 *Vanderbilt Journal of Transnational Law*, 3(2002),740

¹⁸⁹ Riesman MW, 'Unratified treaties and other unperfected acts of International Law: constitutional functions' 740

¹⁹⁰ Riesman MW, 'Unratified treaties and other unperfected acts of International Law: constitutional functions' 747

The EAC-DTA is founded on the United Nations model convention to address the issue of double taxation within the Community.¹⁹¹ The EAC-DTA, like all legal instruments enacted or entered into by the EAC Member States, is subservient to community law.¹⁹² Despite the fact that the EAC Treaty provides that states shall aim to avoid double taxation,¹⁹³ the EAC-DTA does not link itself to the EAC treaty by making any reference to the EAC Treaty.¹⁹⁴

The scope of the EAC-DTA is provided for in Articles 1 and 2 while 3-5 defines specific terms utilised in the DTA. Article 2 of the DTA, which sets out the substantive scope of the DTA, identifies the types of income subject to taxation irrespective of how they are levied. Article 2(3) of the Treaty recognises the tax laws of the Partner States.¹⁹⁵ Article 3 of the DTA describes residents of the contracting states, to include individuals, partnerships, companies and any other body of persons that is treated as an entity for tax purposes.

The EAC-DTA covers specific taxes on income chargeable under the various domestic income tax laws of the Member states.¹⁹⁶ Articles 6-21 (save for Article 14 taxation of capital gains discussed below) provide the basis for taxation of the various income heads, as well as allocating taxation rights to the relevant State. A sampled preview of the incomes covered by the EAC –DTA *vis a vis* sections of the income tax statutes of the five countries suffices to illustrate the general effect of the EAC DTA provisions on the double taxation regime in the EAC.

Dividends

Firstly, dividend, which is provided for under Article 10 of the EAC-DTA, is defined as “income from shares or other rights, not being debt claims, participating in profits, as well as income from the corporate rights which is subjected to the same taxation treatment as income

¹⁹¹ Hattingh J, ‘East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?’ 1.

¹⁹² Article 142(1) (d), *Treaty for the Establishment of the East African Community*

¹⁹³ Article 80(h) *Treaty for the Establishment of the East African Community*

¹⁹⁴ Preamble, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.*

¹⁹⁵ Article 2, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.*

¹⁹⁶ Article 2, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.*

from the shares by the laws of the Contracting State of which the company making the distribution is a resident.”¹⁹⁷ The EAC member states have varying definitions of dividends. In Rwanda dividend is limited to income from shares.¹⁹⁸ Uganda and Tanzania include issues of bonus shares to shareholders in its definition.¹⁹⁹ Kenya, on the other hand, includes the issuance of bonus shares and distributed properties by a company to its shareholders in its definition of dividend.²⁰⁰ Since the EAC-DTA provides a definition of a dividend, in the application of the DTA a contracting state may not apply the understanding of dividend under its domestic law, but is bound by the definition contained in the EAC-DTA.²⁰¹

In Uganda and Burundi, dividends paid to non-residents are subject to a withholding tax rate of 15%²⁰² of the gross amount payable whilst in Tanzania the withholding tax rate stands at 10%.²⁰³ Rwanda on the other hand levies a withholding tax rate of 5% on dividends paid to residents of any of the partner states while Kenya levies a withholding tax rate of 5% on dividends paid to citizens of any of the partner states.²⁰⁴ The heterogeneity in the income tax laws may also lead to double taxation and discrimination; for instance, in the case of Kenya, while EAC citizens benefit from reduced WHT rate, residents who are not EAC citizens are excluded from enjoying the reduced WHT. Furthermore, the heterogeneity may affect the investment decisions made by investors looking to invest in the region leading to harmful tax competition contrary to the provisions of Community law.²⁰⁵ EAC-DTA will be instrumental in tackling this tax competition and aggressive tax planning that is bound to result from the current tax regimes

Interest

¹⁹⁷ Article 10, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

¹⁹⁸ Article 41 *Income Tax Law No.16/2018* (Rwanda).

¹⁹⁹ Section 2 *Income Tax Act (Cap 470)* (Kenya).

²⁰⁰ Section 2 *Income Tax Act (Cap 470)* (Kenya)

²⁰¹ Article 3(2), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*

²⁰² Third Schedule, *Income Tax Act, (Cap 340)* (Uganda); Article 85, *Income Tax Law, (Burundi)*, Article 60 *Income Tax Law, Law No 16/2018* (Rwanda) respectively.

²⁰³ Third Schedule, *Income Tax Act, (Cap 470)* (Kenya) and First Schedule, *Income Tax Act, (Cap 332)* (Tanzania) respectively.

²⁰⁴ Third Schedule, *Income Tax Act, Cap 470* (Kenya), Article 60, *Income Tax Law, Law No 16/2018* (Rwanda)

²⁰⁵ Article 8, *Protocol on the Establishment of the East Africa Community Monetary Union, 2012*

Secondly, Article 11 provides for interest income. The term interest is defined as “income from debt claims of every kind whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profit, and in particular, income from government securities, bonds and debentures.”²⁰⁶ This definition is in line with the domestic legislation of the states making harmonization and incidences of double taxation as a result of heterogeneous definition minimal. In Rwanda, Uganda and Burundi,²⁰⁷ the interest payable to non-residents is taxed at a rate of 15% while in Tanzania it is charged at the rate of 10%.²⁰⁸ Thus, the cost of capital is may be higher in Uganda, Burundi, and Rwanda as compared to Tanzania. The provisions of the EAC-DTA dealing with the taxation of interest provides that the resident receiving such payments must be the beneficial owner before the benefits of the EAC-DTA can apply.²⁰⁹ These benefits take the form of limits on the rate of tax chargeable at source as interest is taxed at 10%.²¹⁰ The EAC-DTA will therefore harmonize the WHT tax rate on interest.

Pension

Thirdly, income from Pensions, Annuities and Social Security Payments is covered under Article 19. The EAC –DTA provides that pensions, annuities and social security payments arising from and paid within the EAC in consideration of past employment to a resident of any of the EAC member states is taxable only in the state in which the payment arises.²¹¹ Some states exempt pension income from tax to encourage saving and accumulation of savings which are invested in various sectors of the economy. In the EAC some states have adopted this policy. In Uganda, pension payments are exempt from tax.²¹² However, in Rwanda, in order for a pension to qualify for tax exemption, the pension payment should be from the public institution in charge of social

²⁰⁶ Article 2, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

²⁰⁷ Article 60, *Income Tax Law, No.16/2018* (Rwanda), Third Schedule, *Income Tax Act, (Cap 340)* (Uganda), Article 113(2), *Income Tax Law No 1/02/2013* (Burundi).

²⁰⁸ Third schedule, *Income Tax Act (Kenya)*, and First Schedule, *Income Tax Act (Cap.332)* (Tanzania)

²⁰⁹ Article 11(2), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

²¹⁰ Article 11, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

²¹¹ Article 19, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

²¹² Section 22, *Income Tax Act* (Uganda).

security or from a qualified pension fund.²¹³ In Kenya and Tanzania, pension income is not exempt from tax. In Tanzania non-residents are subjected 15% WHT.²¹⁴ For non-residents in Kenya, pensions or retirement annuity are taxed at the rate of 5%.²¹⁵ Thus, the ratification of the EAC-DTA by member states will eliminate double taxation by utilising the exemption method, i.e., by providing that pensions and other similar payments are taxable only in the source country.²¹⁶

Capital gains

Apart from providing for taxation on income, the EAC-DTA also provides the basis for the taxation of capital gains. Article 14 the EAC-DTA contains five paragraphs each containing an independent allocation rule. It generally provides that capital gains, other than gains from the disposal of assets of a Permanent Establishment in the source country, immovable property in the source country, ships, aircraft used in international traffic are taxable only in the contracting state which the person disposing of the property is resident.²¹⁷ The EAC-DTA, however, does not specifically provide for the taxation of income from the alienation of shares and this therefore falls within the ambit of either Article 14 (4). It assigns the right to tax exclusively to the state where the alienator is a resident.²¹⁸ As will be discussed in Chapter 4, this is a major weakness of the EAC-DTA as it will encourage tax avoidance.²¹⁹ For example, where a non-resident alienator qualifies for bilateral treaty exemptions, the gain on the transaction may be subject to low, and frequently, no taxation in the other contracting state. Consequently, the EAC-DTA may residually permit double non-taxation of share sales.²²⁰ The EAC Member States such

²¹³ Article 16,17, *Income Tax Law No.16/2018* (Rwanda).

²¹⁴ First Schedule, *Income Tax Act* (Tanzania).

²¹⁵ Third Schedule, Paragraph 3, *Income Tax Act* (Kenya).

²¹⁶ Article 19, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*

²¹⁷ Article 14(4), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

²¹⁸ Article 14 (4), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

²¹⁹ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?' 19.

²²⁰ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?' 19.

as Kenya²²¹ and Uganda,²²² have enacted domestic Limitation of Benefits (LOB) legislation that seeks to neutralize treaty shopping. Essentially, the provision restricts entitlement to treaty benefits for a person who is technically a treaty resident but lacks substantial connection with the residence jurisdiction.²²³ The treaty exemptions applying to indirect share sales, such as considered in Article 14(4) of the EAC-DTA may encourage treaty shopping. The Limitation of Benefits clause which is an anti-avoidance provision is not included in the EAC-DTA. Consequently, EAC-DTA does not appear to be aligned with the domestic tax policy position of the major EAC Member States.²²⁴ The application of the LOB domestic provision in a treaty, where there is no such provision in the treaty itself, may create disputes. The importance of having anti-abuse rules in the DTA was exemplified in the Uganda Case *Commissioner General and URA v Zain International BV*.²²⁵ The facts of the case were as follows: Zain International BV disposed of its 100% shareholding in Zain Africa BV to Bharti Airtel International, both resident in the Netherlands. Zain Africa BV, the subject of the disposal, had a 100% shareholding in Celtel Uganda Holdings BV which owned 99.99% of Celtel Uganda Limited. Celtel Uganda Ltd.'s shares in Uganda were not transferred, and its property was not disposed of. The transfer of the shares in Zain Africa BV took place in the Netherlands. The Uganda Revenue Authority (URA) issued a tax assessment on Zain on the ground that the transaction was one of the gain arising from the disposal of an interest in immovable property located in Uganda in terms of Article 13 of the DTA between Uganda and the Netherlands. Zain contended that the income was not sourced from Uganda as it had sold its shares in the Netherlands to a Netherlands entity and so its income was sourced in the Netherlands and not in Uganda.²²⁶ The Ugandan High Court ruled in favour of the Taxpayer. However on appeal, the Court of Appeal ruled in favour of the URA, stating that the URA had jurisdiction over tax proceeds on the sale of shares between two foreign companies involving the sale of assets in Uganda.²²⁷ The Court of

²²¹ Section 41 (5), *Income Tax Act* (Kenya).

²²² Section 88(5) *Income Tax Act* (Uganda).

²²³ Oguttu WA, 'Tax base erosion and profit shifting — part 2: a critique of some priority OECD action points from an African perspective — preventing excessive interest deductions and tax treaty abuse', *The Comparative and International Law Journal of Southern Africa* (2016), 156.

²²⁴ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?'9.

²²⁵ *Commissioner General URA v Zain International BV* (Civil Appeal No.0011 Of 2012) [2014]. https://ulii.org/system/files/judgment/court-appeal-uganda/2014/120/court-appeal-uganda-2014-120_0.pdf on 18 April 2020.

²²⁶ *Commissioner General URA v Zain International BV* (Civil Appeal NO.0011 OF 2012) [2014], 2.

²²⁷ *Commissioner General URA v Zain International BV* (Civil Appeal NO.0011 OF 2012) [2014], 3.

Appeal gave the URA an opportunity to study the transaction again and determine what taxes to claim. By the time the URA reassessed Zain, the company had liquidated all its assets in Uganda.²²⁸ The URA requested the Dutch authorities to assist in the recovery of the taxes due in terms of Article 27 of the DTA.²²⁹ However, Zain has applied for Mutual Agreement Procedure in the Netherlands to resolve the case. The treaty between Uganda and Netherlands did not contain an anti-abuse provision.²³⁰ URA would have been in a more secure position in its claim against Zain had the DTA included this provision.²³¹ On the other hand, in the case of Zain International, a possibility of double non-taxation could have occurred because the Netherlands exempts capital gains realised on disposal of shares qualifying for a participation exemption.²³²

Under the domestic law of the partner states, there is heterogeneity in the application of capital gains. In Rwanda, capital gain from business are also taxable under the provisions of the Income Tax Act. However, the capital gain on secondary market transactions on listed securities and gains or losses realized in reorganization by the transferring company are exempted from capital gains tax.²³³ Reorganization is defined in the Rwanda Income Tax Act to include takeovers, mergers and acquisitions.²³⁴ The tax treatment of takeovers, mergers and acquisitions in Burundi is similar to that of Rwanda as capital gains tax is not charged on company restructuring.²³⁵ It follows that Rwanda and Burundi are favourable for equity financing through takeovers, mergers and acquisition. In Kenya, capital gains tax is charged on the whole of a gain which accrues to a company or an individual on or after 1st January 2015 on the transfer of property situated in Kenya, whether or not the property was acquired before 1st January 2015.²³⁶ The Eighth Schedule to the Income Tax Act lists land, buildings, and marketable securities as properties liable for capital gains tax.²³⁷ The tax is paid by a person, whether resident or non-resident, while transferring the property, that is, the transferor and the loss may be carried forward to offset or

²²⁸ Commissioner General URA Vs Zain International BV (Civil Appeal NO.0011 OF 2012) [2014,31].

²²⁹ Oguttu WA, 'Tax base erosion and profit shifting — part 2: a critique of some priority OECD action points from an African perspective — preventing excessive interest deductions and tax treaty abuse' 150.

²³⁰ Article 13(4) OECD MTC.

²³¹ Oguttu WA, 'Tax base erosion and profit shifting — part 2: a critique of some priority OECD action points from an African perspective — preventing excessive interest deductions and tax treaty abuse' 150.

²³² Article 13, *Corporate Income Tax Act 1969* (Netherlands).

²³³ Article 32, *Income Tax Law No. 16/2018* (Rwanda).

²³⁴ Article 54, *Income Tax Law No. 16/2018* (Rwanda).

²³⁵ Article 103 *Income Tax Law No 1/02/2013*. (Burundi).

²³⁶ Article 2, Eighth Schedule, *Income Tax Act (Cap 470)* (Kenya).

²³⁷ Article 1, Eighth Schedule, *Income Tax Act (Cap 470)* (Kenya).

deducted against a gain of a similar nature at a future date.²³⁸ On the other hand Capital Gains tax is not payable on gains arising from the transfer of shares traded on securities exchange licensed by the Capital Markets Authority.²³⁹ However, gains arising from the transfer of shares traded on unlicensed securities exchange are subjected to capital gains tax at the rate of 5%.²⁴⁰ In Rwanda secondary market transactions on listed securities are exempted from capital gains tax²⁴¹ while in Uganda,²⁴² the same is taxable. In Tanzania on the other hand shares and securities listed on the Dar es Salaam Stock exchange are excluded from Capital Gains Tax where the shareholder owns less than 25% of the shares.²⁴³ The divergent domestic law provisions on the alienation of shares could be cured by a harmonized approach that encourages the freedom of establishment and cross border establishment.

Double taxation Reliefs

In addition to allocation of taxation rights on different types of income the EAC-DTA also provides for double taxation relief. It provides the methods through which relief from double taxation can be sought. The EAC-DTA provides for two methods for the elimination of (juridical) double taxation by the state of residence: **Exemption method and Credit method.** Article 24 of the Treaty employs both methods depending on the applicable allocation rule. The methods under the DTA are different depending on the country of residence, which is determined by the provisions of Article 4 of the Treaty. Where the source state is limited to a maximum rate under the Treaty, such as in Articles 10 to 13, the credit method is employed, and this is because the exemption is considered a path towards tax evasion, which affects the national revenue of the Partner states.²⁴⁴ Double taxation relief offered under EAC- DTA may be more generous than what is provided for under domestic law in a state such as Kenya which provides for a tax deduction on taxes paid in a foreign jurisdiction for non-citizens where there is no DTA. The EAC-DTA will either allow for a full exemption or tax credit both of which confer greater tax benefit to the taxpayer than the unilateral relief granted by states as the relief

²³⁸ Article 4, Eighth Schedule, *Income Tax Act (Cap 470)* (Kenya).

²³⁹ Section 18, *Finance Act 2015*(Kenya).

²⁴⁰ Section 34, *Income Tax Act (Cap 470)* (Kenya).

²⁴¹ Article 39, *Income Tax Law No.16/2018* (Rwanda).

²⁴² Section 21(1) (k), *Income Tax Act* (Uganda).

²⁴³ Section 3, *Income Tax Act* (Tanzania).

²⁴⁴ Article 24, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.*

entrenched under the DTA restricts a country's ability to unilaterally amend the double taxation relief in the domestic law to the detriment of the taxpayer.²⁴⁵ For example, if Tanzania unilaterally offers ordinary tax credit then it subsequently repeals its law and adopts deduction method, the EAC-DTA will cushion the taxpayers who conduct cross-border trade and investment by creating certainty which is a key component in conducting business and trade.

Exchange of information and non-discrimination

Finally, the EAC –DTA also has special provisions that aid in tax administration such as exchange of information and non-discrimination provisions. Fiscal evasion can be prevented through the exchange of information.²⁴⁶ However, the information exchange mechanism in the EAC–DTA (2010) appears to be weaker compared to the scope of application of the provisions in the UN Model (2011) and OECD Model as it is limited to only exchange of information on taxes that are covered under the EAC-DTA.²⁴⁷ Secondly The EAC-DTA also does not take into account the recent developments in international tax law by providing for automatic exchange of information among tax authorities.²⁴⁸ Automatic exchange of information involves the systematic and periodic transmission of taxpayer information by the source country to the residence country concerning various categories of income.²⁴⁹ This reduces the possibility for tax evasion and protects the tax base from non-compliance with tax laws.²⁵⁰ Automatic exchange of information promotes the efficient use of state resources as states can send and receive pre-agreed information each year, without having to send a specific request.²⁵¹ The non-discrimination provision in the EAC-DTA requires neutrality in taxation to ensure that a state where an investment is made treats resident and non-resident investors similarly.²⁵² This treaty

²⁴⁵ Holmes K, *International tax policy and double tax treaties: an introduction to principles and application*, 104.

²⁴⁶ Article 27 (1), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

²⁴⁷ Article 27(1), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

²⁴⁸ <http://www.oecd.org/tax/transparency/automaticexchangeofinformation.htm> on 19 April 2020.

²⁴⁹ <http://www.oecd.org/tax/transparency/automaticexchangeofinformation.htm> on 19 April 2020.

²⁵⁰ <http://www.oecd.org/tax/transparency/automaticexchangeofinformation.htm> on 19 April 2020.

²⁵¹ <http://www.oecd.org/tax/transparency/automaticexchangeofinformation.htm> on 19 April 2020.

²⁵² Article 25, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

provision is critical for the economic objective of cross border neutrality to promote trade and investment.²⁵³

The Treaty also provides a dispute resolution mechanism where the individuals or corporates with tax disputes may refer disputes.²⁵⁴ The other important provision in the EAC-DTA is the non-discrimination of persons of a contracting state in the other contracting state.²⁵⁵ However the non-discrimination clauses of the EAC-DTA (2010) only apply to the taxes that are within the scope of the treaty, i.e. generally taxes on income.²⁵⁶ This is weaker than Article 24(4) of the UN Model regarding discrimination which applies to the deductibility of interest, royalties and other disbursements which has been omitted from the EAC-DTA (2010).²⁵⁷

2.3. Conclusion

The objective of this chapter was to review the legal regime governing the elimination of double taxation within the EAC, i.e., the provisions in the individual member states' tax systems that grant unilateral relief from double taxation and the provisions of the EAC Treaty (insofar as they touch on double taxation) and the EAC-DTA.

From the foregoing, it is evident that states in the exercise of tax sovereignty develop divergent tax regimes which do not work harmoniously for the development of the Common Market. Second, Community law is the oil that runs the engine of integration. The limited focus placed on the elimination of double taxation and the narrow application of the EAC treaty is detrimental to the growth and development of the Common Market. Third, as is apparent from the analysis in 2.2.2, although the EAC-DTA will facilitate the avoidance of double taxation in the EAC, several aspects of the EAC-DTA (2010) follow provisions that have been replaced in the UN Model and may, therefore, be regarded as outdated and weak in provisions. Despite the

²⁵³ Ault HJ, Sasseville J, 'Taxation and non-discrimination a recommendation', *World Tax Journal* (2010), 103.

²⁵⁴ Article 26, Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

²⁵⁵ Article 25, Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

²⁵⁶ Article 25, Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

²⁵⁷ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose, 11.

weaknesses identified in both the EAC Treaty and salient provisions of EAC-DTA in tackling double taxation, they are essential to the integration process and thus the survival of the EAC.

CHAPTER THREE: APPLICATION OF THE CURRENT EAC LEGAL REGIME IN CURBING DOUBLE TAXATION

Having looked at the legal regime regulating double taxation in the East Africa Community in the previous chapter, this chapter of the study analyses double taxation vis-a-vis the objectives of the Common Market. The chapter also analyses how double taxation can result in violation of EAC Common Market. The chapter reviews the application of gross-based withholding Tax to illustrate dangers of double taxation in the EAC. The chapter will then review how double taxation is addressed in the European Union. The European Union is used in this study as an example from which EAC can learn as the two organization are on a similar path of realizing a successful Common Market /internal market aimed at lifting economic prospects of Partner States.²⁵⁸ The Chapter will then review the Caribbean Community Multilateral Tax treaty that has been in existence since 1973 (revised in 1994) to draw lessons from a regional community that has implemented a regional tax treaty. Finally, the Chapter will review the economic and political context of the EAC and the suitability of the approaches utilized by the European union and the Caribbean Community.

3.1. Objectives of the EAC: Common Market

Article 5(2) of the Treaty for the Establishment of the East African Community enjoins Partner States to establish among themselves a Customs Union, a Common Market, a Monetary Union and ultimately Political Federation. The EAC Common Market envisages an arrangement where Partner States operate as a single market for goods, services, capital and labour, having common revenue and trade laws. In order to achieve the EAC objective of the Common Market, the EAC Treaty sets out operational principles.²⁵⁹ The most relevant operational principles to this study are the fundamental freedoms of movement of goods, services, labour, capital, information and technology.²⁶⁰ Member states are obligated to ensure that all legal instruments and policies

²⁵⁸ Afton T, 'How the East African Community guard against base erosion and profit shifting while working towards deeper integration: lessons from the European Union,' *World Tax Journal* (2017),569.

²⁵⁹ Article 7, *Treaty for the Establishment of the East African Community*.

²⁶⁰ Article 7, *Treaty for the Establishment of the East African Community*.

conform to the provisions of the EAC Treaty and its attendant Protocols.²⁶¹ Any legal instrument or policy that impedes the fundamental freedoms is liable to be struck down on the basis that it hinders the implementation and operation of the EAC Common Market.

In practice, the objectives of the Common Market are hampered by discriminatory policies which distinguish between nationals and non-nationals. Harsher tax treatment of cross-border economic activities than purely internal activities amounts to tax discrimination.²⁶² The EAC Common Market protocol is centred on the principle of non-discrimination of nationals of other Partner States on grounds of nationality.²⁶³ For example, equal treatment is guaranteed by each EAC Member State to service providers of other Member States, which would in principle extend to the tax regimes of each EAC Member State.²⁶⁴ The Common Market Protocol however, establishes an exception to the equal treatment obligation, so that any restriction on non-national service providers is acceptable if the: difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes.²⁶⁵ The protocol further limits that application of the curve out by providing that exception is only valid if the domestic tax measure under consideration does not amount to arbitrary or unjustifiable discrimination.²⁶⁶ This curve out is intended to facilitate the levying and collection of taxes without increasing the taxpayer's burden.²⁶⁷

The determination of whether the current double taxation regime is at cross-purposes with EAC is within the purview of the EACJ.²⁶⁸ Ideally the application of EAC fundamental freedoms to national tax regimes ought to be featured in case law of the EACJ; however, the issue of double taxation in relation to fundamental freedoms of the EAC is yet to be adjudicated before the EACJ. The CJEU on the other hand features in a vast body of case law on the application of the operational principles on the EU internal market. Some of these cases will be reviewed later in this section. However, in the next section I will demonstrate how double taxation negates the purpose of the EAC Treaty.

²⁶¹ Article 8, *Treaty for the Establishment of the East African Community*.

²⁶² Kolfer GW, Mason R, 'Double taxation: a European "switch in time?"', 64.

²⁶³ Article 10, *Protocol on the establishment of the East African Community Common Market*.

²⁶⁴ Article 17, *Protocol on the establishment of the East African Community Common Market*.

²⁶⁵ Article 21(1)(d), *Protocol on the establishment of the East African Community Common Market*.

²⁶⁶ Article 21(1), *Protocol on the establishment of the East African Community Common Market*.

²⁶⁷ Hattingh J, 'East African Community/European Union - the East African Community multilateral tax treaty – fit for purpose?', 7.

²⁶⁸ Article 30, *Treaty for the Establishment of the East African Community*.

3.2. How Double Taxation can result in violation of EAC Community Law.

The problem of double taxation is complex as it involves the concurrent application of domestic laws of two sovereign states. The sovereignty of the EAC Partner States in establishing their own tax regimes leads to instances of double taxation or non-taxation.²⁶⁹ The EAC has laid great emphasis on the harmonization of tax laws,²⁷⁰ however, as discussed in the previous chapter harmonisation of the domestic tax laws of EAC Partner States would not yield into eliminating double taxation. This is because double taxation arises from the simultaneous assertion of source taxing rights by the source country and residence taxing rights by the residence country. Double taxation exposes a non-national taxpayer to a tax disadvantage not suffered by domestic taxpayers. Acknowledging that double taxation may hamper economic activity in the EAC, Article 80(h) of the Treaty provides that states may take measures to avoid double taxation. However, as discussed in 2.2 above, Article 80(h) of the Treaty may not grant actionable rights to taxpayers. However, double taxation may violate other provisions of the Treaty and its attendant Protocols.²⁷¹

3.2.1 Double Taxation and Free Movement

Double taxation can be analyzed on two main fronts. The first argument is based on the fact that double taxation is likely to dissuade or deter persons from exercising their rights to free movement.²⁷² The concept of the Common Market is central to the EAC. The EAC Common Market envisages free movement of goods, services, labor, capital and freedom of establishment.²⁷³ The EAC Common Market is envisaged to be a single market where distortions to trade and investment are eliminated. Double taxation is one such distortion as it discourages the free movement of goods, services, labour, capital and right of establishment.²⁷⁴ The current regime may therefore violate the fundamental freedoms of the Common Market by placing a double burden on cross-border activities.²⁷⁵ For example, a Partner State would violate the freedom of movement of workers if, without further justification, it assessed higher taxes on foreign workers than on its own nationals.

²⁶⁹ Murciego AC, Laborda JL, *The effect of double taxation treaties and territorial tax systems on foreign direct investment: evidence for Spain*, <http://www.economics-ejournal.org/economics/journalarticles/2019-22> on 14 April 2020.

²⁷⁰ Article 32, *Protocol on the establishment of the East African Community Common Market*.

²⁷¹ Kolfer GW, Mason R, 'Double taxation: a European "switch in time?"' 66.

²⁷² Hilling M, *Free movement and tax treaties in the Internal Market*, Lustu Forlag, Uppsala, 2005,107.

²⁷³ Article 76, *Treaty for the Establishment of the East African Community*.

²⁷⁴ Kolfer GW, Mason R, 'Double taxation: a European "switch in time?"' 68.

²⁷⁵ Kolfer GW, Mason R, 'Double taxation: a European "switch in time?"' 68.

In the European case *F.W.L. de Groot v Staatssecretaris van Financiën*, the court stated:

“... provisions which preclude or deter a national of a Member State from leaving his country of origin to exercise his right to freedom of movement therefore constitute an obstacle to that freedom even if they apply without regard to the nationality of the worker concerned.”²⁷⁶

In the absence of a DTA, unilateral measures serve as the primary mechanism for avoiding double taxation in the EAC. However, due to the inherent weaknesses of unilateral measures, taxpayers may still be subject to double taxation in a variety of contexts identified in section 2.1 above. Since unilateral measures cannot adequately address the issue of double taxation in cross-border transactions, it is common for States to enter into tax treaties such as DTAs.²⁷⁷ In the absence of an operational EAC-DTA, intra-EAC traders, service providers and investors are worse off than their counterparts from countries who have DTAs with the EAC member states. For example, the under the Uganda-Mauritius DTA, Article 10 affords Mauritius residents a reduced tax rate on dividends. Therefore as a result of the DTA, Mauritius residents have better investment access to Uganda than Kenyan residents despite Kenya and Uganda being in a Common Market.²⁷⁸

The provisions of the EAC-DTA must be in conformity with the objectives of the EAC Treaty and its attendant Protocols. In this case the EAC-DTA must promote the fundamental freedoms in respect of goods, services, capital and right of establishment as envisaged by the EAC Treaty and its attendant Protocols. As noted in the previous chapter the EAC-DTA makes no reference to the EAC Treaty and its attendant Protocols

3.2.2. Double Taxation and Discrimination

The second argument is based on the fact that double taxation has a negative effect on non-nationals or non-residents compared with nationals or residents.²⁷⁹ This fosters discrimination which contravenes the non-discrimination rule espoused in EAC community law. There is no universally accepted definition of discrimination and more so tax discrimination. The definition adopted by the CJEU is that a Member State discriminates when it taxes cross-border economic

²⁷⁶ C-385/00 *F.W.L. de Groot v Staatssecretaris van Financiën* [2002] ECR I-11819, 78.

²⁷⁷ Kolfer GW, Mason R, ‘Double taxation: a European “switch in time?”’, 66.

²⁷⁸ *White Sapphire Ltd and Crane Bank Ltd vs Uganda Revenue Authority*.

²⁷⁹ Hilling M, *Free movement and tax treaties in the Internal Market*, 108.

activities more harshly than similar purely domestic activities.²⁸⁰ To determine whether a taxpayer has been discriminated against the CJEU compares the aggrieved non-resident taxpayer to a similarly situated resident taxpayer with only domestic economic activities.²⁸¹ If the non-resident receives worse tax treatment than the similarly situated resident, the Court generally concludes source partner state discriminated against the non-resident.²⁸² Not every difference in treatment is discriminatory, a cross-border situation is discriminatory only when the cross-border situation is "similar" to a purely domestic situation, such that there is no justification for treating the two situations differently.

The EAC Common Market protocol is centered on the principle of non-discrimination of nationals of other Partner States on grounds of nationality. Article 10 states that parties shall ensure "non-discrimination of the workers based on their nationalities, in relation to employment remuneration and other conditions of work and employment."²⁸³ Similarly Article 13(2) on the right of establishment stipulates that "the Partner States shall ensure non-discrimination of the nationals of the other Partner States, based on their nationalities. In the same vein, Article 13 (6) provides that Companies and firms established in accordance with the national laws of a Partner State and having their registered office, central administration or principal place of business and which undertake substantial economic activities in the Partner State shall, for purposes of establishment, be accorded non-discriminatory treatment in other Partner States."²⁸⁴ As it stands the current tax regime perpetuates discrimination against tax payers undertaking intra-EAC economic activity hampering the achievement of the Common Market protocol.

The current regime promotes tax discrimination as a result of the harsher tax treatment of cross-border economic undertakings than purely internal undertakings.²⁸⁵ As discussed in Chapter 2, the EAC domestic tax regimes are such that tax rates are substantially higher for non-residents than residents which might be interpreted as a discrimination of non-residents. The domestic laws are littered with overt nationality discrimination. This is evidenced in the various tax rates including Withholding tax (WHT) rates for residents of individual EAC states which are lower

²⁸⁰ Case C-279/93, *Finanzamt Köln-Altstadt v. Schumacker*, 1995 E.C.R. 1-225, 30.

²⁸¹ Mason R, 'Flunking the ECJ's tax discrimination test', *Columbia Journal of Transnational Law* (2007), 77.

²⁸² Mason R, 'Flunking the ECJ's tax discrimination test', 77.

²⁸³ Article 10, Protocol on the establishment of the East African Community Common Market.

²⁸⁴ Article 13 Protocol on the establishment of the East African Community Common Market.

²⁸⁵ Kolfer GW, Mason R, 'Double taxation: a European "switch in time?"', 68.

than the WHT rates for non-residents. For example in Burundi no withholding tax is deducted from dividend payments to a resident company but a 15% deduction is made to non-resident companies.²⁸⁶ In *Royal Bank of Scotland –v- Greece*, the CJEU held that a Member State may not impose a higher tax rate on companies established in a fellow Member State than on domestic companies.²⁸⁷ In cases where a state imposes harsher tax treatment on cross border transactions than domestic transactions then the state may be viewed as contravening the provisions of the Common Market. The current state of affairs is exacerbated by countries exercising tax sovereignty without regard for the EAC Treaty or Common Market Protocol.

In the *British American Tobacco (U) Ltd –v- the Attorney General of Uganda*,²⁸⁸ the court stated

“.....by purporting to construe the cited domestic tax laws to the exclusion of the Treaty and Customs Union Protocol, URA acted in a manner likely to jeopardize the achievement of the Treaty’s objectives, thus rolling back the gains of the Customs Union and the Common Market that have been realized thus far. A negation of the benefits of such regional trade initiatives would be unfortunate trajectory for the EAC. The dichotomy between the commitments made under the Treaty and attendant Protocols, on the one hand and the reality posed by the conflicting misapplication of domestic legislation on the other hand does not auger well for EAC Integration.”

Like the domestic law of the member states, the EAC-DTA is also subject to EAC Treaty’s objectives and principles. The EAC –DTA prohibits discrimination based on the nationality of the taxpayer or of its shareholders. It states:

“ The nationals of a Contracting State shall not be subjected in any of the other Contracting States to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation or connected requirements to which nationals of the other States in the same circumstances are or may be subjected.”²⁸⁹

This article has the effect of prohibiting discrimination based on nationality and does not specifically prohibit discrimination against non-residents. The EAC-DTA is weak in provisions

²⁸⁶ Article 113, *Income Tax Law* (Burundi).

²⁸⁷ *Royal Bank of Scotland plc. V Greece*, 1997 E.C.R. I-2651.

²⁸⁸ Reference No.7 of 2017 *British American Tobacco (U) Ltd Vs The Attorney General Of Uganda*, 44 <http://eacj.eac.int/?cases>

²⁸⁹ Article 25(1), *Agreement between Government of the Republic of Kenya; the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*

with regard to non-discrimination based on the fact that EAC residents who are not EAC national as well cannot bring a claim under this clause. It is noteworthy that the CJEU previously concluded that EU member states tax provisions that denied benefits to non-residents from other member states was liable to operate primarily to the detriment of nationals of other member states.²⁹⁰ Therefore tax provisions that denied benefits to non-residents was liable for contravening the non-discrimination principle which is a key tenet of the EU.

To further illustrate how domestic tax laws of the member states and the EAC-DTA can result in violation of the objectives of the Common Market, the study will review the subject of imposition taxes on the gross amount of intra-community payment at source (gross based Withholding Tax).

3.2.3. Gross based Withholding Tax

The classical justifications for withholding tax are often its collection mechanism because the revenue authority in one country cannot collect tax in the other country.²⁹¹ Secondly, information regarding the deductible expenses of non-residents is not easily verifiable.²⁹² From this perspective, the objective of the withholding mechanism is not to impose a different tax burden on non-residents but to facilitate the administration and collection of taxes.²⁹³ The WHT discussed is the flat-rate taxes on the gross amount of inter-community payments imposed at source.²⁹⁴ These taxes are widely encountered in the EAC encompassing both passive and active income.²⁹⁵ For instance, in Kenya the following types of payments earned by non-residents are liable for WHT: dividends, interest, royalties, managerial, technical, agency, contractual, professional or consultancy services, training and professional fees, natural resource income, mining or petroleum contract services income, booking, gaming and betting winnings, immovable property rental income, shipping operation income, and income from transmitting

²⁹⁰ Case C-279/93, Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. I-225, 27,29

²⁹¹ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?' Bulletin for International Taxation (2016), 15

²⁹² Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?', 15

²⁹³ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?', 15

²⁹⁴ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?', 15

²⁹⁵ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?' .13

messages by radio, cable, VSAT or similar apparatus.²⁹⁶ Many of these categories are also encountered in Tanzania, where further items, such as income from equipment hire, insurance premiums and pensions, attract this form of taxation.²⁹⁷ In Uganda, incomes of non-resident entertainers or sportspersons, and the purchase price of commercial buildings are subject to WHT.²⁹⁸ In Burundi, non-resident persons receiving income from Burundi are taxed at 15% of gross income.²⁹⁹

WHT are typically applied to passive income (royalties, interest and dividends). Gross based WHT may not be appropriate and is highly distortive where a non-resident incurs substantial expenses in earning the income. For example, EAC partner states' tax on cross-border interest payments is levied via a WHT on the gross amount of the interest paid. This might lead to a very high effective tax on creditors if considerable expense incurred to fund a loan. The high effective tax rate may be passed on to debtors in the form of increased interest due on the loans which is unfavourable to cross border investments. Another income that may be subject to gross based withholding tax, is (cross-border) rental income from immovable property. In such cases, the payer of the rent is required to withhold the tax and pass it on to the designated tax authorities. There are also instances where gross based WHT is applied to active income in particular payments for services i.e. Technical Services. For example, technical fees paid to non-residents are often subject to a final withholding tax under domestic law. If, however, the fees are derived through a permanent establishment or fixed base situated in the source State, they must be taxed as business profits on a net basis.

As discussed in the previous Chapter, countries such as Kenya have unilaterally extended preferential rate of WHT to EAC citizens. Despite this high gross WHT applied exclusively to non – residents may be highly distortive as they do not meet the objective of neutrality between domestic and cross-border taxpayers especially when in fact, act like a turnover-based tax aimed at revenue raising.³⁰⁰ This is illustrated in the table below:

²⁹⁶ Section 35, *Income Tax Act*, (Kenya)

²⁹⁷ Sections, 82, 83, 86, *Income Tax Act* (Tanzania).

²⁹⁸ Section 118, *Income Tax Act*, (Uganda).

²⁹⁹ Article 113, *Income Tax Act* (Burundi).

³⁰⁰ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?', 13.

Table 4: Gross based Withholding Tax

	Resident Taxpayer	Cross –border Taxpayer
Gross Income	100	100
Expenses	(85)	(85)
Taxable Profit	15	15
Income tax in home state @30%	4.5	4.5
WHT at Source(10%x100)	-	10
Credit for WHT (Ordinary tax Credit		4.5
Total Tax	4.5	10
Effective Tax rate (total tax/ taxable profit	30%	66.67%

From the foregoing table , residual double taxation in the form of excess tax credits arises when gross based source tax rate is high and charged on active income.³⁰¹ Therefore, withholding taxes can distort the free movement of capital, goods and services if they are levied on gross income, whereas a resident is more often taxed based on net income.³⁰²

However, it should be noted that not all gross based WHT taxes on non-residents amounts to tax discrimination or hampers free movement. For example, if a Partner State taxes non-residents' gross income at a lower rate than residents' net income, non-residents may suffer no disadvantage from the difference in treatment.³⁰³ They could even end up owing less tax than they would on a net basis. The CJEU has held that a Partner State may use different methods for

³⁰¹ Hattingh J, 'East African Community/European Union - the East African Community multilateral tax treaty – fit for purpose?', 14.

³⁰² Hattingh J, 'East African Community/European Union - the East African Community multilateral tax treaty – fit for purpose?', 13.

³⁰³ Mason R, 'Flunking the ECJ's tax discrimination test', 84.

calculating the tax due from residents and non-residents, as provided that it does not result in a greater final tax liability than would be imposed under the method used for residents.³⁰⁴

The EAC-DTA prescribes WHT rates as follows: Dividends 5%,³⁰⁵ Interest 10%,³⁰⁶ Royalties 10%³⁰⁷ and Management/Professional Fees 10%.³⁰⁸The EAC-DTA provides better rates for WHT than what is given unilaterally, and as a result there will be uniform application for the aforementioned types of income. The question, however, remains whether the WHT regime as provided for under the domestic law and the EAC-DTA constitute a breach of the EAC Treaty objectives.

The rate of withholding is obviously critical. While the EAC-DTA significantly reduces the WHT rates for the various incomes identified above, it is weak in provisions as for certain incomes it does not specify whether the WHT is gross based or net based. The clauses of the EAC-DTA which permit gross based withholding tax are at the risk of breaching EAC law as they give rise to distortion in the operation of the EAC internal market.³⁰⁹ These clauses include taxation on immovable property, dividends, interest, royalties, management and professional fees, capital gains, independent personal services, artistes and sportspersons pensions.³¹⁰ On the other hand, clauses that govern the taxation of business profits and profits from the operation of ships, trains and aircrafts are less likely to distort because they require net taxation in the source state. However, the tax rate differentiation for residents and non-residents in domestic law may

³⁰⁴ Case C-265/04, *Bouanich v. Skatteverket*, 2006 ECJ Judgment of 19 January 2006.

³⁰⁵ Article 10 (2), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

³⁰⁶ Article 11 (2) *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

³⁰⁷ Article 12 (2), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

³⁰⁸ Article 13 (2), *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

³⁰⁹ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?', 16.

³¹⁰ Article 6, 10, 11, 12, 13, 14, 15, 18, 19, 21, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

still give rise to discrimination.³¹¹ Hence, net taxation imposed at rates that do not differentiate residents from non-residents is less likely to lead to a breach of the EAC Common Market.³¹² The reduced rate is assumed to be a fair approximation of the tax a resident taxpayer would have paid.³¹³ The WHT regime presented may not be effective as it presents a trade –off between a simple and effective collection and an approximation of tax that would have been paid by a resident. This approximation may lead to high effective tax rate for taxpayers or loss of potential revenue for the State. The WHT regime also does not take into account advancements made in cross-border assistance between tax administrations i.e. Exchange of Information and assistance in collections of taxes.³¹⁴

Gross based WHT may lead to distortion as it will discourage cross-border economic activities. This will in turn affect the Common Market as gross based final WHT does not meet the neutrality objective between domestic and cross-border taxpayers.³¹⁵ Therefore the use of Withholding tax as provided for in the domestic regime and the EAC-DTA would constitute a breach of the fundamental freedoms on which the EAC Common Market must operate.³¹⁶

3.3. European Union Approach to Double Taxation

Like the EAC, the EU does not have a multilateral DTA in operation. Since the European Union and the EAC have similar goals and objectives lessons can be derived from the EU on matters relating to double taxation. The EU has dealt with the problem of double taxation through the development of directives aimed at furthering the single market and through case law of the CJEU. The CJEU has consistently interpreted that the fundamental freedoms prohibit tax discrimination such as harsher tax treatment of cross-border economic activities than purely internal activities, in the case of *Royal Bank of Scotland –v- Greece*³¹⁷, where it was held that a Member State may not impose a higher tax rate on companies established in a fellow Member

³¹¹ Hattingh J, ‘East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?’, 17.

³¹² Hattingh J, ‘East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?’, 17.

³¹³ Ault H, Sasseville J ‘Taxation and non-discrimination’ World Tax Journal (2010), 116.

³¹⁴ Article 27, Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

³¹⁵ Ault H, Sasseville J ‘Taxation and non-discrimination’ World Tax Journal (2010), 116.

³¹⁶ Hattingh J, ‘East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?’, 16.

³¹⁷ *Royal Bank of Scotland plc. V Greece*, 1997 E.C.R. I-2651 -holding that imposition by Greece of higher tax rates on foreign banks than domestic banks violated the foreign bank’s freedom to establish operations in Greece.

State than on domestic companies. The CJEU has also invalidated, in the case of *Cadbury Schweppes plc. –v- Commissioner of Inland Revenue*, a variety of common international tax practices because they restrict EU nationals' ability to conduct trade or business across Member State borders, including controlled foreign corporation regimes,³¹⁸ limitation of group loss relief to domestic companies as it was in the case of *Marks and Spencer plc. v Halsey*,³¹⁹ limitation of economic double tax relief to domestic dividends in *Manninen case*³²⁰ and thin capitalization rules.³²¹To mirror the EAC analysis the study will review the EU approach to gross based final withholding tax.

3.3.1 EU's Approach to Withholding Tax

The EU has made noteworthy steps intended at tackling double taxation through the development of EU Law through directives that eliminate withholding tax for some of the incomes.³²² EU law on withholding tax has further developed as a result of various decisions that have significantly dismantled most of the Withholding taxes in the EU. To realise the single market, the EU has passed directives aimed at achieving close economic integration. One such directive is the Parent-Subsidiary Directive (2011/96), which prohibits source-based withholding tax for non-portfolio dividends which are paid intra-community.³²³ Similarly, under the Interest and Royalties Directive (2003/49), withholding taxes on interest or royalties paid intra-community to companies are banned.³²⁴

Withholding tax based on gross income has been the subject of review by the CJEU. One such case is *Arnoud Gerritse v Finanzamt Neukölln-Nord*,³²⁵ where Arnoud Gerritse a resident of Netherlands performed as a drummer at a radio station in Berlin on 25 April 1996. The radio station deducted 25% tax from the fee payable to Mr. Gerritse as provided for in the German

³¹⁸ C-196/04, *Cadbury Schweppes plc. v. Commissioners of Inland Revenue*, E.C.R. Judgement of 12 September 2006

³¹⁹ C-446/03, *Marks and Spencer plc. v. Halsey*, E.C.R. Judgement of 13 December 2005.

³²⁰ C-319/02, *Manninen*, 2004 E.C.R. Judgment of 7 September 2004.

³²¹ Douma S, 'The three ds of direct tax jurisdiction: disparity, discrimination and double taxation', 46 *European Taxation* (2006), 522,523.

³²² Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?', 12

³²³ Preamble (3) Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

³²⁴ Article 1, Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

³²⁵ C-234/01, *Arnoud Gerritse v Finanzamt Neukölln-Nord*, ECJ Judgement of 19 January 2006.

Law. The German national court referred the dispute to the CJEU seeking to ascertain whether national legislation which, as is the present case, taxes the income of a resident and that of a non-resident differently in so far as the former is taxed on his net income after deduction of business expenses while the latter is taxed on his gross income with no deduction of such costs is contrary to Article 59 of the EU Treaty. The German law that prescribed 25% gross based final WHT was in accordance with the DTA concluded between the Kingdom of the Netherlands and the Federal Republic of Germany to avoid double taxation. The CJEU held that the German income tax law which treats the income of a resident and that of a non-resident differently by taxing the net income of the resident and the gross income of the non-resident, contravenes EU law³²⁶.

Another significant case on Withholding tax is the *Denkavit International BV* case.³²⁷ The case concerned dividends that were distributed by two French companies to their holding company, *Denkavit International BV*, a company located in the Netherlands. The French tax system applies different rules to resident and non-resident parent companies. A French shareholder that is eligible under the French participation exemption regime is exempt on the dividends it receives. The DTA concluded between France and the Netherlands applies a withholding tax of 5% and grants a tax credit for taxes paid in the Source state. However, under the Dutch system, dividends are fully exempt and this credit could not be used by the Dutch holding company. *Denkavit International* argued that the French system was discriminatory because it granted an exemption to residents. The issues for the court to determine were first, whether the freedom of establishment was contravened by imposing the burden of taxation on a non-resident parent company in receipt of dividend while relieving resident companies of similar burden. Secondly, was whether the Withholding tax can be challenged under the principle of establishment where a tax convention allows for the same. And lastly, whether the fact that a non-resident company would be unable to set off the tax as provided in the tax convention must be regarded as incompatible with the freedom of establishment. The court held that a state cannot tax dividends payable to a non-resident parent company if an exemption applies to dividends paid to a resident parent company. The court also held that the fact that the tax credit is theoretically available does not remove the discriminatory nature of the Withholding Tax since the non-resident company could not avail itself of the tax credit.

³²⁶ *Arnoud Gerritse Case*, 53.

³²⁷C-170/05 *Denkavit International BV*, ECJ Judgement of 14 December 2006.

It is evident from the decisions of the CJEU that withholding tax can be challenged when non-residents are subject to a WHT and residents are exempt (Denkavit International case). WHT can also be challenged with regard to the calculation of the taxable base since they are levied on gross income, whereas a resident is more often taxed on the basis of net income (Arnoud Gerritse case). The classic justifications for gross-based withholding tax identified above are diminished by tax treaty provisions which facilitate the exchange of taxpayer information³²⁸ and assistance in the collection of taxes.³²⁹ These provisions abrogate the revenue rule, which is at the heart of the justification for withholding mechanisms.³³⁰

The role played by CJEU in the development of jurisprudence on the treatment of cross-border taxpayers is not without criticism. The first critique is that the CJEU's noted, tax cases have resulted in massive revenue losses in the Member States, without providing Member States clear guidelines for how to conform national taxes to EC law.³³¹ The second critique is that the CJEU has intruded on national tax policy, traditionally the exclusive province of the states.³³² Lastly the CJEU has failed to provide EU taxpayers with a clear conception of their rights under EC law. This is as a result of the lack of harmonization of the decisions of the court. This legal uncertainty inhibits tax planning by EU nationals, thereby inhibiting the very market integration that the prohibition on tax discrimination was meant to foster.³³³

3.4. Caribbean Community Approach

Unlike the EU's approach, the Caribbean Community opted for a multilateral tax treaty to address the problem of double taxation. In 1973 some countries in the Caribbean entered into Treaty of Chaguaramas which established the Caribbean Community and Common Market (CARICOM).³³⁴ The treaty established free trade in goods, services and capital within the

³²⁸ Article 27, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

³²⁹ Article 28, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania, the Republic of Burundi, the Republic of Rwanda and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

³³⁰ Hattingh J, 'East African Community/European Union - the East African Community Multilateral Tax Treaty – fit for purpose?', 15.

³³¹ Mason R, 'Flunking the ECJ's tax discrimination test', 78.

³³² Mason R, 'Flunking the ECJ's tax discrimination test', 78.

³³³ Mason R, 'Flunking the ECJ's tax discrimination test', 78.

³³⁴ *Treaty Establishing the Caribbean and Common Market* signed at Chaguaramas 4 July 1973.

Caribbean Community.³³⁵ Soon after the establishment of CARICOM, the member countries entered into a multilateral tax treaty (1973 CARICOM tax treaty). The tax treaty taxing rights were differentiated on the basis of the level of development (the more developed countries are Barbados, Guyana, Jamaica, Trinidad and Tobago and the least developed countries are Antigua, Belize, Dominica, Grenada, St. Lucia, St. Vincent , St. Kitts-Nevis Anguilla and Montserrat).³³⁶The treaty applied to transactions between the less developed countries and transactions between the less developed and the more developed countries. The 1973 CARICOM tax treaty however did not apply to transactions between the more developed signatories.³³⁷ The treaty allocated greater taxing rights to the less developed countries by for instance allowing them to tax income from interest and royalties at domestic tax rates but limited the more developed countries to WHT rates at 10% interest and 5% royalties.³³⁸ This approach enabled developing countries to tax income at a higher rate than the developed countries. However, it did not have its intended effect of spurring economic growth as the high tax rate of developing countries did not attract the desired foreign investment.³³⁹

The 1973 CARICOM tax treaty was reviewed and signed in 1994.³⁴⁰While it borrowed greatly from the OECD and UN Model treaty , it is unique in so far as it provides that only a source country has a taxing right on investment income.³⁴¹ Allowing the source country the exclusive right to tax serves the following purposes: first is the administrative ease for investors who need to only understand the tax law of the source country and tax administrators need not conduct frequent audits on taxpayers with income sources within the CARICOM region.³⁴² Secondly it preserves tax incentives given by the source country. Thirdly it facilitates the development of the

³³⁵ Brooks K, 'The potential of multilateral tax treaties' in Lang M, et. Al (eds) *Tax Treaties: Building Bridges between Law and Economics*, IBFD, 2010,229.

³³⁶ Brooks K, 'The potential of multilateral tax treaties' in Lang M, et. Al (eds) *Tax Treaties: Building Bridges between Law and Economics* 229.

³³⁷ Brooks K, 'The potential of multilateral tax treaties' in Lang M, et. Al (eds) *Tax Treaties: Building Bridges between Law and Economics* 229.

³³⁸ Brooks K, 'The potential of multilateral tax treaties' in Lang M, et. Al (eds) *Tax Treaties: Building Bridges between Law and Economics* 229.

³³⁹ Brooks K, 'The potential of multilateral tax treaties' in Lang M, et. Al (eds) *Tax Treaties: Building Bridges between Law and Economics* 231.

³⁴⁰ Agreement Among the Governments of the Member States of the Caribbean Community for The Avoidance of Double Taxation and The Prevention of Fiscal Evasion with Respect to Taxes of Income, Profits or Gains and Capital Gains and for The Encouragement of Regional Trade and Investment.

³⁴¹Holmes K, *International tax policy and double tax treaties*, 68.

³⁴² Brooks K, 'The potential of multilateral tax treaties' in Lang M, et. Al (eds) *Tax Treaties: Building Bridges between Law and Economics*,234.

less developed countries which allows them collect tax revenue but also allows them to provide tax incentives to attract investors.³⁴³

The 1994 CARICOM tax treaty is lauded as advantageous for facilitating trade, preventing tax evasion and avoidance through exchange of information, developing common approaches to treaty interpretation, and reducing administrative costs.³⁴⁴

Like CARICOM, EAC is made up of countries at different levels of development. Another similarity is that they both approached problem of double taxation by signing of a Multilateral Tax Treaty albeit that the EAC-DTA is not in force. The following lessons could be drawn from the CARICOM experience. First, the CARICOM tax treaty was aligned to the fundamental principle of the CARICOM. Furthermore the oversight administration of the treaty is assigned to CARICOM secretariat.³⁴⁵ This ensures that there is dexterity in the application of the treaty under the treaty. Secondly, the CARICOM tax treaty is a departure from the OECD and UN Models which are largely residence based. As evidenced above residence –based treaties create revenue imbalance between the more developed countries and the lesser developed countries which results in unfairness. Thirdly, the treaty addresses the unfairness question raised in residence–based treaties by ensuring capital importing countries collect tax revenue for income sourced in their countries. The CARICOM Treaty is a source based treaty that has been in operation for a long time and the EAC may draw lessons from it in addressing the challenges affecting the EAC which will be addressed in the next section.

The Treaty is not without criticism however. For example, it provides that dividends paid to residents of other CARICOM members will not be taxed in either the source country or the resident.³⁴⁶ It may encourage treaty shopping and base erosion by multinational enterprises. It also provides an incentive for tax competition where source countries can considerably lower the

³⁴³ Brooks K, 'The potential of multilateral tax treaties' in Lang M, et. Al (eds) *Tax Treaties: Building Bridges between Law and Economics*, 235.

³⁴⁴ Brooks K, 'The potential of multilateral tax treaties' in Lang M, et. Al (eds) *Tax Treaties: Building Bridges between Law and Economics*, 235.

³⁴⁵ Article 2, *Agreement Among the Governments of the Member States of the Caribbean Community for The Avoidance of Double Taxation and The Prevention of Fiscal Evasion with Respect to Taxes of Income, Profits or Gains and Capital Gains and for The Encouragement of Regional Trade and Investment*.

³⁴⁶ Article 11, *Agreement Among the Governments of the Member States of the Caribbean Community for The Avoidance of Double Taxation and The Prevention of Fiscal Evasion with Respect to Taxes of Income, Profits or Gains and Capital Gains and for The Encouragement of Regional Trade and Investment*.

source taxes.³⁴⁷ The aforementioned treaties do not have an anti-treaty shopping provision which is aimed at preventing base erosion and profit shifting.³⁴⁸

3.5.EAC Context

The EAC realized a major milestone towards achieving regional integration when it established a customs union in 2005.³⁴⁹ This was followed by establishment of its common market in the year 2010.³⁵⁰ Moreover, the signing of Monetary Union Protocol in 2013 envisaged that the partner states will establish this monetary union and a single common currency in the near future. Despite these developments, integration and realization of the incidental gains of the EAC has since slowed down.³⁵¹ There are other underlying factors that are unique to the EAC that affects the development and application of EAC law. For example Under EAC 1, Kenya obtained the largest share of benefits arising from integration under it.³⁵² While this is attributable to advanced infrastructure and economic structure, it occasioned a degree of mistrust within the community which has slowed down adoption of progressive integration policies.³⁵³

These challenges to integration affects double taxation legal regime in different ways. First, the EAC is made up of states at different levels social, economic and political development. Co-operation can only be achieved if countries entering into a DTA have approximately equal economic flows which will realize reciprocal benefits out of the DTA for those involved. However, most DTAs are designed along the residence-based principle, which preferred by developed countries. However as also noted above, residence –based model has been largely disadvantageous for developing countries as it leads to loss of tax revenue and effectively shifts tax revenues from the developing country which is more often the source country to the residence country. Because the EAC countries are at different levels of development with some

³⁴⁷ Nyakama K, 'How to design a regional tax treaty and tax treaty policy framework in a developing country' IMF, 2021 www.imf.org on 21 June 2021.

³⁴⁸ BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances www.oecd.org on 21 June 2021.

³⁴⁹ The East African Community After Ten Years Deepening Integration; Edited by Hamid R. Davoodi; February 2012 (imf.org) on 17 June 2021.

³⁵⁰ The East African Community After Ten Years Deepening Integration; Edited by Hamid R. Davoodi; February 2012 (imf.org) on 17 June 2021.

³⁵¹ <https://www.eac.int/monetary-union> on 17 June 2021.

³⁵² Afton T, 'How the East African Community guard against base erosion and profit shifting while working towards deeper integration: lessons from the European Union, 575.

³⁵³ Afton T, 'How the East African Community guard against base erosion and profit shifting while working towards deeper integration: lessons from the European Union,575.

being more developed than others, residence-based DTA with iniquitous results may result in future conflicts. This is because developing countries are also not at the same level of development and lack of reciprocity. This study therefore contends that it would be more favorable for the EAC to adopt a source-based DTT as this portends a fairer way of allocating tax rights as it has higher rates of source-based taxation on passive income and a lower permanent establishment threshold for active income. As discussed in the previous section the source –based tax treaty adopted by other regional bodies such as CARICOM may help in addressing the challenges posed by residence –based tax treaty. The EAC-DTA is modelled after the UN Model. It is a residence-based but preserves more source taxing rights than the OECD Model. For example it includes withholding taxes on technical services fees.³⁵⁴

Secondly, the limited capacity of developing countries in collection of withholding taxes may impact EAC members states adoption of the EU approach on Withholding Tax Gross-WHT together with liability imposed on the remitter for failure to withhold facilitates the collection of tax revenue.³⁵⁵ Gross based WHT allows the developing countries to focus its limited resources on auditing and enforcement procedures on the resident remitter and eliminates the need for any substantial correspondence with the non-resident taxpayer.

Thirdly, there is unbridled tax competition between the partner states. Each partner state seems actively engaged in the game of providing the most attractive tax incentives to potential investors. Unnecessary tax competition is a harmful practice as it occasions race to the bottom, which effectively reduce member states tax collection on one hand and inhibits the EAC countries ability to co-operate effectively during implementation on the other hand. As evidenced in the CARICOM approach, harmful tax competition is a likely outcome of the source based tax treaty.

Finally, EAC member countries are affected with political and economic instability characterized by incessant internal conflict experienced in Burundi and South Sudan. This affects the countries focus on the promotion of trade and investment which is the focus of the EAC Common market.

³⁵⁴ Article 2, United Nations Model Tax Treaty (2017).

³⁵⁵ Irish CR, 'International Double Taxation Agreements and Income Taxation at Source', *The International and Comparative Law Quarterly* (1974), 296.

The aforementioned challenges have negatively impacted the integration process and may also explain the reluctance of some partner states to ratify the EAC-DTA.

The author argues that while the EAC may draw some lessons from the EU's approach, the political, social and economic context may affect the application of the law. Furthermore, the CARICOM source based treaty may provide solution provided that the same is adopted in to development disparity within the EAC as well the fear of the tax base being eroded. The Source based treaty must however be in line with the current international tax policy aimed at preventing based erosion and profit shifting.

3.6. Conclusion

The objective of this chapter was to analyse double taxation vis-a-vis the objectives of the Common Market. The chapter also analysed the efficacy of the EAC regime in its current form in eliminating double taxation and furthering the objectives of the EAC Common Market through the illustration of gross-based final withholding Tax. Finally, the chapter reviewed how double taxation is addressed by the European Union and CARICOM.

The problem of double taxation is founded on the concurrent application of the laws of two taxing jurisdictions, rather than just one.³⁵⁶ The lessons from the EU show that despite the progress made in addressing double taxation in the EU, they have not managed to address the problem of balancing between Partner States tax autonomy and market integration. Partner State tax autonomy preserves the ability of each state to raise sufficient revenue to provide the desired level of public goods to their citizens. The EAC should therefore cautiously learn from the EU noting that the need to raise revenue by the Partner States is as important as market integration. As discussed in the previous section CJEU's, tax cases have resulted in massive revenue losses in the Member States this would be an even bigger problem for developing countries like the EAC countries.

The EAC's approach to tackle double taxation was to develop the EAC-DTA. However, the EAC-DTA is also flawed as it may allow for double taxation incidences as shown with respect to Withholding tax. The EAC-DTA should be reviewed in line with the economic and political context of the EAC to focus on the elimination of tax-induced distortion, facilitation of trade and investment as well as reduction of harmful tax competition. The CARICOM tax treaty approach

³⁵⁶ Kolfer GW, Mason R, 'Double taxation: a European "switch in time?" 67

offers key lessons for the EAC. This and other recommendations will be discussed in the next chapter.

CHAPTER FOUR: FINDINGS, RECOMMENDATIONS AND CONCLUSION

4.1. Introduction

The final chapter summarizes the findings of the study of the previous chapters and offers recommendations on necessary reforms that may be adopted in resolving double taxation in the EAC. The reforms proposed shall be based on the current challenges arising from double taxation. The author draws from and contextualises methods adopted by other regional blocs, such as the European Union and CARICOM, to reduce double taxation.

4.2. Findings

The mainstay of this thesis is that double taxation continues to threaten the survival and growth of the East African community. The primary objective of the EAC is to realize economic integration between member states which the double taxation seems to delay. Article 80(h) of the EAC Treaty provides for avoidance double taxation as an objective of the EAC. Subsequent to this aim, the Common Market Protocol was adopted by the states and emphasises among other things, free mobility of goods, services and capital and the right of establishment.³⁵⁷ To ensure that the norms of the EAC Treaty and the Common Market Protocol are achieved, the member states drew up the EAC Double Taxation Agreement to provide relief against double taxation. The treaty has not been ratified by all states and therefore has not come into force, yet, as demonstrated in this paper, double taxation is still a major hindrance to economic integration,³⁵⁸ including in the EAC,³⁵⁹ as it distorts free movement of people, goods, services, and capital and freedom of establishment.

This study dissected how double taxation is a barrier to the process of integration in the EAC. The thesis analysed the domestic laws of member states, the provisions of the EAC Treaty and EAC-DTA. Through an analysis of existing legislative and treaty provisions for the elimination of double taxation in the bloc, the thesis findings are to the effect that first, unilateral measures are inadequate to effectively relieve double taxation. Although the EAC states provide for unilateral reliefs against double taxation, these measures are inadequate as illustrated above. If

³⁵⁷ Article 76, *Treaty for the establishment of the East African Community*.

³⁵⁸ Kolfer GW, Mason R, 'Double taxation: A European "switch in time?"', 66.

³⁵⁹ Bett JK, 'Income tax in the East African Community: a case for harmonization and consolidation of policy and law with a focus on corporate income taxation' Unpublished PhD Thesis, University of Nairobi, October 2016, 161 ; www.erepository.uonbi.ac.ke on 20 October 2019.

the EAC member countries could harmonize their tax policies as envisaged under the Treaty as each Partner State domestic laws already provides for tax reliefs against double taxation of these two interventions would achieve the objectives of the EAC- DTA. However, the Partner States will still need to enforce a tax treaty facilitate cooperation of the countries in the conduct mutual agreement procedures, exchange of information and assistance in collection.

Second, there is limited focus placed on the elimination of double taxation within the community. The EAC Treaty and its attendant Protocols are weak in provisions, with only Article 80(h) of the Treaty providing that States may take measures to avoid double taxation. This article is weak in provision because, it is not couched in mandatory terms and may not grant actionable rights to taxpayers. It is also arguable that by providing unilateral measures for avoiding double taxation in domestic law states have complied with Article 80(h) of the EAC Treaty. However, the thesis argues that the narrow application of the EAC treaty is detrimental to the growth and development of the Common Market. Unrelieved double taxation may violate other provisions of the Treaty and its attendant Protocols including violating fundamental freedoms of the common market as set out in Article 7 and the non-discrimination rule. Furthermore, double taxation disadvantages cross-border taxpayers who aim to further the objectives of the EAC Treaty as it distorts trade and discourages the free movement of goods, services, labour, capital and freedom of establishment. In addition, double taxation also fosters tax discrimination by exposing tax payers with cross-border economic activities to harsher tax treatment than tax payers with purely internal activities.

Thirdly, the EAC-DTA was negotiated to facilitate the avoidance of double taxation in the region. It is however not in force as all the EAC member states are yet to ratify it. The EAC-DTA does not make reference to the objectives of the community. Several aspects of the EAC-DTA adopted the provisions the repealed UN Model and may, therefore, be regarded as outdated and weak. From the analysis of the gross based final withholding tax, application of the EAC-DTA would result in double taxation.

Lastly, the EAC-DTA in its current form may not facilitate integration because of the limitations of residence favoured approach which may facilitate tax revenue conflicts between the Partner states and there is need for its review to address the current position before the same comes into force.

It is based on the foregoing findings that the thesis makes recommendations on how to effectively deal with double taxation in the Community. The recommendation draws from the EU and CARICOM who have also dealt with similar challenges.

4.3. Proposed Areas for Reforms

4.3.1 Development of Community Law

As evidenced in 2.2. the EAC Treaty specifically places an obligation on states to avoid double taxation.³⁶⁰ Enforcement of law is majorly by institutions established by the law. The EAC Treaty established the EAC Council and the EAC Legislative Assembly to oversee the implementation of the objectives of the EAC Treaty. The Council acts as the primary organ for policy making in the Community and it comprise of Ministers and nominated Ministers from the EAC member states.³⁶¹ The Council promotes and reviews the implementation of the EAC objectives by introducing bills to the EAC Legislative Assembly for proper implementation of the Treaty.³⁶² The council may also issue binding regulations and directives as permitted under community law.³⁶³ The milestone achievements by the EAC especially the Common Market have been through the Council. The EAC Legislative Assembly on the other hand, is constituted by elected members from each EAC Member State, together with a number of ex-officio members. It is the primary legislative organ of the community with powers to produce community legislation.

Despite having the aforementioned institutions that are able to formulate laws, their powers are subject to those of the Summit which is made up of the EAC Heads of State. For instance, bills passed by the EAC Assembly do not bind the EAC Member States until all heads of state have given their assent.³⁶⁴ In contrast, EU Council directives or regulations automatically bind EU Member States.

The EAC member states need to adopt the EU Council approach by making binding resolutions and directives on tax matters within the EAC2. The EU approach has reduced the instances of double taxation to improve the operation of the single market.³⁶⁵ For instance, in relation to intra-community gross withholding tax that results in double taxation, the EU Council passed the

³⁶⁰ Article 80(h), *Treaty for the establishment of the East African Community*.

³⁶¹ Articles 10 ,11 *Treaty for the establishment of the East African Community*.

³⁶² Article 14, *Treaty for the establishment of the East African Community*.

³⁶³ Article 14 (3) (d), 16, *Treaty for the establishment of the East African Community*.

³⁶⁴ Article 62(1), *Treaty for the establishment of the East African Community*.

³⁶⁵ Hattingh, 'East African Community/European Union-The East African Multi-lateral Tax Treaty-fit for purpose?' 14.

Parent Subsidiary Directive (2011/96), prohibiting source based withholding tax on non-portfolio dividend paid intra-community.³⁶⁶ In 2003, another directive prohibited withholding taxes on intra-community payments of interest or royalties to companies under the Interests and Royalties Directive (2003/49).³⁶⁷ The objective of the EU directives was to achieve closer economic integration in order to realise the common internal market. Elimination of gross based withholding taxes removes residual double taxation in the form of excess foreign credit that arises when gross-based withholding tax is high, especially on active income.³⁶⁸

There is, therefore, considerable scope for the Community institutional organs to work on this central aspect of implementing a common market and monetary union, for example by way of Community directives and legislation aimed at avoiding double taxation and encouraging development of the common market.

4.3.2. Empowerment of the East African Court of Justice

The EAC Court of Justice is the judicial body that is tasked with ensuring adherence to law in its application, interpretation, and compliance with the EAC Treaty.³⁶⁹ The decisions of the EACJ take precedence over decisions of national courts on a similar matter.³⁷⁰ Based on its role, the EACJ is instrumental in furthering integration as it can decide on the legality of any act, regulation, directive, decision or action of an EAC Member State or an institution of the Community on the grounds that it is unlawful or is an infringement of the provisions of the EAC Treaty.³⁷¹

The CJEU provides a good illustration of how the regional court can be utilised to further integration. CJEU decisions address what is essentially the differential burdens of taxation imposed within the common market that may distort fundamental freedoms within the EU.³⁷² The CJEU decisions on gross based withholding tax are a good illustration of the role of regional courts in resolving double taxation disputes. One of the perennial problems with final gross

³⁶⁶European Union Council Parent Subsidiary Directive 2001/96.

³⁶⁷European Union Council Interest and Royalties Directive 2006/05.

³⁶⁸ Hattingh J, 'East African Community/European Union-The East African Multi-lateral Tax Treaty-fit for purpose?' 18.

³⁶⁹ Article 23, *Treaty for the establishment of the East African Community*.

³⁷⁰ Article 33(2), *Treaty for the establishment of the East African Community*.

³⁷¹ Article 30, *Treaty for the establishment of the East African Community*.

³⁷² Hattingh J, 'East African Community/European Union-The East African Multi-lateral Tax Treaty fit for purpose?' 17.

based withholding tax is the inability to deduct legitimate expenditure incurred in order to calculate chargeable income. This may result in discrimination that gives rise to distortion in tax burdens within the common market. Judicial exposition of this concept was illustrated by the CJEU, in the case of *Centro Equestre* (Case C-354/04). The decision was in the context of expenditure denial for gross based withholding tax on service income by a non-resident company. In this case, a condition for deductible expenses of non-residents was that the expenses must have a “direct economic connection” to the income and the expense should be more than 50% of the income.³⁷³ The CJEU held that the 50% restriction breached the freedom to provide services. The Court was of the opinion that the requirement that the expenditure should bear a direct economic connection with chargeable income was acceptable and not discriminatory as this was consistent with the principle of territoriality.³⁷⁴

The CJEU jurisprudence effectively asserts that a common market entails elimination of all obstacles of intra-community trade in order to merge national markets into a single market bringing about conditions as close as possible of a genuine market.³⁷⁵ Terra and Wattel opine that the four freedoms are by far the most important agents of integration and prohibit all differences in taxation in cross-border situations within the Community and comparable domestic tax³⁷⁶

In the context of EAC, the issue is whether the current regime allows the domestic tax law of the EAC member states that residually breaches the EAC Treaty i.e. if domestic law differentiates the cross-border situation and the domestic situation. In the EU such conflicting areas will be clarified by the CJEU as the final arbiter in determining the interests of the common market and the legitimate interest of the EU members in protecting their tax bases and revenue-raising capacity.³⁷⁷ CJEU’s overarching jurisdiction is to strike down any domestic measure and regime that hinders the common market. National restrictions are only allowed in unavoidable situation to protect the public interest and the protection must be proportionate.³⁷⁸

³⁷³Wattle P, Terran M, ‘*European Taxation*’241.

³⁷⁴ C 345/04 *Centro Equestre da leziria Grade Lda V Bundensarnt fur Finanzen* Case.

³⁷⁵ Tiley J, *On the origin of model tax convention; 19th century tax treaties and laws concerned with the avoidance of double taxation, in studies in the history of tax law*, Hart Publishing, Oxford, 2013,10.

³⁷⁶ Wattle P, Terran M, ‘*European taxation*’, 6 ed, Wolters Kluwer, Amsterdam, 2012,12.

³⁷⁷ Wattel P and Terran M, ‘*European taxation*’,17.

³⁷⁸ C-303/07 *Aberdeen Property Finiwest Alpha Oy V Uudenmaan verovirasto and Helsingin kaupunki*, ECJ, Judgment of 18 June 2009.

The EAC Court of Justice has the jurisdiction to interrogate whether the domestic tax regimes of the EAC member states offend the fundamental principles of the EAC. To date however, no judgement appears to be recorded in which the Court applied the EAC community law to a direct tax regime of a member state.³⁷⁹ Furthermore there is limited litigation before the Court on the EAC trade regime and even lesser requests for Preliminary Rulings by national courts to the EACJ.³⁸⁰ Litigation by the business community or commercial corporate entities is very limited before the Court.³⁸¹ The lack of enthusiasm by private sector to file suits at the EACJ over trade related issues extends to tax matters. The lack of enthusiasm by the private sector may be due to a myriad of issues including the lack of awareness of the available forum; the lack of visibility of the court; lack of political goodwill by partner states in enforcing the decisions of the court to mention a few.³⁸² However, the recent case of *British American Tobacco (U) Ltd Vs the Attorney General of Uganda*³⁸³ where the Republic of Uganda was found to have contravened the provisions of the Treaty and the Customs union and Common Market Protocol and was ordered to align its tax laws with that of the EAC law gives hope for greater involvement of the EACJ in the integration process.

Achieving successful market integration will require enforcement of rights conferred upon traders, companies and individuals.³⁸⁴ Effective enforcement of these rights cannot be left only to the Member States or the EAC, who might be unwilling or incapable of ensuring full compliance with Community law.³⁸⁵ The other stakeholders like businesses and citizens ought to be encouraged to enforce these rights to ensure the effectiveness of the common market rules which guarantee the rights.

³⁷⁹ Article 21 (1)(d), *Protocol on the establishment of the East African Community Common Market*.

³⁸⁰ Ugirashebuja E, 'Preliminary references under EAC law', in Ugirashebuja E., Ruhangisa J., Ottervanger T., & Cuyvers A. (Eds.), *East African Community law: institutional, substantive and comparative EU aspects*, Brill Nijhoff, Leiden, 2017, 273.

³⁸¹ Odek JO, 'Judicial enforcement and implementation of EAC law', in Ugirashebuja E., Ruhangisa J., Ottervanger T., & Cuyvers A. (Eds.), *East African Community law: institutional, substantive and comparative EU aspects*, Brill Nijhoff, Leiden, 2017, 485.

³⁸² Mukaindo P, 'Towards a just community :Thr Role of the East African Court of Justice and National Courts in the Integration Agenda' unpublished Masters Thesis, University of Nairobi, October 2014, 106

³⁸³ Reference No.7 of 2017 *British American Tobacco (U) Ltd Vs The Attorney General Of Uganda*
<http://eacj.eac.int/?cases>.

³⁸⁴ Mei A P, 'The East African Community: the bumpy road to supranationalism: some reflections on the judgments of the Court of Justice of the East African Community in Anyang' Nyong'o and others and East African Law Society and others', Maastricht Faculty of Law Working Paper (2009),29.

³⁸⁵ Mei A P, 'The East African Community: the bumpy road to supranationalism: some reflections on the judgments of the Court of Justice of the East African Community in Anyang' Nyong'o and others and East African Law Society and others', 29.

4.3.3. Review of the EAC Double Taxation Agreement

4.3.3.1. Entry into force

It should be appreciated that the 2010 EAC Double Taxation Agreement signed by five Partner states, was an update of the 1997 Kenya, Uganda and Tanzania multilateral tax treaty which never entered into force.³⁸⁶ Today, only three member states have ratified the EAC Double Taxation Agreement, 2010.³⁸⁷ Tanzania and Burundi have not ratified the Treaty and hence it is not in force. This disparity in ratification of the EAC-DTA may be as a result of the political and economic tensions experienced in the region reviewed in chapter 3 above ;³⁸⁸ it further exacerbated by the failure to set a target for the ratification/effective date for the member states of the EAC. The EAC-DTA should be reviewed and supplemented to provide a deadline for ratification.

4.3.3.2. Aligning the EAC-DTA to EAC Objectives

The most remarkable thing about the EAC-DTA is that the drafters failed to consider the pre-existing EAC Treaty principles and objectives, especially the fundamental freedoms in relation to movement of goods, services capital, and freedom of establishment. As has been observed already, the EAC-DTA is akin to the national legislation while the EAC Treaty is the Constitution, and as a general principle of constitutional law, legislation is subject to the Constitution. It is the same principle that applies in the context of the EAC-DTA and EAC Treaty, where the former is subservient to the latter. The EAC-DTA should operate while abiding to the normative principles of the EAC Treaty. Under the EAC Common Market Protocol, the free movement of goods, services and capital and freedom of establishment within the Community are key in achieving regional economic integration. The CARICOM tax treaty is an important example of a treaty aligned to the objectives of the Caribbean Common Market.³⁸⁹

³⁸⁶ *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (28th April, 1997) Treaties IBFD.

³⁸⁷ Trade Mark, *EAC Harmonize tax regime* at <https://www.trademarkkea.com/news/eac-to-harmonise-tax-regimes> on 10 April 2020.

³⁸⁸ <https://www.theeastafrican.co.ke/tea/business/tanzania-burundi-miss-deadline-on-double-taxation> on 15 June 2021.

³⁸⁹ Preamble, *Treaty Establishing the Caribbean and Common Market* signed at Chaguaramas 4 July 1973.

A few observations have been noted in the domestic laws of the EAC member states and perpetuated by the EAC-DTA, which are likely to breach the EAC Treaty principles. The obvious area of the domestic tax laws that need assessment is the imposition at the source of the final flat-rate tax on the gross amount of the intra-community payment, which is referred as the final withholding tax at the source. As discussed in 3.2 above, final withholding tax on active business is highly distortive, especially when, economically, they are no longer used as a collection mechanism but in fact act as turn-over based tax for raising taxes. It is evident that where the EAC-DTA permits a member state to charge a tax that violates the EAC Treaty, then it follows, although unintentionally, that the same breaches the community law. Conversely, where the EAC-DTA prevents the EAC member state from imposing the offending tax, then it ensures, although inadvertently, the compliance with the community law.

Regarding the withholding tax, the clauses in the EAC-DTA permitting this form of taxation are most at risk of offending the EAC community law. These clauses include those dealing with taxation of immovable property, dividends, interests, royalties, management and professional fees, capital gains, artistes and sportspersons, pensions, and professors and teachers, at least one of the EAC member state imposes final gross-based withholding tax on the payment that fall within the scope of these circumstances that may give rise to a distortion in the operation of the internal market.³⁹⁰ The inherent weaknesses in these clauses of the EAC-DTA is that they do not necessarily promote neutrality in the tax burdens of the EAC residents, although the last assertion would require a case to case consideration to establish where the residual double taxation, that is, an excess foreign tax credit position, is eliminated by a tax treaty in a particular instance.

The provisions of the EAC-DTA that govern the taxation of business and profits derived from the operation of transport systems are far less likely to cause a distortion in tax burden. This is because they require net taxation in the source state, which generally would be the same for residents, although tax differentiation between residents and non-residents may still give rise to discrimination. With regard to net taxation imposed at rates that do not differentiate residents from non-residents, breach of the operational principles of the EAC community law is less likely

³⁹⁰Hattingh J, 'East African Community/European Union-The East African Multi-lateral Tax Treaty fit for purpose?' 17.

to arise, meaning that the EAC-DTA would, in this instance, ensure compliance with EAC community law. The EAC-DTA should be updated to be aligned to the objectives of the EAC objectives

Having said the foregoing, while the EU approach would promote neutrality and in turn promote trade, the EAC economic and political context must be taken into consideration. Neutrality ought not to be at the expense equity and fairness. To balance these competing principles within the region, the answer might lie in the EAC adopting a more source favoured tax treaty akin to the treaties adopted by CARICOM. Other source-based regional treaties include the Andean treaty, The Central African Economic and Monetary Union, the West African Economic and Monetary Union treaties which provide that a source country has a taxing right, but without restricting the taxing rights of a resident country.³⁹¹The review of the EAC-DTA ought to borrow a leaf from the CARICOM tax treaty which has balanced the tension between tax revenue and prevention of double taxation. It has further aligned the purpose of the tax treaty with the encouragement of regional trade and investment with the necessary amendments avoid the risk of erosion of the revenue base.

4.3.3.3. Update of the EAC-DTA in line with the current developments in International tax policy

The EAC-DTA is further weak in its provisions as it has flaws that may perpetuate harmful tax practices in the EAC. Indirect shares sale is a good example to demonstrate this weakness. Indirect shares sales refer to corporate investment structures in which a resident company owns either immovable property or rights that are associated with the territory or population of a country, for example a mobile phone operator licence, mining operations or exploitation licences and licences to broadcast media in a particular territory. Article 14(4) of the EAC-DTA effectively provides for treaty exemption from source taxation on the sale of indirect shares.³⁹² The effect of this is almost certain to result in a lower or no tax burden for the ultimate non-resident in the investment claim as compared to EAC resident in comparable circumstances. The combined benefits of the EAC common market and the EAC-DTA may permit investors from third-party states to dispose investments through an indirect share sale in the entire EAC without

³⁹¹ Nyakama K, 'How to design a regional tax treaty and tax treaty policy framework in a developing country'5.

³⁹² Hattingh J, 'East African Community/European Union-The East African Multi-lateral Tax Treaty fit for purpose?',20

any income tax liability to the EAC member states and up to the low or no tax jurisdiction in the investment chain. This is the opposite of the type of discriminatory tax distortion that should be eliminated in the establishment of the common market and monetary union, where non-residents in the community are subjected to a lower tax burdens than residents in comparable circumstances. It should be noted that the major EAC members, that is, Kenya, Uganda and Tanzania have enacted their domestic legislation that seeks to neutralise treaty exemptions applying to indirect shares sales, such as considered in Article 14(4) of the EAC DTA.³⁹³ As a consequence, the EAC-DTA does not appear to be aligned with the domestic policy position of the major EAC member states as it does not provide for a limitation of benefits clause .

It is obvious that if unchecked investors from of the third-party states' are likely to treaty shop in the EAC as a result of the current tax policies, especially when EAC member states conclude bilateral tax treaties that enable double non-taxation.³⁹⁴ The conclusion of such treaties could therefore amount to breach of the commitment of the EAC member states to avoid harmful tax competition under Article 8 of the EAC Monetary Union Protocol, 2012.³⁹⁵ The definition of the harmful tax competition focuses on tax advantages provided to particular entities in "an EAC member state that are "to the detriment to other" EAC member states.³⁹⁶ Consequently, when an EAC member state permits a third-party state investor to set up a resident entity that benefits from a bilateral tax treaty with low or no tax jurisdiction, and this entity in turn invests in other EAC member states in the circumstances where divestment would be exempt from source taxation under the EAC-DTA, the tax revenue loss would be detrimental to the source EAC member state. The obvious route is for the inclusion of the Limitation of benefits provisions in EAC-DTA to limit the possibilities for harmful tax practices in the EAC in respect to indirect shares sales. This approach would also require re-negotiation of tax treaties, which although cumbersome, would be worth the effort in order to avoid the potential harm to the tax bases of all the EAC member states. A renegotiated EAC- DTA that takes into account the different

³⁹³ Article 14, *Agreement between Government of the Republic of Kenya, the United Republic of Tanzania and the Republic of Uganda for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*.

³⁹⁴The Star, *NGO says recently nullified Double Tax Avoidance Agreement between Kenya and Mauritius could have been used for tax evasion by businesses* <https://www.business-humanrights.org/en/ngo-say-recently-nullified-double-tax-avoidance-agreement-between-kenya-mauritius-could-have-been-used-for-tax-evasion-b-businesses> on 8 April 2019.

³⁹⁵ Article 8, *Protocol on the establishment of the East African Community Monetary Union Protocol, 2012*

³⁹⁶ Article 14, *Protocol on the establishment of the East African Community Common Market, 2005*.

developmental levels of the partners stated is likely to be more attractive to the Partner states as there will be no fear of unfair loss of tax revenue.

At the very least, the EAC-DTA should be updated and supplemented before it enters into force. This would be best realised by way of a Multi-lateral Protocol to the EAC-DTA.³⁹⁷

4.4. Conclusion

The thesis focused on the EAC response to double taxation in domestic law and community law, and although they both acknowledge the problem of double taxation, the measures employed are ineffective specifically:

Effect of double taxation on the common Market: The primary objective of the EAC is the deepening and widening of economic integration between member states. Article 80(h) of the EAC Treaty stipulates the objective of avoidance of double taxation in the EAC. Furthermore the Common Market Protocol emphasises, among other things, free movement of goods, services and capital and the right of establishment.³⁹⁸ This paper has demonstrated how double taxation may give rise to a distortion in the operation of the internal market in so far as there is no neutrality in the tax burden of EAC residents, which is a major hindrance to economic integration as it interferes with free movement of people, goods, services, capital and freedom of establishment.

Sufficiency of the unilateral measures to relieve double taxation: As illustrated in Chapter 2 and 3 the EAC states provide for unilateral reliefs against double taxation. Though unilateral reliefs are crucial in the avoidance of double taxation, they are inadequate in certain instances as illustrated by secondary adjustments in Transfer Pricing, and there is need for coordination between states, especially in a common market whose objectives are the freedom of movement of goods, services, capital and the freedom of establishment as illustrated in 3.1.

Sufficiency of the EAC-DTA and the EAC treaty in eliminating double taxation. The EAC-Treaty as the “constitution” of the EAC obligates states to avoid double taxation; however, it does not specify how this should be achieved. As illustrated in 3.1, unilateral measures are not fully effective in the elimination of all types of double taxation and states need to develop a coordination framework to eliminate double taxation. A major weakness of the EAC Regime is that the issue of double taxation and the obligation of states to avoid it hasn’t been interrogated

³⁹⁷ Hattingh, East African Community/European Union-The East African Multi-lateral Tax Treaty fit for purpose?, 20.

³⁹⁸ Article 76, Treaty for the establishment of the East African Community.

by the EACJ. In contrast, CJEU has interrogated the issue and has built case law that aims to further the objectives of the EU and reform state actions that lead to double taxation as illustrated by the case of gross based withholding tax. The partner states acknowledged the need to coordinate to avoid double taxation developed and signed the EAC-DTA. However, the analysis of the EAC-DTA shows that it did not link itself to the EAC Treaty as it made no reference to it in the preamble. Secondly, the EAC-DTA is outdated as it does not take into account recent developments in international tax law. This weakness may lead the EAC countries to lose tax revenue as a result of double non-taxation. Furthermore, the EAC-DTA also allows for gross based withholding tax, which contravenes and abrogates the objectives of the common market. The EAC-DTA is marked with fundamental omissions, the existence of which makes the document either inoperable or obsolete. Thus, the renegotiation of the Treaty is key to ensuring that it can be supplemented and updated in its provisions and subsequent application. The main concluding argument in this thesis is that the failure to update and amend the EAC-DTA will render it not fit for purpose and hamper integration in the bloc. The EAC member states can learn from the robust lessons of the EU to achieve the EAC Treaty objectives of a common market and monetary union, as precursor to a political federation.

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APPENDICES: ETHICAL CERTIFICATE AND ORIGINALITY REPORT



2nd August 2021

Ms Rasanga Luise,
lusemudi@gmail.com

Dear Ms Rasanga,

RE: Double Taxation in the East African Community

This is to inform you that SU-IERC has reviewed and **approved** your above **SU masters** research proposal. Your application reference number is **SU-IERC1119/21**. The approval period is **2nd August 2021 to 1st August 2022**.

This approval is subject to compliance with the following requirements:

- i. Only approved documents including (informed consents, study instruments, MTA) will be used
- ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-IERC
- iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-IERC within 48 hours of notification
- iv. Any changes, anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-IERC within 48 hours
- v. Clearance for export of biological specimens must be obtained from relevant institutions.
- vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal.
- vii. Submission of an executive summary report within 90 days upon completion of the study to SU-IERC

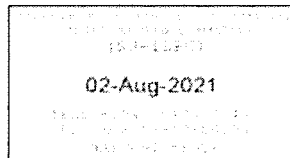
Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology and Innovation (NACOSTI) <https://research-portal.nacosti.go.ke/> and also obtain other clearances needed

Yours sincerely,

for: Dr Virginia Gichuru,

Secretary; SU-IERC

**Cc: Prof Fred Were,
Chairperson; SU-IERC**













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
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